The Co-operative Bank plc

Pillar 3 Disclosures for the year ended 31 December 2014

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1. Overview

1.1 Background

This document sets out the Pillar 3 disclosures for The Co-operative Bank and its subsidiaries (the Bank) as at 31 December 2014. These disclosures have been prepared to give information on the basis of calculating capital requirements and on the management of risks faced by the Bank in accordance with the rules laid out in the Capital Requirements Regulation (Part 8), unless otherwise stated and should be read in conjunction with the Risk sections of the Bank's Annual Report and Accounts including the Risk Management section and the Principal Risks and Uncertainties section. These are available on the Bank's website http://www.co-operativebank.co.uk/.

The European Union Capital Requirements Directive (CRD) came into effect on 1 January 2007. Commonly referred to as Basel II, the legislative framework introduced capital adequacy standards and an associated supervisory framework in the EU. This was replaced by Capital Requirements Regulation (CRR) and Capital Requirements Directive (together collectively known as CRD IV) which came into force 1 January 2014. In the UK, implementation of the Directive has been through rules introduced by the Prudential Regulation Authority (PRA). These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

The Bank has a PRA waiver to use the Basel II Internal Ratings Based (IRB) approach to credit risk. This allows the Bank to calculate capital requirements for some of the Retail, Corporate and Treasury assets classes using internally developed models that reflect the credit quality of the assets.

Asset	Portfolio	IRB exposure classes	CRD approach
Retail	Mortgages (including Buy to Let Mortgages)	Retail – residential mortgages	Retail IRB
	Loans	Retail – other	Retail IRB
	Credit cards, overdrafts	Retail – qualifying revolving retail exposures	Retail IRB
Corporate	Corporate (total assets >£350k)	Corporates	Foundation IRB
	Business Banking	Corporates	Foundation IRB
	Registered Social Landlords (RSL)/housing associations	Corporates	Foundation IRB
	Specialised lending	Corporates	Foundation IRB (slotting approach)
Treasury	Central governments and central banks	Central governments and central banks	Foundation IRB
	Financial institutions	Institutions	Foundation IRB
	Structured investments/ credit trading funds	Corporates	Foundation IRB (securitisation ratings based approach)
	Securitisation	Securitisations	Foundation IRB (securitisation ratings based approach)

For other exposures and risk areas, the standardised approach is adopted, which uses capital risk weighting percentages set by CRD IV requirements.

For prime retail mortgages there has been a programme of harmonisation, with Exposure at Default (EAD) models now structurally aligned between the brands and further model harmonisation is scheduled for 2015.

1.2 Basis and frequency of disclosures

In meeting these disclosure requirements, the Bank has also considered recommendations made by the Enhanced Disclosure Task Force (EDTF) which seeks to give enhanced information above and beyond the minimum Pillar 3 disclosure requirements. These are set out in more detail in Section 2: Changes to disclosures.

Basel III was implemented in the UK from 1 January 2014, through both the European CRR and the Capital Requirements Directive (CRD IV) and through the PRA's policy statement PS7/13 http://www.bankofengland.co.uk/pra/Pages/publications/implemcrdiv.aspx. The term CRD IV is used throughout these disclosures as a collective term for CRD IV, CRR and the PRA's policy statement.

These disclosures may differ from similar information in the 2014 Annual Report and Accounts prepared in accordance with International Financial Reporting Standards; the information in these disclosures may therefore not be directly comparable with that information. All figures are as at 31 December 2014, the Bank's year end, unless otherwise stated.

Disclosures are issued on an annual basis and published on the same day as publication of the Annual Report and Accounts.

1.3 Location and verification

These disclosures have been subject to internal verification and reviewed by the Bank's Audit Committee (AC) on behalf of the Board but have not been, and are not required to be, subject to independent external audit. They are published on the Bank's website http://www.co-operativebank.co.uk/

1.4 Remuneration

In order to comply with the disclosure requirements of CRD IV and the PRA's Remuneration Code, the responsibilities and decision making process for determining remuneration policy, the link between pay and performance and the design and structure of remuneration, including the performance pay plans, have been disclosed in the 2014 Annual Report and Accounts on pages 67 to 84. The 2014 Annual Report and Accounts are published on the Bank's website https://www.co-operativebank.co.uk/investorrelations/financialresults.

1.5 Scope of disclosure

The Pillar 3 disclosures in this document relate to The Co-operative Bank plc (PRA firm reference number 121885). The subsidiary undertakings included within these disclosures are:

Operating company	Nature of business	Consolidated capital regulatory returns	Solo consolidated capital returns[1]
The Co-operative Bank plc	Banking	Yes	Yes
Co-operative Commercial Limited	Investment company	Yes	No*
Unity Trust Bank plc (held through Co-operative Commercial Limited)	Banking	Yes	No*
Britannia Treasury Services Limited	Holding company	Yes	Yes
Platform companies	Mortgage origination	Yes	Yes
Mortgage Agency Services Number One, Two, Four – Six Limited	Mortgage lending (acquired)	Yes	Yes
Western Mortgage Services Limited	Mortgage administration	Yes	Yes
Asset finance companies	Leasing	Yes	Yes
Britannia Asset Management Limited	Holding company	Yes	Yes
Britannia Development and Management Company Limited	Property investments	Yes	Yes
Britannia Life Direct Limited	Financial services	Yes	Yes
Britannia International Limited	Isle of Man based retail deposits	Yes	No*
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	Yes	No
Leek Finance (Number Seventeen – Twenty Two) plcs	Securitisation vehicles	Yes	No
Silk Road Finance (Number One – Three) plcs	Securitisation vehicles	Yes	No
Cambric Finance Number One plc	Securitisation vehicle	Yes	No
Meerbrook Finance (Number One – Four, Six, Eight) Limited	Securitisation vehicles	Yes	No
Calico Finance Number One Limited	Securitisation vehicle	Yes	No
Southside Regeneration Limited	Property holding company	Yes	No

* A capital deduction is made at a solo consolidated level to represent the equity investment in these companies. No equity investment is held in securitisation vehicles hence there is no capital deduction as a solo consolidated level.

1. Until its expiry in September 2014, the Bank had regulatory approval to operate under a 'solo-consolidation' permission, which allowed it to be regulated for prudential purposes as through the Bank and specified solo-consolidated subsidiaries formed a single legal entity. In March 2015, the Bank was granted a new permission to apply solo consolidation, though with respect to a smaller number of subsidiaries. The Bank and its subsidiaries do not have the processes in place to comply with regulatory reporting obligations resulting from this change, or with large exposure requirements in respect of exposures to certain FCA-authorised subsidiaries. The Bank intends to address these issues to a timetable set by the regulators. The Bank has already acted to ensure its FCA-authorised subsidiaries comply with capital requirements on an individual basis.

The scope of the Bank's prudential consolidation is the same basis as its consolidation for accounting purposes.

1.6 Regulatory Position

In December 2014, the Bank submitted a revised plan to the PRA. This 2015–2019 plan, once delivered, will help the Bank to comply with FCA and PRA regulatory requirements and expectations.

Please see page 26 of the Bank's Annual Report and Accounts for further information regarding the Bank's regulatory position.

There are no current or foreseen material restrictions or legal impediments to the movement of capital or to the repayment of liabilities between UK based consolidated entities, with the exception of:

- Britannia International Limited, where dividend payments are subject to local regulatory approvals;
- Securitisation vehicles and Covered Bond LLP with assets being ring-fenced within such entities; and
- Unity Trust Bank plc, which being separately regulated, needs to maintain a minimum prescribed level of capital.

1.7 Summary of key capital ratios

These disclosures are primarily in accordance with CRD IV requirements which came into force 1 January 2014. The Bank's key capital ratios are included below:

Table 1 CRD IV key capital ratios

	CRD IV		CRD IV	
	Transitional	**Fully Loaded**	Transitional	Fully Loaded
	2014	**2014**	2013	2013
Common Equity Tier 1 ratio	**12.7%**	**13.0%**	7.1%	7.2 %
Total Capital Ratio	**14.9%**	**15.0%**	9.0%	8.9%
Risk Weighted Assets (£m)	**12,632.2**	**12,632.2**	15,073.7	15,073.7
Leverage ratio		**4.3%**		2.4%

Further details on this can be found in section 4 of this document.

The Bank has only reported the leverage ratio on a fully-loaded basis as per PRA guidance. The 31 December 2014 leverage ratio has been calculated using the Basel Committee January 2014 exposures definition. This is in line with guidance provided to the Bank by the PRA. The 31 December 2013 leverage ratio remains on a CRD IV exposures basis.

The 2013 comparators other that the leverage ratio outlined above have been restated to be on a comparable basis.

2. Changes to disclosures

Basel III has been implemented in the EU through publication of CRR and a further iteration of CRD. Together this package of requirements is known as CRD IV and came into force 1 January 2014. The European Banking Authority is providing technical standards relating to CRD IV some of which are not yet finalised. CRD IV disclosures in this document are based on the Bank's interpretation of published rules. The Bank publishes its Pillar 3 disclosures on an annual basis; hence its 31 December 2014 Pillar 3 disclosures are the first to be fully disclosed on a CRD IV basis. 2013 comparatives have not been restated for the application of CRD IV, apart from where the Bank previously provided some CRD IV disclosures within its 2013 Pillar 3 disclosures.

Significant changes to the calculation of own funds as a result of the implementation of CRD IV include:

- Inclusion of Available For Sale gains or losses within CET1 (gains are excluded from CET1 on a transitional basis for 2014 only);
- Allocation of minority interests between CET1, Tier 1 and Tier 2 capital;
- Additional deductions from CET1;
- Introduction of Credit Valuation Adjustment for derivative exposures;
- Introduction of Asset Valuation Correlation for exposures to large financial institutions;
- Deduction from CET1 or risk weighting of deferred tax assets and significant investments dependent upon thresholds of own funds; and
- Introduction of a non-risk based leverage ratio.

Changes to the Pillar 3 disclosures as a result of the implementation of CRD IV include:

- Own funds disclosures fully aligned with EBA disclosure templates (summary template included in section 4, full template in Appendix 1);
- Disclosure of the countercyclical capital buffer and geographical location of exposures for calculation of the buffer;
- Disclosure of specific and general credit risk adjustments rather than individual and collective;
- Introduction of disclosure on main features of capital instruments (included in Appendix 2);
- Introduction of disclosure on encumbered assets; and
- Additional remuneration disclosure relating to ratio of variable to fixed pay, and disclosure of remuneration above €1 million – split by 0.5 million bands. All applicable remuneration disclosures are included within the Directors remuneration report in the Bank's 2014 Annual Report and Accounts.

The Bank has continued to review its disclosures in line with EDTF recommendations, and has made the following improvements to its EDTF disclosures:

- EDTF 7 – summary diagram of key risks
- EDTF 8 – qualitative disclosure of stress testing
- EDTF 11 – two years flow statement for own funds
- EDTF 16 – quantitative disclosure added to qualitative disclosure for flow statement of risk-weighted assets
- EDTF 17 – addition of actual compared to estimates for PD and LGD including narrative
- EDTF 19 – disclosure of EBA defined template for encumbered assets as per CRD IV requirements
- EDTF 20 – additional qualitative disclosure including behavioural analysis
- EDTF 23 – additional qualitative analysis and narrative regarding market risk
- EDTF 26 – analysis of aggregate credit risk exposures including enhanced narrative
- EDTF 28 – reconciliation of the opening and closing balances of non-performing or impaired loans (this disclosure is aligned to the notes to the accounts)
- EDTF 29 – additional disclosure of derivatives split by credit rating

Although every endeavour has been made to meet all the additional disclosure requirements there are still some areas where disclosures have not fully met the requirements as follows:

- CRR requirement to split out SME from corporate has been made in certain disclosures, however it has not been possible to fully disclose these across the whole document, predominately relating to 2013;
- CRR split of geographical exposures. The Bank's exposures are predominately within the UK and therefore the geographical split has not been disclosed on the basis of immateriality; and
- CRR requirement regarding equity disclosures have not been disclosed within the document on the grounds of immateriality.

Further information regarding the EDTF recommendations can be found at http://www.financialstabilityboard.org/2014/09/r_140930a/.

Table 2 EDTF disclosure update

The table below provides an index to the Bank's disclosures in accordance with the EDTF's recommendations either within its Annual Report and Accounts (ARA) or Pillar 3 disclosures.

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management ARA	Other sections of the ARA
General	1	Risks to which the business is exposed	5	Principal Risk	Strategic review
	2	Definition of risk terminology, principles and appetite	3, 5	Risk Appetite	
	3	Top and emerging risks and the changes during the reporting period	5	Principal risk profile	
	4	Analysis of future regulatory developments affecting our business model and the Bank's profitability	5		
Risk governance and risk management	5	The Bank's risk management organisation, process and key functions	3	Risk Management Framework	Strategic review
	6	Risk culture and risk governance and ownership	3		
	7	Key risks, risk appetite and risk management	3, 5		
	8	Stress testing and the underlying assumptions	4		Capital Management
Capital adequacy	9	Minimum Pillar 3 disclosure requirements	4		Capital management
	10	Reconciliation of accounting balance sheet to regulatory balance sheet	4		
	11	Flow statement of movements in regulatory capital since the previous reporting period including changes in Common Equity Tier 1, Tier 1 and Tier 2 Capital	4		
	12	Discussion of targeted level of capital and how this will be established	1, 4, 5		
	13	Analysis of Risk Weighted Assets	4		
	14	Analysis of capital requirements for each Basel asset class	4		
	15	Analysis of credit risk for each Basel asset class	4		
	16	Flow statements reconciling the movements in Risk Weighted Assets for each Risk Weighted Asset type	4		Capital management
	17	Discussion of Basel credit risk model performance	5		
Liquidity and funding	18	Analysis of the Bank's liquid asset buffer	4	Liquidity risk 2.3.1	Note 40: Fair values of financial assets and liabilities
	19	Encumbered and unencumbered assets analysed by balance sheet category		Liquidity risk 2.5	
	20	Consolidated total assets, liabilities and off-balance sheet commitments analysed by remaining contract maturity at the balance sheet date		Liquidity risk 2.4	
	21	Analysis of the Bank's sources of funding		Liquidity risk 2.3.2	
Market risk	22	Relationship between the market risk measures for trading and non-trading portfolios and the balance sheet	5	Market risk 3.1	
	23	Discussion of trading significant trading and non-trading market risk factors	5	Market risk 3.1	
	24	VaR assumptions, limitations and validation	5	Market risk 3.4	
	25	Description of the primary risk management techniques employed by the Bank	5	Market risk 3.2	

2. Changes to disclosures continued

Type of risk	Recommendation	Disclosure	Section in Pillar 3	Section in Risk Management ARA	Other sections of the ARA
Credit risk	26	Analysis of the aggregate credit risk exposures	5	Credit risk 1.2, 1.3, 1.4	Note 18: loans and advances to customers
	27	Describe the policies for identifying impaired and non-performing loans	5	Credit risk 1.3	
	28	Reconciliation of the opening and closing balances of non-performing or impaired loans in the period	5	Credit risk 1.3	
	29	Analysis of counterparty credit risk that arises from derivative transactions	5	Credit risk 1.3.4	
	30	Discussion of credit risk mitigation, including collateral held for all sources of risk	5	Credit risk 1.3	
Other risks	31	Description of other risks	5	Other risks 4–10	Note 33: Provisions for liabilities and charges Note 36: Contingent liabilities
	32	Discussion of publicly known risk events	5		

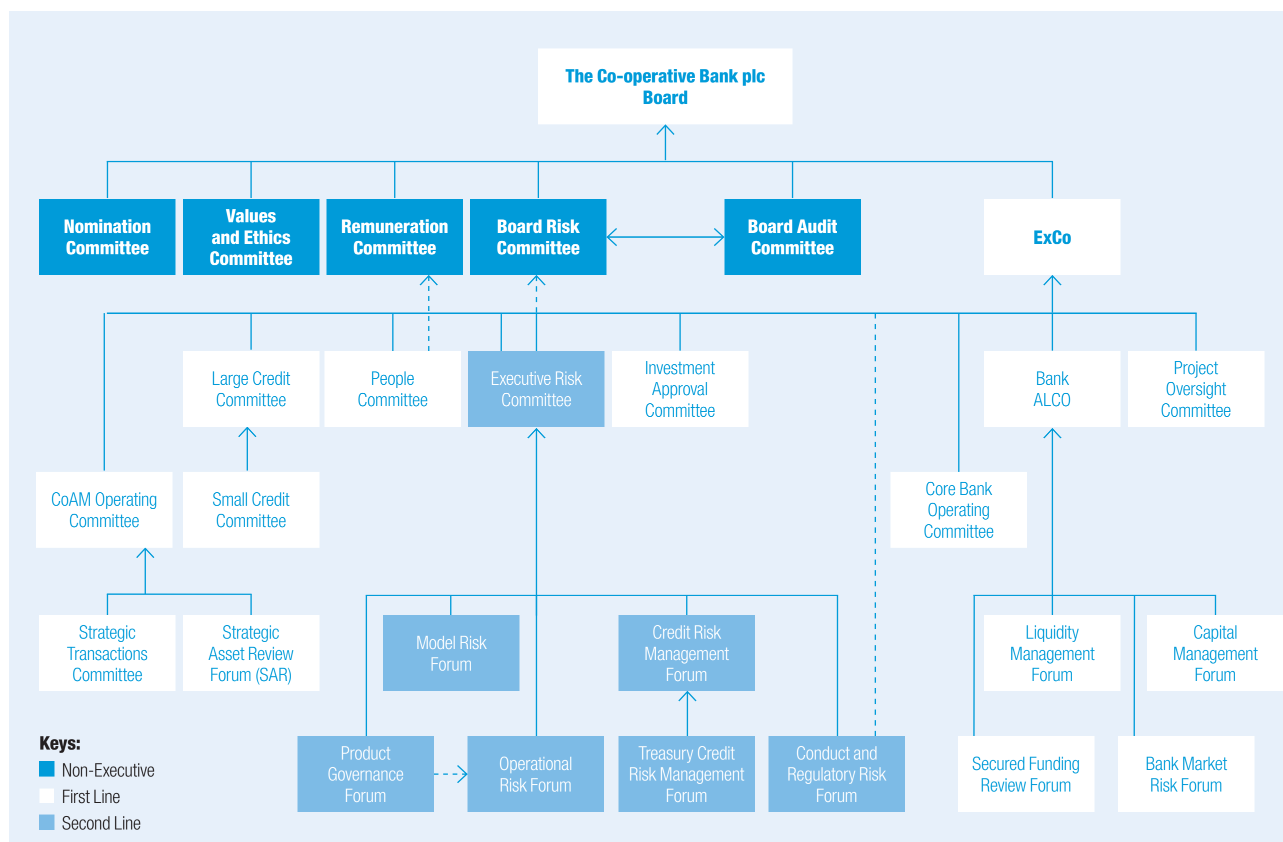
3. Risk Management policies and objectives

3.1 Overview

- The management of risk lies at the heart of the Bank. One of the main risks incurred arises from the extension of credit to customers through regulatory operations of the Bank. Beyond credit risk, the Bank is also exposed to a range of other risk types such as market, liquidity, operational, pension, conduct, reputational and other risks that are inherent to its industry, strategy, product range and geographical coverage.
- The Bank continues to operate the three lines of defence governance model, to ensure appropriate responsibility and accountability is allocated to management, whilst recognising that the system is designed to manage rather than eliminate risk of failure to achieve business objectives. The three lines of defence are:
  - the Bank's business teams and first line management act as the first line of defence and are responsible for identifying where a business unit is exposed to risks, including from the development of new products, processes or other business change. They also manage the risks that reside within their business units on a day-to-day basis, implementing effective monitoring and control processes to ensure that the Bank's business' risk profile is understood and maintained within the Board-defined risk appetite;
  - the Bank's compliance and risk functions act as the second line of defence. They oversee and challenge the implementation and monitoring of the risk framework and consider current and emerging risks across the Bank. They also review and challenge the delegated authority framework and oversee appropriate escalation of breaches, mitigating actions and reporting to the Executive Risk Committee (ERC); and
  - the Bank's internal audit function acts as the third line of defence. It is responsible for independently verifying that the principal risk control framework has been implemented as intended across the business and challenging the overall management of the framework to provide assurance to the Audit Committee and senior management as to the adequacy of both the first and second lines.

3.2 Risk governance structure

The diagram below illustrates the Bank's Risk Management Committee structure as at the end of 2014. The Bank continues to review and refine this structure.



First line committees are responsible for ensuring that the risk and control environment is established and maintained in day-to-day decision making. The second line committees give oversight and challenge to the first line and review and approve the component parts of the Risk Management Framework that are designed in the first line.

3.3 Board and sub-committees

The Bank's risk governance structure provides risk evaluation and management whilst ensuring the Bank manages the regulatory environment as efficiently as possible. The risk focus of these Committees is described below:

Committee	Risk focus
The Board	The Board has collective responsibility for the long term success of the Bank. Its role is to provide leadership of the Bank within a framework of prudent and effective controls which enables risk to be assessed and managed. It sets the Bank's values and standards and ensures that its obligations to its shareholders, customers and other stakeholders are understood and met. The Board sets the Bank's strategy and approves plans presented by management for the achievement of the strategic objectives it has set. It determines the nature and extent of the significant risks it is willing to take in achieving its strategic objectives and is responsible for ensuring maintenance of sound risk management and internal control systems.
Remuneration Committee	The Remuneration Committee determines the remuneration for the Executive Directors and the Executive Committee of the Bank and it sets and recommends to the Board for approval, the overarching principles and parameters of the remuneration policy across the Bank to ensure an overall coherent approach to remuneration for all employees.
Board Risk Committee (BRC)	The BRC is responsible for the review and report of its conclusions to the Board in respect of the Bank's risk appetite and Risk Management Framework, taking a forward looking perspective and anticipating changes in business conditions.
Board Audit Committee (AC)	The AC monitors, reviews and reports to the Board on the formal arrangements established by the Board in respect of the financial and narrative reporting of the Bank, the internal controls and the Risk Management Framework, and the internal/external audit process.
Nomination Committee (NC)	The NC reviews and makes recommendations on Board composition, succession planning for Executive Directors, Non-Executive Directors and certain Senior Executives, identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board.
Values and Ethics Committee (V&E)	The V&E Committee recommends to the Board for its approval and adoption of the Co-operative Values and Ethical Policies of the Bank and to advise the Board of the Bank's conformity with such values and ethics in its operations and activities.

The Initial Public Offering (IPO) Committee is a special purpose Committee not considered part of the overall governance structure described above.

3.4 Executive and management committees

The Executive has established sub-committees and senior management committees whose responsibilities include implementing the Risk Management Framework, identifying the key risks facing the business and assessing the effectiveness of planned management actions. These are detailed below:

Committee	Risk focus
Executive Committee (ExCo)	ExCo manages the business in line with the risk appetite statement, and in doing so ensures the implementation of the risk strategy set by the Bank's Board so as to deliver an effective risk management environment.
Executive Risk Committee (ERC)	The ERC is chaired by the Chief Risk Officer (CRO). Its purpose is to provide a mechanism to ensure all the Bank's risks are reviewed, challenged and approved in line with decisions made at ExCo (with escalation to the BRC where required).
Large Credit Committee (LCC)	The LCC supports the Chief Executive Officer (CEO) in sanctioning large counterparty transactions and managing large exposure positions.
Small Credit Committee (SCC)	The SCC is a sub-committee of the LCC and its core purpose is to independently sanction new and increased lending over set limits of authority.
Strategic Transactions Committee (STC)	Chaired by the CEO, the STC reviews, challenges and approves (where permitted within the authority delegated by the Board) strategic transactions designed to achieve the deleveraging of the balance sheet in line with the strategy outlined by the Board for the Non-core assets within the Co-operative Asset Management (CoAM) business. Any deal sanctioned by the STC must be approved by the CEO and Finance Director of the Bank or the Treasurer of the Bank (up to the limit of their delegated authority) and a risk assessment must be carried out by the CRO or other director in the Risk division.
Bank Asset and Liability Committee (ALCO)	ALCO is chaired by the Finance Director. It is primarily responsible for overseeing the management of capital, market, liquidity and funding risks. Its responsibilities include: • Identifying, managing and controlling the Bank's balance sheet risks in executing its chosen business strategy; • Ensuring that the capital and liquidity position of the Bank is managed in line with policy and that adequate capital is maintained at all times; • Overseeing and monitoring relevant risk control frameworks; • Recommending relevant principal risk policies and detailed risk appetite limits to the CEO and the ERC for approval; and • Approval of all product pricing proposals. To assist in carrying out these responsibilities, ALCO is supported by a Bank Market Risk Forum (BMRF), Liquidity Management Forum (LMF), Secured Funding Review Forum (SFRF) and Capital Management Forum (CMF).
People Committee	The People Committee is chaired by the Human Resources Director and is responsible for the review of key people data within the Bank such as headcount and retention and to oversee the hiring of senior roles and all remuneration policies below the Executive level.
Core Bank Operating Committee	Responsible for the delivery of the business plan covering all areas of the Retail and Commercial Bank scorecard and provides oversight of performance. The Core Bank Operating Committee drives first line management of risk across the Retail and Commercial Bank and ensures that a robust and effective control environment exists.
CoAM Operating Committee	Chaired by the Managing Director CoAM, the CoAM Operating Committee is responsible for managing and reviewing the performance of CoAM against both operational and financial objectives in line with the business plan. It reports to the Executive Committee regarding progress of deleverage of the Non-core balance sheet. The CoAM Operating Committee drives first line management of risk across CoAM, ensures that the correct governance processes are followed and that a robust and effective control environment exists.
Strategic Asset Review Forum (SAR)	A forum established at the discretion of the LCC and SCC for all CoAM and BaCB non performing facilities. Its function is to set strategies on a case by case basis and sanction within its authority.
Product Governance Forum	The Product Governance Forum provides independent review and challenge of product proposals, to ensure effective identification, assessment and mitigation of risks prior to launch.
Operational Risk Forum (ORF)	Oversees the design and maintenance of the Bank's operational risk framework and the risk control frameworks. In addition to this the ORF recommends to the CEO, CRO and the ERC relevant underlying policies and detailed risk appetite limits for approval.
Conduct and Regulatory Risk Forum (CRRF)	The core purpose of the CRRF is to support the Regulatory Risk Director in providing oversight of the Bank's Risk Management Framework in respect of regulatory and conduct risk and maintenance of the appropriate authorisations for the regulated entities within the Bank, including oversight of any variation to permission policies.

3.4 Executive and management committees continued

Committee	Risk focus
Model Risk Forum (MRF)	The MRF responsibilities include: • Setting and approving the model review process and standards; • Reviewing and recommending to the CEO and ERC the Bank's model risk policy for approval; • Review and approval of the Model Risk Control Standard; and • Defining the review schedule for existing models and other tasks as identified in the Model Risk Policy.
Liquidity Management Forum (LMF)	LMF is a forum reporting to the ALCO. The role of the LMF is to define the lower level governance requirements for Liquidity Risk across the whole Bank. Liquidity risk materialises if the Bank does not hold sufficient liquidity to meet expected and unexpected liabilities when they become due or requested, without sustaining unacceptable losses. The forum will oversee and challenge all aspects of liquidity risk management within the Bank and make recommendations to the ALCO as appropriate.
Credit Risk Management Forum (CRMF)	The CRMF advises and supports the CRO in designing the credit risk control implementation approach and the Credit Control Framework. It also recommends to the ERC the Credit Risk Policy, credit measurement methodologies and risk appetite. The Treasury Credit Risk Management Forum feeds into this forum specifically in relation to Treasury matters.
Bank Market Risk Forum (BMRF)	The role of the BMRF is to review, challenge and monitor the market risk profile for the Bank, in line with applicable policies and within risk appetite. BMRF is a forum reporting to the ALCO. The role of the BMRF is to define the lower level governance requirements for market risk across the whole Bank.
Secured Funding Review Forum (SFRF)	SFRF's role is to review and progress any issues which may impact either current or future planned secured funding, along with the review of all monthly, quarterly, semi-annual and annual returns for the secured funding vehicles. The primary monitoring of secured funding is via the Committee, with all new issuance and delegated authority requiring Board approval. The core purpose of the Committee is to support the ALCO in carrying out its responsibilities.
Capital Management Forum (CMF)	The role of the CMF is to review, challenge and monitor the Bank's capital adequacy, in line with capital policy and within risk appetite and review of capital adequacy stress testing. The CMF is responsible for making recommendations to the ALCO as appropriate.
Investment Approval Committee (IAC)	The purpose of the IAC is to oversee and challenge the execution of all significant investments, divestments and major capital expenditure proposals as contained within the Bank's turnaround in accordance with the authorities delegated to it by ExCo, ensuring: • That all investments are being made in accordance with the Bank's Five Year Business Plan; • The strategic investment portfolio remains balanced when considering investment demands against scarce resources; • Executive sponsors are empowered to deliver within defined constraints; and • Decisions taken are done so in accordance with the requirements of the Risk Management Framework and all applicable Bank PDC Risk Policies and Control Standards.
Project Oversight Committee (POC)	The purpose of the POC is to oversee and challenge the delivery of the Change Portfolio for the Bank, in accordance with the authorities delegated to it by ExCo, ensuring: • There is clarity of delivery outcomes; • That benefits are delivered within agreed time, cost and quality thresholds; • Sponsors have the necessary executive support to deliver successfully; and • Key risks and issues threatening delivery are receiving the appropriate levels of intervention.

3.5 Risk Management Framework

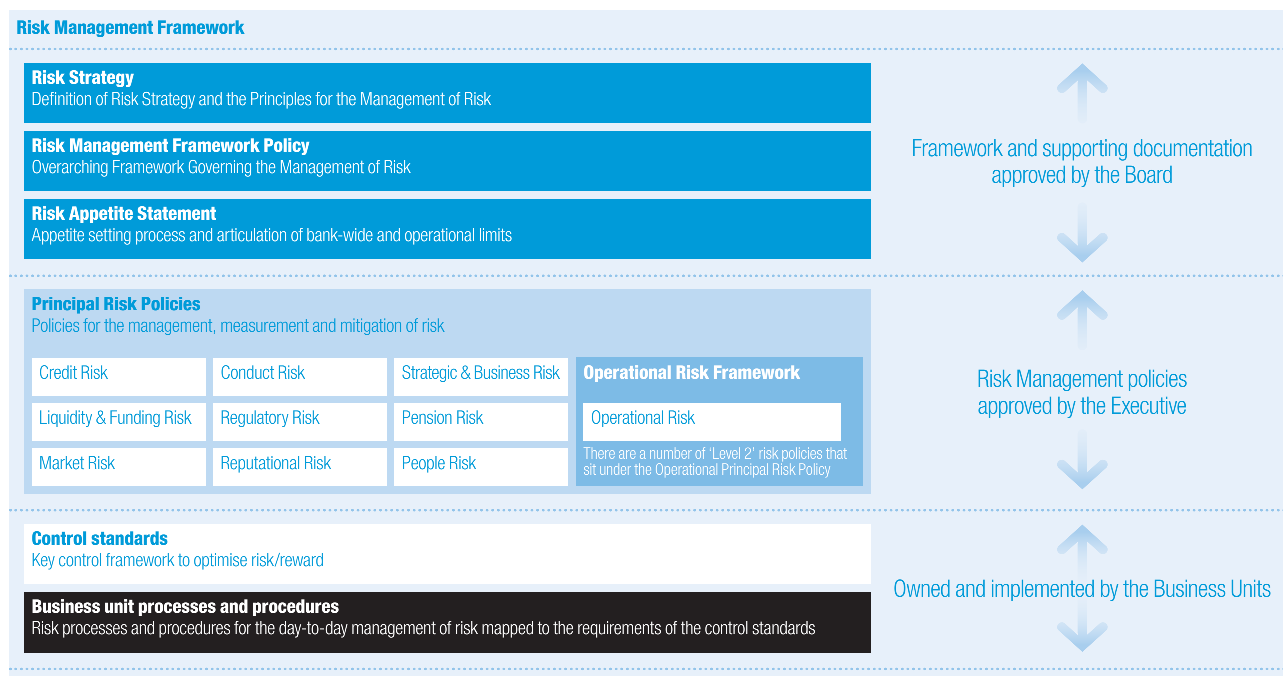
Through the Risk Management Framework the Bank manages enterprise-wide risks, with the objective of maximising risk adjusted returns while remaining within risk appetite.

Underpinning the framework is a set of principles that describe the Bank's risk management culture:

- Balancing risk and return: risk is taken in support of the requirements of our stakeholders, in line with our strategy and within our risk appetite;
- Responsibility: it is the responsibility of all employees to ensure that risk-taking is disciplined and focused. We take account of our social responsibilities and our commitments to customers;
- Accountability: risk is taken only within agreed authorities and where there is appropriate infrastructure and resource. All risk-taking must be transparent, controlled and reported;
- Anticipation: we seek to anticipate future risks and ensure awareness of all known risks; and
- Competitive advantage: we seek to achieve competitive advantage through efficient and effective risk management and control.

The Risk Management Framework articulated below consists of a hierarchy of strategies, policies and standards which are designed to support the Bank's risk-based decision-making.

The Risk Management Framework is under continuous review and will continue to be refined as the Bank embeds it into its day-to-day operations.



3.6 Risk strategy and principles

The Bank's overall risk strategy is maintained by the CRO and approved by the Board. The risk strategy sets out the:

- Way in which risk management supports the Bank through bringing transparency, clarity and insight;
- Strategic goals for risk management across the Bank; and
- Risk management principles that must be followed across the Bank in order to achieve those strategic goals.

To achieve the strategic goals, the following principles are mandated across the organisation:

- The Board requires the business to be managed in line with the risk strategy which sets out the agreed vision within the agreed risk appetite. Risk, as well as reward, should be taken into account in a consistent way across the business when pursuing all strategic objectives to maintain the desired risk profile;
- The Board is ultimately responsible for all the Bank's risks and approves limits for the business so it may operate within the agreed risk appetite. The Board expects management to realise strategic objectives whilst understanding these limits to build an effective risk culture;
- An independent review and challenge is provided by the CRO who is supported by an appropriate governance structure to implement and continuously improve the Risk Management Framework;
- Recognised, emerging or current risks are managed in line with the Bank's approach for identification, measurement, management, monitoring and reporting;
- Stress testing exercises are carried out to assess the impact of a range of adverse scenarios with different probabilities and severities to inform the Bank's strategic planning processes;
- Management monitors the aggregated risk profile of the Bank and its regulated entities and reviews trends which are reported to the Board and externally to regulators to meet external obligations; and
- Risk management techniques are adopted across the business with the use of these evidenced through documentation and self-certification.

The Bank's risk strategy and Risk Management Framework is under continuous review. Whilst the Bank has started to embed improved risk management processes and procedures it still falls short of best practice and further improvement will continue in 2015.

3.7 Risk appetite statement

The Board has primary responsibility for identifying the key business risks facing the Bank, approving the Bank's risk strategy and the acceptable level of risk appetite and associated tolerances, and delegates the setting of the detailed risk limits and tolerances to the CEO. The CEO uses the Executive Committee (ExCo) and Executive Risk Committee (ERC) governance structure to assist in consideration, review and setting of these more detailed risk appetite limits and tolerances. Any escalation or approval goes to Board Risk Committee (BRC).

The Bank's risk appetite framework encompasses five risk appetite pillars, which are customer outcomes, capital adequacy, earnings, liquidity & funding and operational control.

Each of the five risk appetite pillars is supported by quantitative measures to ensure that the Bank operates within the expectations of key stakeholders, including its customers, rating agencies and regulators.

The risk appetite review and refresh process is aligned to the annual planning cycle, and tolerances for each of the risk appetite measures are recalibrated against the revised plan.

The agreed measures are discussed on a rotational monthly basis at ERC and BRC. At the end of 2014, the Bank was outside of its long term risk appetite across a number of measures reflecting the current capital position and operational controls (including IT resilience) of the Bank. This continues to be closely monitored and the Bank's plan envisages moving within risk appetite over the plan period. In order to remain outside shorter term risk appetites, the Board requires a formal risk acceptance to be tabled detailing when and how management will bring the position within risk appetite.

4. Capital adequacy

4.1 Assessing the adequacy of internal capital

Capital is held by the Bank to protect its depositors, to cover its inherent risks, to provide a cushion for unexpected losses and to support the development of the business. The Bank's objective is to achieve a capital base in excess of regulatory requirements.

Assessment of capital adequacy is made on a forward looking basis with reference to prevailing and forthcoming prudential rules including those under consultation. From 1 January 2014 the Bank has been subject to CRD IV which implemented Basel III within the EU.

ALCO is responsible for ensuring that the capital and solvency position of the Bank is managed in line with policy. The CMF is a sub-forum of ALCO and is responsible for oversight of all aspects of Bank capital risk management, monitoring and control including consideration of prudential regulations. CMF has specific responsibility as follows:

- Review, challenge and monitor current and forecast capital adequacy with reference to regulatory requirements, Board risk appetite and financial plan;
- Review and ratify the Bank's ICAAP and capital adequacy stress testing;
- Assess and report on risks and opportunities to plan and on capital management actions;
- Review and monitor Bank capital management control standards; and
- Report to and make recommendations to ALCO as appropriate.

The Bank's approach to assessing capital adequacy to support current and future requirements is conducted via the Bank's ICAAP, the financial planning process and through stress testing and scenario analysis. Stress testing is performed at least annually, with a formal ICAAP submission required to be submitted to the PRA at least once every two years. The Bank's ICAAP is constructed in two stages:

Stage 1 – initially assesses the capital adequacy of the Bank's Pillar 1 charge (credit, market and operational risks), and analyses and quantifies, where appropriate, additional Pillar 2 risks (including operational risk add-on, concentration risk, pension scheme risk, interest rate risk in the banking book, securitisation risk, liquidity risk, reputational risk and contagion risk).

Stage 2 – models the Bank's five year plan earnings and balance sheet in order to ensure that its Pillar 1 and Pillar 2 capital requirements are met during a severe but plausible stressed environment over the plan period, utilising appropriate management actions. The Bank's most material risk is credit risk, making up 91% of its RWAs. On this basis, the Bank's principal stress in determining its Pillar 2 capital is that of credit quality deterioration as a result of the Bank's chosen view of stress conditions.

For most of 2014 the Bank was not compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital it expects the Bank to hold. On 31 December 2014 the contribution from The Co-operative Group helped push the Bank into ICG compliance, however due to the Bank's ongoing losses, this position should be regarded as a very temporary situation. The Bank met the Pillar 1 capital requirement throughout the year.

The revised plan, which has been accepted by the PRA, anticipates that the Bank will meet the 7% CET1 ratio throughout the planning period. The capital plan anticipates sustainably meeting ICG by the latter part of the planning period, and is designed to build a capital buffer to withstand a severe stress test scenario, like the one ran by the Bank of England in 2014, towards the end of the plan.

Please see page 26 of the Annual Report and Accounts for information on the Regulatory position of the Bank.

4.2 Capital stress testing

The Bank uses stress testing as part of its assessment of capital adequacy; this includes stress testing in relation to:

- Financial plan;
- ICAAP; and
- Annual stress testing exercise.

Stress testing is embedded within the Bank's financial planning process, with stressed scenarios applied to the Bank's base case plan, at least on an annual basis, or more frequent, where required. This enables the Bank's senior management and Board to assess the plan under adverse scenarios to ensure the plan remains within risk appetite or that appropriate strategic decisions can be taken.

Scenarios capture a magnitude of macroeconomic variables including GDP, interest rates, unemployment, house prices and commercial real estate prices. An example scenario includes Euro sovereign debt concerns and weakening global economic activity, causing UK exports to recede. The Bank also performs stress testing against PRA defined anchor scenarios, as well as its own bespoke scenarios.

Individual business areas prepare business plans as part of the financial planning process. Stress testing models are utilised to stress businesses' plans over a forward looking 5 year planning horizon.

Stress testing results are prepared on both a pre and post management action basis, and compared to both risk appetite and minimum regulatory requirements. Review and challenge of stress testing results are undertaken by the business and the second line of defence, with review through the Bank's committee structure.

4.2 Capital stress testing continued

The Bank also undertakes reverse stress testing to assess the point at which the Bank is likely to fail, on both an individual and combined event basis.

The Bank was a participant in the Bank of England 2014 UK concurrent stress test of the eight major UK banks and building societies. This was designed specifically to assess resilience to a very severe housing market shock and to a sharp rise or snap back in interest rates. This was not a forecast or expectation by the Bank of England regarding the likelihood of a set of events materialising, but a coherent, severe 'tail risk' scenario.

Results of this exercise were published on 16 December 2014 and can be found on the Bank of England website www.bankofengland.co.uk.

As a result of its failure of this stress test, the Bank was required to submit a revised plan which was accepted by the PRA in December 2014. This plan is designed to enable the Bank to withstand a severe stress towards the end of the plan period. As part of the plan, the Bank has committed to reducing its risk-weighted assets to £7.5bn by the end of 2018, and will primarily undertake this through reducing the Optimum portfolio which is particularly vulnerable to a housing market stress.

The Bank's plan is complex and the execution risk is significant. Please see the Principal Risks and Uncertainties section of the Annual Report and Accounts for further details.

Reflecting the current economic conditions, the Bank's risk appetite includes the requirement to hold sufficient capital to meet a mild downturn in activity, such as is experienced once in every ten years; a '1-in-10' stress. The Bank submitted its most recent ICAAP in July 2014. When the ICAAP was prepared, based on 31 December 2013 data, the Bank forecast remaining above the 4.5% CET1 minimum requirement in a 1-in-10 stressed scenario and would be above 7% at the end of the forecast period.

4.3 Capital adequacy

All CRD IV disclosures are shown on a transitional and fully loaded basis except for the leverage ratio which is only calculated on a fully loaded basis. Through its Policy Statement PS7/13, the PRA implemented CET1 deductions and prudential filters in full from 1 January 2014, with the exception of available for sale unrealised gains. The Bank's fully loaded and transitional positions for Additional Tier 1 and Tier 2 capital are similar however, elements of minority interests retain a transitional element.

Significant changes to the calculation of own funds as a result of the implementation of CRD IV include:

- Allocation of minority interests between Common Equity Tier 1, Tier 1 and Tier 2 capital;
- Additional deductions from Common Equity Tier 1 capital;
- Introduction of Credit Valuation Adjustment for derivative exposures;
- Introduction of Asset Value Correlation for exposures to large financial institutions;
- Deduction from Common Equity Tier 1 capital or risk weighting of deferred tax assets and significant investments dependent upon thresholds of own funds; and
- Introduction of non-risk based leverage ratio.

During 2014 the Bank has continued to make progress towards improving its capital position. In 2014, The Co-operative Group injected the planned £313m Common Equity Tier 1 due from the December 2013 LME. A further £400m capital raising, £387m after costs, was completed in May 2014.

- Fully loaded Common Equity Tier 1 ratio has increased to 13.0% as at 31 December 2014 (2013: 7.2% restated). Further details can be found in section 4.4.
- Fully loaded leverage ratio has increased to 4.3% as at 31 December 2014 (2013: 2.4% restated) reflecting an increase in Tier 1 of £556.4m and a decrease in exposure of £6.6bn.
- For most of 2014 the Bank was not compliant with its Individual Capital Guidance (ICG), being the PRA's statement as to the regulatory capital, Pillar 2a, it expects the Bank to hold above Pillar 1. On 31 December 2014 the contribution from The Co-operative Group helped push the Bank into ICG compliance, however due to the Bank's ongoing losses, this position should be regarded as a very temporary situation. The Bank met the Pillar 1 capital requirement throughout the year.
- Along with CET1 %, the leverage ratio is expected to worsen during the plan period. It is expected to be sustainably above 3% towards the end of the plan period.

4.4 Capital ratios

The Bank's capital ratios are as follows:

Table 3 Capital ratios

	CRD IV transitional 2014	**CRD IV fully loaded 2014**	CRD IV transitional 2013	CRD IV fully loaded 2013
Common Equity Tier 1 ratio	**12.7%**	**13.0%**	7.1%	7.2%
Tier 1 ratio	**12.9%**	**13.0%**	7.3%	7.2%
Total Capital Ratio	**14.9%**	**15.0%**	9.0%	8.9%

Fully loaded CET1 has increased to 13.0% from 7.2% restated as at 31 December 2013.

4.4 Capital ratios continued

The increase in CET1 reflects:

£700.2m increase in permanent share capital and related share premium accounts relating to the £313m injection from The Co-operative Group as part of the 2014 Commitment, and £387m capital raising (net of costs); £236.4m regulatory losses for the year; and £46.8m reduction in expected loss shortfall.

The reduction in Risk Weighted Assets is primarily due to a £1.1bn reduction in Corporate CoAM (Non-core) driven by ongoing asset sales and deleveraging activity in the Non-core business. The Illius portfolio (a portfolio of repossessed housing stock) was sold (£151.3m) in November 2014. The reduction in the Retail Risk Weighted Assets of £0.4bn has been driven by the unsecured portfolios reducing over the course of the year.

Operational risk risk-weighted assets have decreased by £123.4m following the annual recalculation of the Pillar 1 Operational Risk requirement following the 2013 year end results.

December 2013 retained earnings included in the regulatory capital position have been amended for the restatement of FSCS levy, changes to hedge accounting and the write off of certain assets. Further information can be found in note 3 of the Bank's 2014 Annual Report and Accounts.

Within its Policy Statement PS7/13, the PRA utilised the option provided in CRD IV to transition to the minimum CET1 ratio. The 2014 minimum CET1 ratio is 4.0% and minimum Tier 1 ratio is 5.5% for UK banks. As at 31 December 2014, the Bank's transitional CET1 ratio of 12.7% is 8.7% (£1,101.6m) higher than the 4.0% minimum CET1 ratio. In addition the Bank's transitional Tier 1 ratio of 12.9% is 7.4% (£935.0m) higher than the 5.5% minimum Tier 1 ratio.

However, the PRA confirmed within its Supervisory Statement SS3/13 that it expects major UK banks and building societies, including The Co-operative Bank, to maintain a CET1 ratio of at least 7.0%.

4.5 Capital resources

The following table shows the capital resources of the Bank.

Table 4 Total capital resources

	2014		2013 (restated)	
	Year 1 CRD IV transitional rules £m	**CRD IV fully loaded £m**	Year 1 CRD IV transitional rules £m	CRD IV fully loaded £m
Common Equity Tier 1 capital: instruments and reserves				
Permanent share capital and the related share premium account	**1,759.5**	**1,759.5**	1,059.3	1,059.3
Retained earnings	**(36.7)**	**(36.7)**	731.7	731.7
Available for sale and cash flow hedge reserves	**83.6**	**83.6**	(1.0)	(1.0)
Minority Interests	**6.1**	**10.6**	6.9	12.1
Other Reserves	**410.0**	**410.0**	410.0	410.0
Independently reviewed interim profits net of any foreseeable charge or dividend	**–**	**–**	–	–
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**2,222.5**	**2,227.0**	2,206.9	2,212.1
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Prudential valuation in trading book	**(0.4)**	**(0.4)**	(2.1)	(2.1)
Intangible assets (net of related tax liability)	**(103.7)**	**(103.7)**	(110.7)	(110.7)
Deferred tax assets not arising from temporary differences	**–**	**–**	–	–
Cash flow hedge reserves	**(59.0)**	**(59.0)**	(13.1)	(13.1)
Expected loss shortfall	**(191.5)**	**(191.5)**	(238.3)	(238.3)
Securitisation positions treated as deduction	**–**	**–**	–	–
Losses for the year	**(236.4)**	**(236.4)**	(768.4)	(768.4)
Filter for unrealised gains on debt instruments held in the available for sale category	**–**	**–**	–	–
Unrealised gains or losses on available for sale assets (revaluation reserve)	**(24.6)**	**–**	–	–
Qualifying AT1 deductions that exceed AT1 capital	**–**	**–**	–	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(615.6)**	**(591.0)**	(1,132.6)	(1,132.6)
Common Equity Tier 1 (CET1) capital	**1,606.9**	**1,636.0**	1,074.3	1,079.5

4.5 Capital resources continued

	2014		2013 (restated)	
	Year 1 CRD IV transitional rules £m	**CRD IV fully loaded £m**	Year 1 CRD IV transitional rules £m	CRD IV fully loaded £m
Additional Tier 1 (AT1) capital: instruments				
Perpetual non-cumulative preference shares	**–**	**–**	–	–
Minority interest	**22.9**	**2.3**	21.7	2.4
Additional Tier 1 (AT1) capital before regulatory adjustments	**22.9**	**2.3**	21.7	2.4
Additional Tier 1 (AT1) capital: regulatory adjustments				
Intangible assets	**–**	**–**	–	–
Expected loss shortfall (half)	**–**	**–**	–	–
Total regulatory adjustments to Additional Tier 1 (AT1) capital	**–**	**–**	–	–
AT1 adjustments in excess of AT1 capital	**–**	**–**	–	–
Additional Tier 1 (AT1) capital	**22.9**	**2.3**	21.7	2.4
Tier 1 capital (T1 = CET1 + AT1)	**1,629.8**	**1,638.3**	1,096.0	1,081.9
Tier 2 (T2) capital: instruments and provisions				
Capital instruments	**196.4**	**196.4**	196.3	196.3
Minority interests	**0.8**	**3.0**	0.9	3.2
Credit risk adjustments	**52.2**	**52.2**	63.9	63.9
Tier 2 (T2) capital before regulatory adjustments	**249.4**	**251.6**	261.1	263.4
Tier 2 (T2) capital: regulatory adjustments				
Expected loss shortfall (half)	**–**	**–**	–	–
Revaluation reserves	**–**	**–**	–	–
Total regulatory adjustments to Tier 2 (T2) capital	**–**	**–**	–	–
Tier 2 (T2) capital	**249.4**	**251.6**	261.1	263.4
Total capital (TC = T1 + T2)	**1,879.2**	**1,889.9**	1,357.1	1,345.3

1. Following the full implementation of CRD IV reporting in 2014, the December 2013 capital resources have been reported in line with the Bank's 2014 CRD IV interpretation. The previously reported Tier 2 credit risk adjustment for 2013 has been revised to £63.9m. The fully loaded total capital ratio for 2013 has correspondingly been revised from 8.6% to 8.9%.
2. December 2013 retained earnings included in the regulatory capital position have been amended for the restatement of FSCS levy, changes to hedge accounting and the write off of certain assets. Further information can be found in note 3 of the Bank's 2014 Annual Report and Accounts.
3. Other Reserves include the £410m capital redemption reserve created as a result of the Bank's Liability Management Exercise in 2013. See note 39 in the Annual Report and Accounts.
4. Minority interest represents the share of the capital and reserves of Unity Trust Bank plc that is attributable to third party investors. Under CRD IV the amount of minority interest which can be recognised by the Bank is allocated between the different tiers of capital.

4.5 Capital resources continued

The following table is a flow statement of movements in the Bank's capital resources.

Table 5 Movement in transitional capital resources during the year

	£m
CET1 capital after regulatory adjustments as at 31 December 2013	1,074.3
Permanent share capital	12.8
Retained earnings	–
Minority Interests	(0.8)
Losses for the period	(236.4)
Share premium account	687.4
Intangible assets	7.0
Available for Sale reserve	14.1
Capital Redemption Reserve	–
Expected loss shortfall	46.8
Prudential valuation in the trading book	1.7
Unrealised gains or losses on available for sale assets (revaluation reserve)	–
CET1 capital after regulatory adjustments as at 31 December 2014	**1,606.9**
AT1 capital after regulatory adjustments as at 31 December 2013	21.7
Minority Interest	1.2
AT1 capital after regulatory adjustments as at 31 December 2014	**22.9**
Total Tier 1 after regulatory adjustments as at 31 December 2014	**1,629.8**
T2 capital after regulatory adjustments as at 31 December 2013	261.1
Paid up capital instruments and subordinated loans	0.1
Minority Interest	(0.1)
IRB Excess of provisions over expected losses eligible	(11.7)
T2 capital after regulatory adjustments as at 31 December 2014	**249.4**
Total capital resources as at 31 December 2014	**1,879.2**

4.5 Capital resources continued

Basel II, implemented in the UK through the PRA's GENPRU and BIPRU requirements, was the prevailing legislation in force during 2013. Hence the comparative table below showing movements from 2012 to 2013 remains on a Basel II basis.

This table therefore does not agree to the CRD IV capital resources disclosed within table 4.

	£m
Core Tier 1 Capital after regulatory adjustments as at 31 December 2012	1,333.2
Permanent share capital	(400.2)
Retained earnings	(186.7)
Minority Interests	1.6
Losses for the period	(738.2)
Share premium account	1,040.7
Intangible assets	151.8
50% of excess of expected losses over impairment (net of tax)	112.2
50% of securitisation positions	(26.6)
Core Tier 1 Capital after regulatory adjustments as at 31 December 2013	1,287.8
Other Tier 1 Capital after regulatory adjustments as at 31 December 2012	109.8
Non-cumulative irredeemable preference shares	(60.0)
50% of excess of expected losses over impairment	(40.8)
50% of material holdings	(0.3)
Other Tier 1 capital after regulatory adjustments as at 31 December 2013	8.7
Total Tier 1 after regulatory adjustments as at 31 December 2013	1,296.5
Tier 2 Capital after regulatory adjustments as at 31 December 2012	850.4
Revaluation reserves	–
Collective provisions	0.2
Subordinated notes and perpetual subordinated bonds	(915.8)
50% of excess of expected losses over impairment	152.9
50% of securitisation positions	(26.6)
50% of material holdings	(0.3)
Excess on limits for Tier 2 Capital	50.2
Tier 2 capital after regulatory adjustments as at 31 December 2013	111.0
Total capital resources as at 31 December 2013	1,407.5

4.5 Capital resources continued

Table 6 Reconciliation of capital resources to statutory balance sheet

Item	Balance per accounts	Regulatory presentation	Regulatory Balance per accounts	Cashflow hedge reserve	Unrealised Gains on AFS Assets	Minority Interests	Deferred tax assets that are risk weighted	EL	Prudent valuation in trading book	Capital Resources Transitional Rules
Equity										
Ordinary share capital	**22.6**	Paid up capital instruments	**22.6**	**–**	**–**	**–**	**–**	**–**	**–**	**22.6**
Share premium account	**1,736.9**	Share premium	**1,736.9**	**–**	**–**	**–**	**–**	**–**	**–**	**1,736.9**
Retained earnings	**(273.1)**	Retained earnings	**(36.7)**	**–**	**–**	**–**	**–**	**–**	**–**	**(36.7)**
	–	Regulatory losses for the period	**(236.4)**	**–**	**–**	**–**	**–**	**–**	**–**	**(236.4)**
Available for sale reserve	**24.6**	Available for sale reserve	**24.6**	**–**	**(24.6)**	**–**	**–**	**–**	**–**	**–**
Cashflow hedging reserve	**59.0**	Cashflow hedging reserve	**59.0**	**(59.0)**	**–**	**–**	**–**	**–**	**–**	**–**
Capital redemption reserve	**410.0**	Other reserves	**410.0**	**–**	**–**	**–**	**–**	**–**	**–**	**410.0**
Non-controlling interests	**34.5**	Minority interest	**34.5**	**–**	**–**	**(4.7)**	**–**	**–**	**–**	**29.8**
Total Equity	**2,014.5**		**2,014.5**	**(59.0)**	**(24.6)**	**(4.7)**	**–**	**–**	**–**	**1,926.2**
Non-Equity	**–**		**–**	**–**	**–**	**–**	**–**	**–**	**–**	
Other borrowed funds	**196.4**	Capital instruments	**196.4**	**–**	**–**	**–**	**–**	**–**	**–**	**196.4**
Intangible assets	**(103.7)**	Intangible assets (net of related tax liability)	**(103.7)**	**–**	**–**	**–**	**–**	**–**	**–**	**(103.7)**
Deferred tax assets	**21.0**	Deferred tax assets not arising from temporary differences	**21.0**	**–**	**–**	**–**	**(21.0)**	**–**	**–**	**–**
Impairment[1]	**683.2**	Expected loss shortfall	**683.2**	**–**	**–**	**–**	**–**	**(874.7)**	**–**	**(191.5)**
	–	Expected loss Tier 2 add-back	**–**	**–**	**–**	**–**	**–**	**52.2**	**–**	**52.2**
	–	Prudent valuation in trading book	**–**	**–**	**–**	**–**	**–**	**–**	**(0.4)**	**(0.4)**
Total Non-Equity	**796.9**		**796.9**	**–**	**–**	**–**	**(21.0)**	**(822.5)**	**(0.4)**	**(47.0)**
Total balances subject to own funds calculations	**2,811.4**	**Total balances subject to own funds calculations**	**2,811.4**	**(59.0)**	**(24.6)**	**(4.7)**	**(21.0)**	**(822.5)**	**(0.4)**	**1,879.2**

1. Impairments are included within Loans and advances to customers within the statutory Balance Sheet. Only impairment relating to exposures calculated under the IRB approach to credit risk are applicable for the calculation of Expected loss shortfall. Therefore the impairment number included in the table above relates to IRB exposures only, and is a subset of the Bank's total impairment.

4.6 Pillar 1 capital requirements and Risk Weighted Assets

The following table analyses the Pillar 1 capital requirement by approach and exposure class. In the table below and throughout the document unless otherwise stated, the documented exposures are reported as EAD. For IRB exposures, EAD is defined as the amount estimated to be outstanding at the time of default. This includes undrawn commitments after credit conversion factors and the result of netting and potential future exposures for derivatives. For standardised exposures, EAD includes undrawn commitments post credit conversion factor and is net of specific provisions.

The following table analyses the capital requirements by approach and exposure class:

Table 7 Pillar 1 capital requirements

2014

IRB exposure class	Capital requirement £m	Risk weighted asset £m	Exposure at default £m	Average risk weight %	Average exposure at default £m
Central government and central bank	0.0	0.3	2.8	11%	1.5
Institutions	35.8	446.9	1,567.1	29%	1,770.5
Corporates	66.2	827.3	1,424.0	58%	1,696.6
Securitisations	74.3	928.4	1,623.8	57%	1,692.2
Retail exposures secured by real estate collateral	345.3	4,315.8	19,128.8	23%	19,862.9
Qualifying revolving	40.2	503.0	2,162.9	23%	2,720.3
Other retail exposures	37.7	471.7	434.5	109%	492.4
Total IRB	599.5	7,493.4	26,343.9	28%	31,846.2
Specialised lending	170.7	2,133.5	3,067.4	70%	3,609.9
Standardised exposure class					
Central government and central bank	–	–	8,084.4	0%	8,395.2
Regional governments or local authorities	0.4	5.2	25.8	20%	53.1
Administrative bodies and non-commercial	1.2	14.4	71.9	20%	54.7
Multilateral development banks	–	–	588.2	0%	632.5
Institutions	12.3	153.8	144.8	106%	190.0
Corporates	75.0	937.9	944.4	99%	1,088.1
Secured by mortgages on immovable property	0.9	11.1	32.6	35%	27.6
Retail	7.1	89.3	130.7	75%	125.8
Exposures in Default	5.9	73.2	52.8	139%	51.6
Other items[1]	47.1	588.6	1,042.5	56%	1,032.8
Total standardised	149.9	1,873.5	11,118.1	17%	11,651.3
Total credit risk	920.1	11,500.4	40,529.4	28%	43,497.5
Total market risk	–	–	N/A	N/A	N/A
Operational risk	90.5	1,131.8	N/A	N/A	N/A
Total Pillar 1	1,010.6	12,632.2	N/A	N/A	N/A

1. Other items within the Standardised approach include equity shares with a value of £8.1m (2013: £5.7m) representing two separate investments. It is subject to the standardised approach as an immaterial portfolio and not considered material for Pillar 3 disclosure purposes relating to equity shares.

Counterparty risk arising from derivative exposures is reported within the appropriate standardised approach exposure classes dependent upon the counterparty classification.

Institutions calculated under the standardised approach include £145m of RWAs (£12m capital requirement) relating to the calculation of Credit Valuation Adjustments for derivatives.

In accordance with CRR Article 150 (Conditions for permanent partial use) the Bank has received permission from the regulator to exempt its exposures to certain counterparty classes, namely central governments (sovereigns) and central banks and Multilateral development banks, from the IRB Approach for the purposes of the calculation of both risk-weighted exposure and expected loss amounts, instead applying the Standardised Approach for these exposures. The revised approach was implemented for the purposes of the Bank's regulatory reporting submissions as of 1 January 2014.

Throughout 2014 the Bank did not have a trading book.

4.6 Pillar 1 capital requirements and Risk Weighted Assets continued

Pillar 1 capital requirements

2013

IRB exposure class	Capital requirement £m	Risk weighted asset £m	Exposure at default £m	Average risk weight %	Average exposure at default £m
Central government and central bank	0.0	0.4	8,510.8	0%	8,469.0
Institutions	56.1	701.4	2,839.1	25%	4,153.9
Corporates	93.0	1,163.0	2,133.2	55%	2,380.7
Securitisations	84.1	1,051.7	1,816.5	58%	1,878.5
Retail exposures secured by real estate collateral	362.2	4,526.8	21,406.3	21%	22,326.4
Qualifying revolving	56.8	709.8	2,450.3	29%	2,188.0
Other retail exposures	49.7	620.7	578.2	107%	661.1
Total IRB	701.9	8,773.8	39,734.4	22%	42,057.6
Specialised lending	220.5	2,756.2	4,495.3	61%	5,138.2
Standardised exposure class					
Central government and central bank	–	–	–	–	–
Regional governments or local authorities	2.2	27.2	135.8	20%	135.5
Administrative bodies and non-commercial	7.3	91.2	97.5	94%	95.1
Multilateral development banks	–	–	20.0	0%	20.0
Institutions	5.0	62.1	314.6	20%	309.0
Corporates	98.9	1,236.6	1,237.3	100%	1,625.2
Secured by mortgages on immovable property	0.8	10.0	27.0	78%	21.1
Retail	5.1	63.3	84.4	75%	61.6
Exposures in Default	7.6	95.6	74.8	128%	99.5
Other items	56.2	702.5	1,168.0	60%	1,120.7
Total standardised	183.1	2,288.5	3,159.4	72%	3,487.7
Total credit risk	1,105.5	13,818.5	47,389.1	29%	50,683.5
Total market risk	–	–	N/A	N/A	N/A
Operational risk	100.4	1,255.2	N/A	N/A	N/A
Total Pillar 1	1,205.9	15,073.7	N/A	N/A	N/A

4.6 Pillar 1 capital requirements and Risk Weighted Assets continued

Table 8 Flow statement of Risk Weighted Assets

A flow statement for the movement in Credit Risk RWAs during the year is set out in the table below:

	Corporate £m	Retail Unsecured £m	Retail Secured £m	Treasury £m	Total £m
Credit Risk RWAs at 31 December 2013	5,748.3	1,393.8	4,688.1	1,988.3	13,818.5
Book size[1]	(1,420.8)	(130.7)	(367.9)	(99.8)	(2,019.2)
Book quality[2]	56.5	(186.4)	147.0	(5.9)	11.2
Model updates[3]	–	–	–	–	–
Methodology and policy[4]	–	–	–	(158.8)	(158.8)
Acquisitions and Disposals[5]	–	–	(151.3)	–	(151.3)
Credit risk RWAs at 31 December 2014	**4,384.0**	**1,076.7**	**4,315.9**	**1,723.8**	**11,500.4**

1. Book size – organic changes in book size and composition (including new business and maturing loans).
2. Book quality – quality of book changes caused by experience such as underlying customer behaviour or demographics, including changes through model calibrations/realignments.
3. Model Updates – Model implementation, change in model scope or any change to address model malfunctions.
4. Methodology and policy – methodology changes to the calculations including those driven by regulatory policy change, such as new regulation (eg CRD IV).
5 Acquisitions and Disposals – significant acquisition or disposal of distinct portfolios.

Corporate RWAs have reduced by 23.7% during 2014, predominantly as a result of the net decrease in book size, driven by the deleveraging activity within the Non-core portfolio. This decrease has occurred throughout the portfolio, with 52% attributed to Specialised Lending, 26% to Standardised and 22% to other FIRB portfolios. The largest decrease in RWAs has been in the Commercial Real Estate sector as a direct result of the deleveraging strategy.

Book quality movement is a result of the changes in risk profile due to ongoing close portfolio management.

There have been no corporate model updates or methodology and policy changes in 2014 that resulted in RWA movements.

The reduction in Retail RWAs has been driven by the sale of the Illius portfolio and a gradual decline across Retail portfolios over the year.

The movement in Treasury RWAs is primarily due to a change in methodology with the CRD IV rules coming into effect 1 January 2014. There has been a RWA reduction of £158.8m resulting from the exemption of the Bank's exposures to certain counterparty classes from the IRB approach to the standardised approach as permitted under CRR Article 150.

The tables below reconcile the statutory balance sheet included within the Annual Report and Accounts to EAD.

Table 9 Reconciliation of statutory balance sheet to gross drawn credit risk exposure

	Balance Sheet Assets under the Regulatory Scope of Consolidation £m	Items Deducted from Own Funds £m	Balance Sheet Gross £m	Provisions	Securitisations Adjustment[1]	Adjustment relating to prior years £m	Other Adjustments £m	Gross Drawn Credit Risk Exposure £m
Cash and balances with central banks	**4,765.3**	**–**	**–**	**–**	**–**	**4,765.3**	**–**	**4,765.3**
Loans and advances to banks	**1,608.4**	**–**	**–**	**–**	**–**	**1,608.4**	**–**	**1,608.4**
Loans and advances to customers	**25,913.2**	**–**	**–**	**659.5**	**(101.7)**	**26,471.0**	**–**	**26,471.0**
AFS financial assets	**3,167.5**	**–**	**–**	**–**	**–**	**3,167.5**	**(0.4)**	**3,167.1**
Treasury bills/other eligible bills	**1,255.0**	**–**	**–**	**–**	**–**	**1,255.0**	**–**	**1,255.0**
Derivatives and SFTs (e.g. reverse repos)	**470.7**	**–**	**–**	**–**	**–**	**470.7**	**–**	**470.7**
Equity shares	**2.8**	**–**	**–**	**–**	**–**	**2.8**	**–**	**2.8**
Investments in group undertakings (eg insurance subs)	**5.3**	**–**	**–**	**–**	**–**	**5.3**	**–**	**5.3**
Goodwill and other intangible assets	**103.7**	**(103.7)**	**–**	**–**	**–**	**–**	**–**	**–**
Deferred tax assets	**21.0**	**–**	**–**	**–**	**–**	**21.0**	**–**	**21.0**
Other assets	**270.0**	**–**	**–**	**–**	**–**	**270.0**	**–**	**270.0**
Total balance sheet	**37,582.9**	**(103.7)**	**–**	**659.5**	**(101.7)**	**38,037,0**	**(0.4)**	**38,036.6**

1. This represents the difference between mortgages and the underlying bonds.

4.6 Pillar 1 capital requirements and Risk Weighted Assets continued

Table 10 Reconciliation of gross drawn credit risk exposure to Exposures at Default

	Gross drawn credit risk exposure £m	Off-Balance sheet items under regulatory scope £m	Gross Credit risk exposure £m	Credit conversion factor	Net Credit risk exposure £m	Other regulatory adjustments £m	EAD £m
IRB approach							
Central governments and central banks	2.8	–	2.8	0%	2.8	–	2.8
Institutions	1,291.8	–	1,291.8	0%	1,291.8	275.3	1,567.1
Corporates	4,133.5	456.0	4,589.5	78%	4,491.4	–	4,491.4
Retail mortgages	18,382.9	290.7	18,673.6	85%	18,630.0	498.8	19,128.8
Qualifying Revolving Retail Exposures	501.5	2,013.1	2,514.6	83%	2,162.9	–	2,162.9
Retail SME	434.5	–	434.5	–	434.5	–	434.5
Other retail	–	–	–	–	–	–	–
Equity claims	–	–	–	–	–	–	–
Securitisation positions	1,623.8	–	1,623.8	–	1,623.8	–	1,623.8
Total	26,370.8	2,759.8	29,130.6		28,637.2	774.1	29,411.3
Standardised approach							
Central governments or central banks	8,536.4	–	8,536.4	–	8,536.4	(452.0)	8,084.4
Regional governments or local authorities	13.4	84.7	98.1	15%	25.8	–	25.8
PSE	65.3	31.3	96.6	21%	71.9	–	71.9
Multilateral development banks	588.2	–	588.2	–	588.2	–	588.2
International organisations	–	–	–	–	–	–	–
Institutions	299.0	0.6	299.6	100%	299.6	(154.8)	144.8
Corporates	880.2	121.7	1001.9	53%	944.4	–	944.4
Retail	127.8	8.7	136.5	33%	130.7	–	130.7
Secured by mortgages on immovable property	24.6	16.0	40.6	50%	32.6	–	32.6
Exposures in Default	88.4	3.6	92.0	100%	92.0	(39.2)	52.8
Covered bonds	58.5	–	58.5	–	58.5	–	58.5
Securitisation positions	–	–	–	–	–	–	–
Short term claims on institutions and corporates	–	–	–	–	–	–	–
Collective investment undertakings	–	–	–	–	–	–	–
Equity	8.1	–	8.1	–	8.1	–	8.1
Other items	975.9	–	975.9	–	975.9	–	975.9
Total	11,665.8	266.6	11,932.4		11,764.1	(646.0)	11,118.1
Overall total	38,036.6	3,026.4	41,063.0		40,401.3	128.1	40,529.4

4.7 Capital buffers

The Bank is not classified as a Global Systemically Important Institution (G-SII), and hence does not have a requirement to hold a G-SII buffer. The UK has not yet defined which institutions will be classified as an Other Systemically Important Institution (O-SII); however HM Treasury has already confirmed that it will set the UK O-SII buffer at 0%.

The capital conservation buffer to be introduced 1 January 2016 includes a transitional requirement and increases by 0.625% per annum until the final requirement of 2.5% is reached from 1 January 2019. Hence the capital conservation buffer was 0% at 31 December 2014.

The Bank is required to calculate its institution specific countercyclical buffer dependent upon the geographic location of obligors. The European Commission published a Regulatory Technical Standard (EU Regulation No 1152/2014) in 2014 to define the location of obligor. Under this methodology, the Bank's exposures can all be classified as UK. The UK countercyclical buffer rate is therefore directly applicable to the Bank. The Financial Policy Committee confirmed in December 2014 that the UK countercyclical buffer rate remains at 0%.

4.8 Leverage ratio

Table 11 Leverage ratio

Leverage exposure	2014	2013
Accounting assets		
Derivative financial instruments	**(551.7)**	(538.6)
Derivative Cash collateral	**–**	–
Securities financing transactions (SFTs)	**–**	–
Loans and advances and other assets	**37,582.9**	43,383.8
Total accounting assets	**37,031.2**	42,845.2
Potential Future Exposure on derivatives	**470.7**	517.7
Total derivatives adjustments	**470.7**	517.7
Counterparty risk leverage exposure measure for SFTs	**–**	–
Regulatory deductions and other adjustments	**(354.6)**	(364.2)
Off balance sheet items	**1,003.4**	1,738.2
Total fully loaded leverage exposure	**38,150.7**	44,736.9
Fully-loaded CRD IV Tier 1 capital	**1,638.3**	1,081.9
Fully loaded leverage ratio	**4.3%**	2.4%

The table above shows the Bank's leverage ratio on a fully loaded basis.

The leverage ratio (calculated as Tier 1 capital divided by adjusted balance sheet exposures) has increased to 4.3% as at 31 December 2014 (2013: 2.4% restated). The improvement in the ratio reflects a £556.4m increase in total Tier 1 capital and a £6.6bn decrease in exposures reflecting the overall deleveraging strategy. The 31 December 2014 leverage ratio has been calculated using the Basel Committee January 2014 exposures definition. This is in line with guidance provided to the Bank by the PRA. The 31 December 2013 leverage ratio remains on a CRD IV exposures basis.

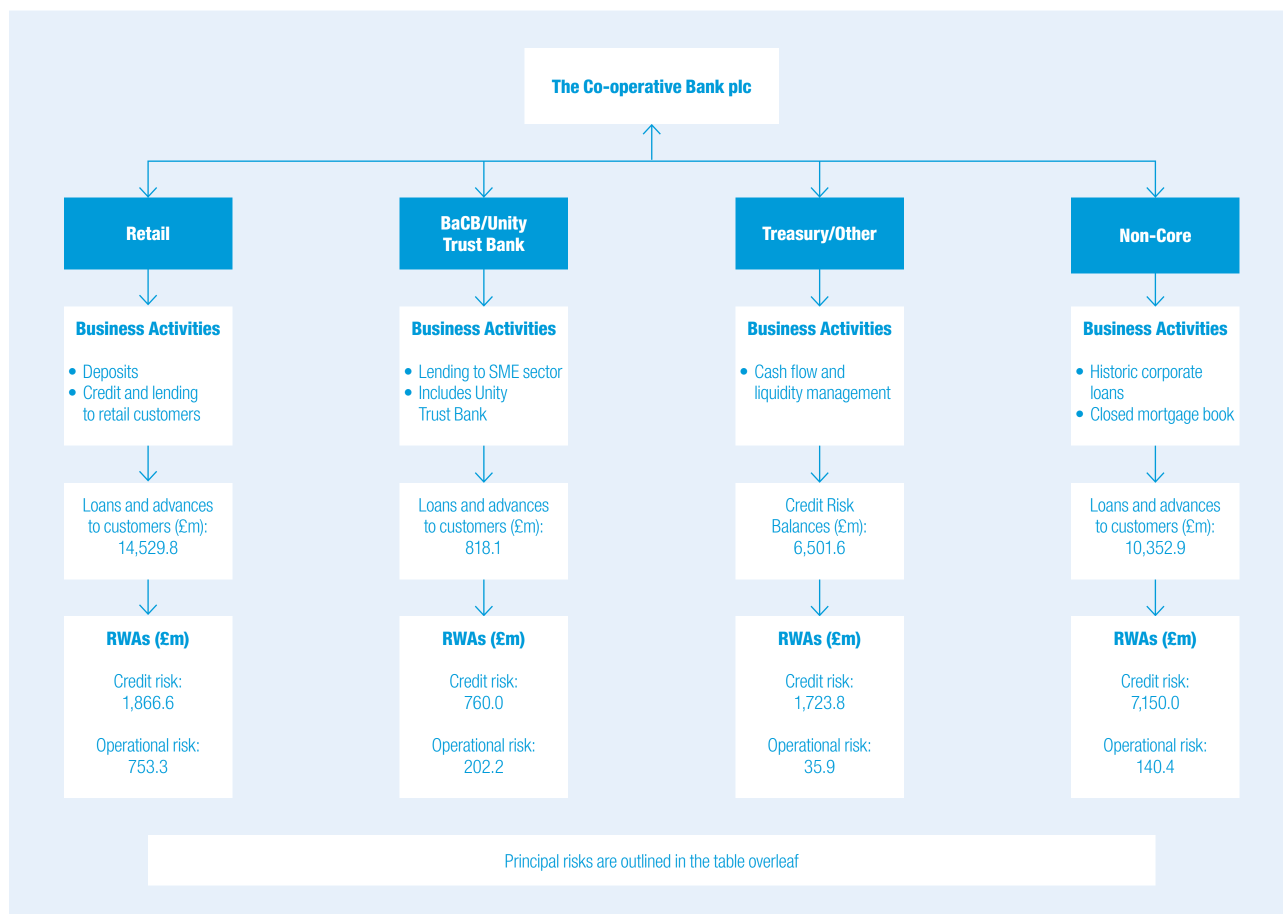
Along with CET1 %, the leverage ratio is expected to worsen during the plan period. It is expected to be sustainably above 3% towards the end of the plan period.

5. Risks and their management

5.1 Overview

Principal risk profile

This diagram below shows the business activities of each of the divisions of the Bank and the RWAs which reside in each division.



5.1 Overview continued

Table 12 Principal Risk Overview

The Bank seeks to understand and manage the various risks that arise from its operations. It defines its principal risks as:

Principal risks	The Bank's definition
1. Credit risk	The current or prospective risk to earnings and/or capital arising from a borrower's failure to meet the terms of any contract with the Bank or the various subsidiaries of the Bank or such borrower's failure to perform as agreed.
2. Liquidity and funding risk	The risk that the Bank's resources will prove inadequate to meet its liabilities as they contractually fall due or as a result of any contingent or discretionary cash outflows that may occur in a stress. It arises from the mismatch of timings of cash flows generated from the Bank's assets and liabilities (including derivatives). Should additional liquidity be required during a time of stress this is likely to result in higher than anticipated funding costs which will negatively impact on retained earnings and therefore capital resources.
3. Market risk	The risk that the value of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates which is managed and hedged in line with the Market Risk Policy to minimise earnings volatility.
4. Operational risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses. Legal risk including litigation, model risk[1] and anti-money laundering and sanctions are also managed within this risk type.
5. Reputational risk	The risk associated with an issue which could in some way be damaging to the reputation of the Bank. Underlying issues amongst others arising as a result of: (i) the Bank's strategic decisions or business performance; (ii) an operational failure; or (iii) external perception. This may result in a requirement to hold additional liquidity in anticipation of a stress scenario, which is likely to negatively impact retained earnings over time and therefore capital resources.
6. Strategic and business risk	The risk arising from changes to the Bank's businesses and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy. This may result in the Bank having to hold additional capital and/or liquidity. This risk is covered by many areas of capital in Pillar 2, specifically execution, concentration and liquidity risk.
7. People risk	People risk is the risk associated with the recruitment, employment and management of individuals within the Bank. A significant portion of the Bank's cost base is staff costs and so managing this resource within budget is key to cost reduction and therefore to retained earnings.
8. Regulatory risk	The risk of fines, public censure, limitation on business, requirements for legal or operational restructuring, or restitution costs arising from the failure to understand, interpret, implement and comply with UK and EU regulatory requirements.
9. Conduct risk	The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.
10. Pension risk	The risk to the Bank's capital and company funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.

1. Model risk is a specific operational risk. It is defined as the risk of model failure or the inappropriate use of models resulting in potential loss, poor decision making and/or reputational damage. Due to the size of the risk and the Bank's reliance on models, it is managed by a separate forum, the Model Risk Forum, to ensure sufficient focus is placed on its management.

Further analysis of the risks, and the management of them, are discussed in more detail in the Risk Management and Principal Risks and Uncertainties sections of the Annual Report and Accounts.

5.2 Credit risk

Credit risk is the risk that borrowers will fail to repay what they have borrowed. The risk to the Bank includes the amounts lent not being repaid, loan interest not being received, cash flows being received later than expected and increased collection costs. This results in the need to set aside provisions and capital to provide for future losses.

5.2.1 Management of credit risk

Credit risk is one of the principal risks set out in the Risk Management Framework and is an integral part of the business activities of this and all other banks. It is inherent in both traditional banking products (loans, commitments to lend and contingent liabilities such as letters of credit) and in 'traded products' (derivative contracts such as forwards, swaps and options, repurchase agreements, securities borrowing and lending transactions).

The inherent risks arising from general economic conditions and uncertainty affecting the global economy and the global financial system, and the Eurozone in particular, receded somewhat in 2014. While the Bank continues to be exposed to these risks and their consequences, the full year performance for 2014 has seen improvement in portfolio performance, reflecting improvement in the UK economy.

All authority to take credit risk derives from the Board. This authority is delegated to the CEO who then sub-delegates to appropriate committees and individuals. The level of credit risk authority delegated depends on seniority and experience, and varies according to the quality of the counterparty, associated security or collateral held.

The Bank's policy for credit risk is approved annually by the ERC and defines appropriate standards and principles for the effective management of credit risk throughout the Bank's divisions.

Credit risk management is an essential element of the Bank's operations. As with all principal risks, the Board requires that the credit business is managed in line with the risk strategy and risk appetite set by the Board. Risk measurement is based on a set of metrics, which are aligned with the Board agreed risk appetite and support the limits framework. These metrics undergo periodic review to assure that they are fit for purpose, ie are able to recognise both emerging and current risks. Credit risk models are subject to annual review by the Model Risk Forum.

Corporate lending discretion was undertaken in 2014 via three principal Executive Lending Committees, the LCC, SCC, STC (see Executive and management committees section). The lending authority of these committees will be removed in 2015 as lending authority moves to key individual lending discretions, which were approved at the Risk Committee in December 2014.

The Credit Risk Management Forum considers key management information to support the oversight and challenge of the credit risk embedded in each division and across the credit risk life cycle. This includes appropriate benchmarking information from similar portfolios in the market and is key to calibrating risk appetite.

The Credit Risk Management Forum is supported by an additional three forums that exist to support the Chief Risk Officer in discharging the second line mandate. These include an Impairment Charge Forum, which was designed to ensure that the credit risk impairment standard is being implemented effectively and that there is sufficient evidence to support the credit risk impairment stock. In addition, the Impairment Adequacy Forum acts as a mechanism for approving and reviewing the refresh of impairment parameters and post model adjustments. The third forum is the Treasury Credit Risk Management Forum which provides day-to-day oversight of the credit risk exposure in the Treasury division.

The Retail division of the Core Bank uses both application and behavioural scoring techniques to rank a customer's risk of default with this, in common with other retail banks, being embedded in the business. The Non-core division, which includes corporate lending, includes a number of specialist models to reflect the embedded credit risk of sectors such as Private Finance Initiatives (PFI) and commercial property. The performance of all rating systems is governed by the IRB Model Working Group with oversight from the Model Risk Forum.

5.2 Credit risk continued

5.2.2 Credit risk exposures

The following table represents the Bank's Exposures at Default (EAD) analysed by approach, exposure class and contractual maturity:

Table 13 Analysis of EAD by residual contractual maturity

2014

Exposure class:	Repayable on demand/ undated £m	Up to 1 year £m	1–5 years £m	5–10 years £m	10–20 years £m	>20 years £m	Total £m
IRB							
Central government and central bank	–	2.8	–	–	–	–	2.8
Institutions	–	1,269.6	249.0	48.4	0.1	–	1,567.1
Corporates	–	558.6	–	–	–	69.6	628.2
SME	–	710.3	0.3	–	–	85.2	795.8
Securitisations	–	1.5	6.0	1,568.9	47.4	–	1,623.8
Retail mortgages	–	167.6	984.4	2,334.6	10,104.5	5,537.7	19,128.8
Qualifying revolving	2,162.9	–	–	–	–	–	2,162.9
Other retail exposures	32.4	42.6	326.2	33.2	0.1	–	434.5
Total IRB	2,195.3	2,753.0	1,565.9	3,985.1	10,152.1	5,692.5	26,343.9
Specialised lending	–	2,937.4	4.5	–	–	125.5	3,067.4
Standardised							
Central government and central bank	–	4,507.7	2,333.5	1,171.2	72.0	–	8,084.4
Regional governments or local authorities	–	10.8	–	–	–	15.0	25.8
Administrative bodies and non-commercial	–	65.5	–	–	–	6.4	71.9
Multilateral development Banks	–	68.5	461.3	52.7	5.7	–	588.2
Institutions	–	69.9	74.8	–	–	–	144.7
Corporates	8.1	36.3	54.4	33.0	1.7	2.3	135.8
SME	–	785.9	–	–	–	22.8	808.7
Secured by mortgages on immoveable property	8.0	1.6	3.5	13.9	1.8	3.8	32.6
Retail	3.2	6.9	84.6	32.5	3.3	0.2	130.7
Exposures in Default	0.2	48.5	3.3	0.8	–	–	52.8
Other items	984.8	35.4	22.3	–	–	–	1,042.5
Total standardised	1,004.3	5,637.0	3,037.7	1,304.1	84.5	50.5	11,118.1
Total credit risk exposures	3,199.6	11,327.4	4,608.1	5,289.2	10,236.6	5,868.5	40,529.4

5.2 Credit risk continued

Analysis of EAD by residual contractual maturity

2013

Exposure class:	Repayable on demand/ undated £m	Up to 1 year £m	1-5 years £m	5-10 years £m	10-20 years £m	>20 years £m	Total £m
IRB							
Central government and central bank	–	5,144.1	2,128.4	1,091.7	116.8	29.8	8,510.8
Institutions	–	1,867.2	876.4	95.3	0.2	–	2,839.1
Corporates	–	273.6	615.3	290.2	399.3	554.8	2,133.2
Securitisations	–	19.8	69.2	1,677.8	49.7	–	1,816.5
Retail mortgages	–	151.7	1,054.0	2,458.6	11,415.6	6,326.4	21,406.3
Qualifying revolving	2,450.3	–	–	–	–	–	2,450.3
Other retail exposures	29.4	35.4	415.3	98.0	0.1	–	578.2
Total IRB	2,479.7	7,491.8	5,158.6	5,711.6	11,981.7	6,911.0	39,734.4
Specialised lending	–	761.5	1,642.0	559.6	750.2	782.0	4,495.3
Standardised							
Central government and central bank	–	–	–	–	–	–	–
Regional governments or local authorities	–	61.5	13.3	16.5	40.5	4.0	135.8
Administrative bodies and non-commercial	1.5	7.8	29.4	45.3	11.7	1.8	97.5
Multilateral development banks	–	–	20.0	–	–	–	20.0
Institutions	–	314.5	0.1	–	–	–	314.6
Corporates	0.7	22.4	353.1	445.1	390.6	25.4	1,237.3
Secured by mortgages on immoveable property	–	1.4	0.6	15.6	2.3	7.1	27.0
Retail	0.3	84.1	–	–	–	–	84.4
Exposures in Default	0.1	2.1	52.0	13.9	6.7	–	74.8
Other items	1,168.0	–	–	–	–	–	1,168.0
Total standardised	1,170.6	493.8	468.5	536.4	451.8	38.3	3,159.4
Total credit risk exposures	3,650.3	8,747.1	7,269.1	6,807.6	13,183.7	7,731.3	47,389.1

The period to 31 December 2014 has seen an overall reduction in EAD, notably for the Institutions, Corporate and Specialised lending asset classes, in line with the Bank's strategy to deleverage Non-core assets as well as for the Retail mortgages asset class, in line with the closed nature of the Optimum portfolio.

In accordance with CRR Article 150 (Conditions for permanent partial use) the Bank has received permission from the regulator to exempt its exposures to certain counterparty classes, namely central governments (sovereigns) and central banks and multilateral development banks, from the IRB Approach for the purposes of the calculation of both risk-weighted exposure and expected loss amounts instead applying the standardised approach for these exposures. The revised approach was implemented for the purposes of the Bank's regulatory reporting submissions as of January 2014.

5.2 Credit risk continued

5.2.3 Impaired and past due exposures

The following table represents the Bank's EAD, impaired and past due exposures and impairment analysed by approach and exposure class:

Table 14 Analysis of impaired and past due exposures

2014

Exposure class	Exposures at Default £m	Of which: Impaired exposures £m	Of which: Past due exposures not impaired £m	Value adjustments and provisions held against impaired exposures £m	Charge for value adjustments in the year £m
IRB					
Central government and central bank	2.8	–	–	–	–
Institutions	1,567.1	–	–	–	–
Corporates	628.2	4.8	0.2	18.9	(13.6)
SME	795.8	96.3	–	27.6	–
Securitisations	1,623.8	–	–	–	–
Retail mortgages	19,128.8	953.7	–	24.4	(17.2)
Qualifying revolving	2,162.9	44.6	1.3	27.4	(4.9)
Other retail exposures	434.5	97.8	4.7	78.3	5.3
Total IRB	26,343.9	1,197.2	6.2	176.7	(30.4)
Specialised lending	3,067.4	1,039.7	–	325.7	(117.4)
Standardised approach					
Central government and central bank	8,084.4	–	–	–	–
Regional governments or local authorities	25.8	–	–	–	–
Administrative bodies and non-commercial	71.9	–	–	–	–
Multilateral development banks	588.2	–	–	–	–
Institutions	144.7	–	–	–	–
Corporates	135.8	52.8	–	6.4	(9.7)
SME	808.7	–	–	–	–
Secured by mortgages on immovable property	32.6	–	–	–	–
Retail	130.7	–	–	–	–
Exposures in Default	52.8	53.3	–	31.1	(14.9)
Other items	1,042.5	–	–	–	–
Total standardised	11,118.1	106.1	–	37.5	(24.6)
Total credit risk exposures	40,529.4	2,343.0	6.2	539.9	(172.4)

The period to 31 December 2014 has seen an overall reduction in exposures at default, notably for Retail mortgages, reflective of the closed nature of the Optimum portfolio as well as for Institutions, Corporate and Specialised lending asset classes, in line with of the Bank's strategy to deleverage Non-core assets. All provisions are disclosed on a statutory basis.

The 2014 net impairment write back of £172.4m compared to a charge of £507.5m in 2013 was primarily driven by the Non-core business with a 2014 net impairment write back of £168.2m (2013: charge of £476.3m).

5.2 Credit risk continued

2013

Exposure class	Exposure at Default £m	Of which: Impaired exposures £m	Of which: Past due exposures not impaired £m	Value adjustments and provisions held against impaired exposures £m	Charge for value adjustments in the year £m
IRB					
Central government and central bank	8,510.8	–	–	–	–
Institutions	2,839.1	–	–	–	–
Corporates	2,133.2	165.8	0.2	86.5	25.9
SME	–	–	–	–	–
Securitisations	1,816.5	18.5	–	–	–
Retail mortgages	21,406.3	1,259.0	–	40.0	24.7
Qualifying revolving	2,450.3	109.4	1.5	88.2	44.3
Other retail exposures	578.2	76.1	3.6	72.0	(5.7)
Total IRB	39,734.4	1,628.8	5.3	286.7	89.2
Specialised lending	4,495.3	1,774.8	1.2	572.0	362.5
Standardised approach					
Central government and central bank	–	–	–	–	–
Regional governments or local authorities	135.8	–	–	–	–
Administrative bodies and non-commercial	97.5	1.4	–	–	–
Multilateral development banks	20.0	–	–	–	–
Institutions	314.6	–	–	–	–
Corporates	1,237.3	38.4	–	7.2	9.3
SME	–	–	–	–	–
Secured by mortgages on immovable property	27.0	–	–	–	–
Retail	84.4	–	–	–	–
Exposures in Default	74.8	155.9	–	86.5	46.5
Other items	1,168.0	0.7	–	–	–
Total standardised	3,159.4	196.4	–	93.7	55.8
Total credit risk exposures	47,389.1	3,600.0	6.5	952.4	507.5

5.2 Credit risk continued

5.2.4 Analysis of Corporate exposures impaired and past due

The following table represents, for Corporate assets (excluding Securitisations), the Bank's EAD, impaired exposures and impairment analysed by approach and exposure class:

Table 15 Analysis of Corporate EAD by sector

2014

Sector	Exposure at Default £m	Of which: impaired exposures £m	Value adjustments and provisions held against impaired exposures £m	Charge for value adjustments in the year £m
Accommodation, food and licensed services	254.8	123.2	11.9	(43.6)
Care	134.0	52.0	6.5	(2.6)
Education	72.9	2.9	0.4	(0.3)
Financial services	63.7	2.5	2.3	(1.0)
Football clubs	17.4	1.1	0.9	(2.1)
Housing associations	895.5	0.6	0.3	(4.6)
Manufacturing	26.2	3.3	1.1	(0.8)
Motor trade/Garages	20.4	3.0	0.8	(1.4)
PFI	1,156.7	–	3.2	(5.7)
Professional services	37.5	3.6	1.5	(0.3)
Property and Construction				
Commercial investment	1,375.7	770.6	260.1	(87.9)
Residential investment	228.1	100.1	36.3	8.3
Commercial development	172.1	102.1	40.9	(2.3)
Residential development	19.8	10.5	3.2	(1.6)
Public sector entities	–	–	–	(0.1)
Renewable energy	501.0	7.7	12.7	(1.6)
Retail/Wholesale trade	163.1	9.4	5.6	(3.4)
Services	160.5	38.4	18.0	(4.3)
Transport, storage and communication	14.5	4.2	2.5	0.1
Utilities	11.6	3.2	1.0	(0.1)
Other	49.9	1.5	0.6	(0.3)
Total	**5,375.4**	**1,239.9**	**409.8**	**(155.6)**
IRB corporates	1,424.0	101.1	46.6	(13.6)
Specialised lending	3,067.4	1,039.7	325.7	(117.4)
Standardised corporates	837.7	52.8	6.4	(9.7)
Standardised past due corporates	46.3	46.3	31.1	(14.9)
Total	**5,375.4**	**1,239.9**	**409.8**	**(155.6)**

The year to 31 December 2014 has seen a significant reduction in impaired exposures and value adjustments and provisions held against impaired exposures, most notably for Commercial investments and Accommodation, food and licensed services. This is reflective of the Bank's strategy to de-leverage Non-core assets.

5.2 Credit risk continued

Table 15 Analysis of Corporate EAD by sector

2013

Sector	Exposure at Default £m	Of which: impaired exposures £m	Value adjustments and provisions held against impaired exposures £m	Charge for value adjustments in the year £m
Accommodation, food and licensed services	564.6	254.8	76.8	41.9
Care	185.7	35.6	9.7	7.7
Education	91.2	1.1	0.7	–
Financial services	106.6	5.7	4.6	1.2
Football clubs	42.8	15.9	6.0	0.4
Housing associations	1,076.9	4.7	4.7	–
Manufacturing	76.0	22.2	6.1	(1.4)
Motor Trade/Garages	83.8	8.9	3.1	2.0
PFI	1,172.7	42.6	9.8	(0.3)
Professional services	88.3	6.9	1.7	0.6
Property and Construction				–
Commercial investment	2,417.6	1,292.8	475.9	293.9
Residential investment	350.2	169.8	35.4	19.3
Commercial development	276.9	135.6	44.8	38.0
Residential development	75.7	17.3	4.9	4.7
Public sector entities	0.2	0.1	0.1	–
Renewable energy	551.6	15.7	15.7	2.8
Retail/Wholesale trade	350.1	28.1	14.6	8.0
Services	343.4	48.9	22.5	15.2
Transport, storage and communication	38.6	10.3	3.9	9.4
Utilities	18.7	1.7	1.2	0.4
Other	29.0	16.2	10.0	0.4
Total	7,940.6	2,134.9	752.2	444.2
IRB corporates	2,133.2	165.8	86.5	25.9
Specialised lending	4,495.3	1,774.8	572.0	362.5
Standardised corporates	1,237.3	38.4	7.2	9.3
Standardised past due corporates	74.8	155.9	86.5	46.5
Total	7,940.6	2,134.9	752.2	444.2

5.2.5 Derivative credit exposure

The Bank enters into a variety of derivative contracts primarily for the purposes of hedging its market risk exposures such as interest rate and foreign exchange risks.

The table below provides an overview of the aggregate notional amounts under the Bank's outstanding derivative contracts by underlying product. The notional amounts shown represent the reference amount to which a rate or price is applied in order to determine the cash flows to be exchanged during the life of the underlying transactions and are not in themselves a measure of potential credit or market risk, rather they provide an illustration of transactional volumes outstanding.

5.2 Credit risk continued

Table 16 Derivative contracts notional amounts

	2014 £m	2013 £m
Interest Rate Contracts		
Exchange-traded		
Futures	**6,070.5**	14,175.0
	6,070.5	14,175.0
Over-the-Counter		
Interest Rate Swaps	**16,172.2**	18,744.9
Currency Interest Rate Swaps	**1,463.2**	904.5
Collars	**2.4**	6.2
Caps	**255.0**	431.8
	17,892.8	20,087.4
Over-the-Counter (settled via CCP)[1]		
Interest Rate Swaps	**3.0**	–
Currency Interest Rate Swaps	**–**	–
Collars	**–**	–
	3.0	–
Total Interest Rate Contracts	**23,966.3**	34,262.4
Foreign Exchange Contracts		
Exchange-traded		
Futures	**–**	–
Options	**–**	–
	–	–
Over-the-Counter		
Foreign Exchange Swaps	**18.9**	1,137.0
Spot Foreign Exchange	**1.5**	29.6
Forward Foreign Exchange	**6.5**	38.9
	26.9	1,205.5
Over-the-Counter (settled via CCP)[1]		
Foreign Exchange Swaps	**–**	–
Spot Foreign Exchange	**–**	–
Forward Foreign Exchange	**–**	–
	–	–
Total Foreign Exchange Contracts	**26.9**	1,205.5
Other Derivative Contracts		
Exchange-traded		
Equity Swaps	**–**	–
Credit Default Swaps	**–**	–
	–	–
Over-the-Counter		
Equity Swaps	**216.8**	456.8
Credit Default Swaps	**–**	175.0
	216.8	631.8
Over-the-Counter (settled via CCP)[1]		
Equity Swaps	**–**	–
Credit Default Swaps	**–**	–
	–	–
Total Other Derivative Contracts	**216.8**	631.8
Total Derivative Notional Amounts	**24,210.0**	36,099.7

1. Central Counterparties

5.2 Credit risk continued

Counterparty Credit Risk

Counterparty credit risk in derivative transactions arises from the risk of counterparty default prior to the settlement date of derivative contracts with the counterparty unable to fulfil present and future contractual payment obligations. The amount at risk may change over time as a function of the underlying market parameters up to the positive value of the contract in favour of the Bank.

A key difference between derivatives and other asset types is that whereas the credit risk of other financial assets is generally represented by the principal amount net of any applicable allowance for credit losses, the counterparty credit risk associated with derivative instruments will ordinarily represent an amount significantly lower than the notional amount of the derivative instrument.

Except where such are settled via central counterparties, the counterparty credit risk associated with over-the-counter derivative instruments will usually be greater than with those traded through recognised exchanges given the more formal regulation and centralised management of the latter contracts.

Gross credit risk exposure is comprised of the estimated replacement cost, or positive fair value, for all contracts plus an add-on for potential future exposure (PFE). The add-on amount is based upon the formula prescribed within Article 274 (Mark-to-Market Method) of the Capital Requirements Regulation (CRR).

The following tables summarises the gross credit exposure associated with the Bank's derivative financial instruments and underlying Mark-to-Market (MtM) and PFE values:

5.2 Credit risk continued

Table 17 Mark-to-Market and Potential Future Exposures

	2014				2013			
	Notional Amount £m	PFE £m	Positive MtM £m	Negative MtM £m	Notional Amount £m	PFE £m	Positive MtM £m	Negative MtM £m
Interest Rate Contracts								
Exchange-traded								
Futures	6,070.5	35.5	9.9	31.5	14,175.0	73.8	14.6	56.0
Options	–	–	–	–	–	–	–	–
	6,070.5	35.5	9.9	31.5	14,175.0	73.8	14.6	56.0
Over-the-Counter								
Interest Rate Swaps	16,172.2	99.2	78.5	536.7	18,744.9	140.1	133.8	473.2
Currency Interest Rate Swaps	1,463.2	55.5	182.3	14.8	904.5	44.6	97.2	–
Collars	2.4	–	–	–	6.2	–	0.1	–
Caps	255.0	0.4	–	–	431.8	1.3	0.6	–
	17,892.8	155.1	260.8	551.5	20,087.4	186.0	231.7	473.2
Over-the-Counter (settled via CCP)								
Interest Rate Swaps	3.0	–	–	–	–	–	–	–
Currency Interest Rate Swaps	–	–	–	–	–	–	–	–
Collars	–	–	–	–	–	–	–	–
	3.0	–	–	–	–	–	–	–
Total Interest Rate Contracts	23,966.3	190.6	270.7	583.0	34,262.4	259.8	246.3	529.2
Foreign Exchange Contracts								
Exchange-traded								
Futures	–	–	–	–	–	–	–	–
Options	–	–	–	–	–	–	–	–
	–	–	–	–	–	–	–	–
Over-the-Counter								
Foreign Exchange Swaps	18.9	0.2	0.4	0.1	1,137.0	44.6	143.8	23.3
Spot Foreign Exchange	1.5	–	–	–	29.6	–	–	–
Forward Foreign Exchange	6.5	0.1	0.1	0.1	38.9	0.4	0.3	0.7
	26.9	0.3	0.5	0.2	1,205.5	45.0	144.1	24.0
Over-the-Counter (settled via CCP)								
Foreign Exchange Swaps	–	–	–	–	–	–	–	–
Spot Foreign Exchange	–	–	–	–	–	–	–	–
Forward Foreign Exchange	–	–	–	–	–	–	–	–
Total Foreign Exchange Contracts	26.9	0.3	0.5	0.2	1,205.5	45.0	144.1	24.0
Other Derivative Contracts								
Exchange-traded								
Equity Swaps	–	–	–	–	–	–	–	–
Credit Default Swaps	–	–	–	–	–	–	–	–
Over-the-Counter								
Equity Swaps	216.8	14.2	50.8	–	456.8	31.9	100.1	–
Credit Default Swaps	–	–	–	–	175.0	17.5	–	0.3
	216.8	14.2	50.8	–	631.8	49.4	100.1	0.3
Over-the-Counter (settled via CCP)								
Equity Swaps	–	–	–	–	–	–	–	–
Credit Default Swaps	–	–	–	–	–	–	–	–
Total Other Derivative Contracts	216.8	14.2	50.8	–	631.8	49.4	100.1	0.3
Total Derivative Notional, PFE and MtM	24,210.0	205.1	322.0	583.2	36,099.7	354.2	490.5	553.5

5.2 Credit risk continued

Table 18 Derivative contracts Credit Risk Exposures

	2014		2013	
	Notional Amount £m	**Gross Credit Risk Exposure[1] £m**	Notional Amount £m	Gross Credit Risk Exposure[1] £m
Interest Rate Contracts				
Exchange-traded				
Futures	**6,070.5**	**45.5**	14,175.0	88.4
Options	**–**	**–**	–	–
	6,070.5	**45.5**	14,175.0	88.4
Over-the-Counter				
Interest Rate Swaps	**16,172.2**	**177.6**	18,744.9	274.1
Currency Interest Rate Swaps	**1,463.2**	**237.9**	904.5	141.7
Collars	**2.4**	**–**	6.2	0.1
Caps	**255.0**	**0.4**	431.8	1.9
	17,892.8	**415.9**	20,087.4	417.8
Over-the-Counter (settled via CCP)				
Interest Rate Swaps	**3.0**	**–**	–	–
Currency Interest Rate Swaps	**–**	**–**	–	–
Collars	**–**	**–**	–	–
	3.0	**–**	–	–
Total Interest Rate Contracts	**23,966.3**	**461.4**	34,262.4	506.2
Foreign Exchange Contracts				
Exchange-traded				
Futures	**–**	**–**	–	–
Options	**–**	**–**	–	–
	–	**–**	–	–
Over-the-Counter				
Foreign Exchange Swaps	**18.9**	**0.6**	1,137.0	188.4
Spot Foreign Exchange	**1.5**	**–**	29.6	–
Forward Foreign Exchange	**6.5**	**0.1**	38.9	0.7
	26.9	**0.7**	1,205.5	189.1
Over-the-Counter (settled via CCP)				
Foreign Exchange Swaps	**–**	**–**	–	–
Spot Foreign Exchange	**–**	**–**	–	–
Forward Foreign Exchange	**–**	**–**	–	–
Total Foreign Exchange Contracts	**26.9**	**0.7**	1,205.5	189.1
Other Derivative Contracts				
Exchange-traded				
Equity Swaps	**–**	**–**	–	–
Credit Default Swaps	**–**	**–**	–	–
	–	**–**	–	–
Over-the-Counter				
Equity Swaps	**216.8**	**65.0**	456.8	132.0
Credit Default Swaps	**–**	**–**	175.0	17.5
	216.8	**65.0**	631.8	149.5

5.2 Credit risk continued

	2014		2013	
	Notional Amount £m	**Gross Credit Risk Exposure[1] £m**	Notional Amount £m	Gross Credit Risk Exposure[1] £m
Over-the-Counter (settled via CCP)				
Equity Swaps	–	–	–	–
Credit Default Swaps	–	–	–	–
	–	–	–	–
Total Other Derivative Contracts	**216.8**	**65.0**	631.8	149.5
Total Notional and Gross Credit Risk	**24,210.0**	**527.1**	36,099.7	844.8
Netting Benefit[(2)]		**(148.4)**		(285.5)
Credit Risk post Netting		**378.7**		559.3
Collateral Held[(3)]		**(92.2)**		(104.9)
Net Credit Risk Exposure		**286.5**		454.4

1. Credit risk prior to the application of netting benefit and credit risk mitigation via collateral held.
2. Netting benefit includes both Mark to Market and Potential Future Credit Exposure impacts.
3. Collateral Held comprises cash and debt securities as valued post the application of regulatory haircuts.

The net credit risk exposure figure at the foot of the above table represents the Bank's credit exposure through derivative transactions after recognition of legally enforceable netting agreements and the application of eligible financial collateral held.

Table 19 Derivative Credit Risk exposure maturity

	< 1 year £m	≥ 1 year to < 5 years £m	≥ 5 years to < 10 years £m	≥ 10 years to < 20 years £m	≥20 years £m	Total £m
Interest Rate Contracts						
Interest Rate Swaps	**4,455.9**	**7,664.6**	**3,106.9**	**560.4**	**387.4**	**16,175.2**
Currency Interest Rate Swaps	**440.3**	**1,022.9**	–	–	–	**1,463.2**
Collars	–	**2.4**	–	–	–	**2.4**
Caps	**183.2**	**69.1**	**1.2**	**1.2**	–	**254.7**
Total Interest Rate Contracts	**5,079.4**	**8,759.0**	**3,108.1**	**561.6**	**387.4**	**17,895.5**
Foreign Exchange Contracts						
Foreign Exchange Swaps	**18.9**	–	–	–	–	**18.9**
Spot Foreign Exchange	**1.5**	–	–	–	–	**1.5**
Forward Foreign Exchange	**6.5**	–	–	–	–	**6.5**
Total Foreign Exchange Contracts	**26.9**	–	–	–	–	**26.9**
Other Derivative Contracts						
Equity Swaps	**156.3**	**60.5**	–	–	–	**216.8**
Credit Default Swaps	–	–	–	–	–	–
Total Other Derivative Contracts	**156.3**	**60.5**	–	–	–	**216.8**
Total Derivative Notional Amounts	**5,262.6**	**8,819.5**	**3,108.1**	**561.6**	**387.4**	**18,139.2**

As of 31 December 2014, 100% of the Bank's counterparty credit risk exposure through OTC derivative transactions (after netting and the application of collateral) was to financial institutions with 83% of counterparty credit risk exposure to counterparties rated A+ and above.

5.2 Credit risk continued

Table 20 Counterparty Credit Risk by sector

	2014		2013	
	Credit Risk Post Application of CRM £m	**% of portfolio**	Credit Risk Post Application of CRM £m	% of portfolio
Sector				
Credit Institutions	**240.5**	**99.8**	357.8	97.8
Other Financial Corporations	**0.4**	**0.2**	8.2	2.2
Sovereigns	**–**	**–**	–	–
Corporates	**–**	**–**	–	–
Central Counterparties	**–**	**–**	–	–
Total	**240.9**	**–**	366.0	–

Table 21 Counterparty Credit Risk by rating

	2014		2013	
	Credit Risk Post Application of CRM £m	**% of portfolio**	Credit Risk Post Application of CRM £m	% of portfolio
Credit Rating				
AA-	**36.8**	**15.3**	33.5	9.1
A+	**163.7**	**68.0**	231.8	63.3
A	**29.1**	**12.1**	65.8	18.0
A-	**0.6**	**0.2**	34.4	9.4
BBB+	**10.7**	**4.4**	0.5	0.1
Total	**240.9**		366.0	

Net counterparty credit risk exposure associated with OTC derivative transactions are concentrated primarily with counterparties incorporated in the USA and UK at 67% and 29% of total exposure respectively. Residual exposure rests with counterparties in Australia, Canada, Denmark, France, Germany and Switzerland.

Table 22 Counterparty Credit Risk by country

	2014		2013	
	Credit Risk Post Application of CRM £m	**% of portfolio**	Credit Risk Post Application of CRM £m	% of portfolio
Country of Incorporation				
Australia	**0.8**	**0.3**	1.1	0.3
Canada	**0.4**	**0.2**	0.7	0.2
Denmark	**0.1**	**0.0**	0.1	0.0
France	**6.0**	**2.5**	6.1	1.7
Germany	**0.2**	**0.1**	6.3	1.7
Switzerland	**2.0**	**0.8**	8.5	2.3
United Kingdom	**69.9**	**29.0**	97.1	26.5
USA	**161.5**	**67.0**	246.1	67.2
Total	**240.9**		366.0	

5.2 Credit risk continued

Credit risk mitigation

The Bank utilises a number of methods to reduce the credit risks associated with its activities. The form and scope of credit risk mitigation will vary dependent upon factors such as the counterparty and underlying transaction type amongst others. These mitigation methods are summarised below:

Netting policies and processes

The Bank documents its derivative activity through the use of bilateral netting master agreements (typically industry standard International Swaps and Derivatives Association (ISDA) agreements) allowing close out netting with a single net settlement of all derivative contracts covered under each agreement concluded with the same legal counterparty in the event of default. This is achieved through the offsetting of all positive and negative market values under the derivative contracts outstanding with the given counterparty. Such agreements effectively serve to eliminate the counterparty credit risk associated with favourable contracts such that unfavourable contracts with the same legal counterparty are not settled before favourable contracts.

Collateral management and valuation policies and processes

In conjunction with the execution of each ISDA Master Agreement a collateral agreement known as a Credit Support Annex (CSA) will typically be established in order to further mitigate credit risk associated with derivative activity. These agreements govern the collateral amounts to be posted or received by the Bank during the contract term. The terms of each CSA may vary according to each party's view of the other party's creditworthiness. Some agreements are linked to external credit ratings such that in the event of a deterioration of a party's (the Bank or a counterparty) external rating, it may be required to lodge collateral.

In the case of repurchase transactions documentation takes the form of the Global Master Repurchase Agreement (GMRA), with collateral valuations calculated by reference to the market prices associated with the underlying debt security.

Transactions subject to collateral agreements are marked to market periodically (usually daily) and the parameters defined in the collateral agreement are applied in order to derive the rebalancing amount of collateral (usually cash) to be called from, or returned to, the transactional counterparty such that variation tolerances set out within the collateral agreement are adhered to.

Form of collateral

The forms of collateral acceptable to the Bank are determined in accordance with strict policies governing issuer type, credit rating and debt seniority. Collateral must also meet the eligibility criteria established by the regulator in order that risk mitigation of the Bank's credit exposures may be recognised. The Bank's collateralised exposures as at 31 December 2014 totalled £847.5m. Collateral lodged with the Bank comprised of cash held in connection with repurchase agreement activity of £755.2m, cash held in connection with derivative activity of £13.3m and government debt securities held in connection with derivative activity; of £79.0m (rated AA+ (£16.2m) and AAA (£62.8m). The credit risk mitigation effect of all collateral held will reflect any reduction in value resulting from the application of prescribed regulatory haircuts.

Credit derivatives

Where the Bank has purchased credit protection in the form of credit default swaps, a credit substitution effect is recognised whereby credit exposure is transferred to the credit protection seller from the reference asset (exposure to which will arise only in the joint event that both the asset and the credit protection seller default). As at 31 December 2014 the Bank had no exposure in connection with purchased credit derivatives (31 December 2013: £105.0m).

Guarantees

Guarantees issued by national or regional governments have historically been available in relation to certain assets within Bank's investment security portfolio, primarily debt securities issued by European special purpose banks operating in the public sector. These guarantees may serve to enhance the credit profile of the exposure and provide security in the event of issuer default. Such exposures will consequently qualify for the application of a lower risk weighting for the purposes of calculating the associated regulatory capital requirement. As at 31 December 2014 total exposure benefiting from guarantees stood at £2.8m, this relating to a single debt security holding guaranteed by a Canadian regional government, itself rated AA- (31 December 2013: £3.1m).

5.2 Credit risk continued

Table 23 Encumbered and non-encumbered assets by balance sheet category

	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
Equity instruments	–	–	2.8	2.8
Debt securities	1,644.5	1,644.5	2,778.0	2,778.0
Other assets	6,959.3	–	26,196.3	–
Assets of the reporting institution	**8,603.8**	**1,644.5**	**28,979.1**	**2,780.8**

	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Carrying amount of selected financial liabilities	4,019.6	8,603.8

An asset is defined as encumbered if it has been pledged as collateral against an existing liability or to collateralise an exposure that the Bank may have, restricting access to that asset in the event of resolution or bankruptcy. An encumbered asset would be no longer available to the Bank for use in secure funding, to satisfy collateral needs or to be sold to reduce the funding requirement.

There is a fair value adjustment applied in the above table that reduces the matching liabilities by £387m. This relates to the merger fair value on debt securities of Leek 17, 18 and 19.

There is also another fair value adjustment applied in the table above that reduces the encumbered assets by £36m. This relates to the merger fair value on Optimum Loans and Advances within Leek 17, 18 and 19.

5.2.6 Impairment

Allowance for impairments relating to loans and advances to customers

The policy on impairment is described in the Risk Management section of the Annual Report and Accounts.

The provisions within the Corporate portfolio are spread over the Corporate exposure classes for foundation IRB and standardised approach. The provisions for Retail exposures relate to Retail exposures secured by real estate collateral exposure class and the unsecured exposures within the 'qualifying revolving' and 'other retail' exposure classes. With the exception of a small portfolio of personal career development loans, all retail exposures are treated under the Retail IRB approach. Reductions in the specific corporate impairments are as a result of asset deleveraging in the Non-core portfolio and collateral revaluations.

Following on from the implementation of CRD IV provisions are now all classified as specific.

The EBA Credit Risk Adjustments Regulatory Technical Standard (RTS) specifies the criteria that need to be met for a provision to be treated as a 'general provision'. In particular, provisions need to cover 'credit risk losses that have not yet materialised' and for which there is 'currently no evidence that a loss event has occurred'. However, under IAS 39 banks are not permitted to book (individually assessed or collective) loss provisions unless there is 'objective evidence that a loss event has occurred'. Therefore, all of the Bank's provisions are all classified as specific.

Table 24 Allowance for impairment

2014

	Specific Retail £m	Specific Corporate £m	Total £m
At the beginning of the year	**200.2**	**752.2**	**952.4**
Adjustment to treatment of balances with debt collection agencies[1]	39.6	–	39.6
Charge against profits	(16.8)	(155.6)	(172.4)
Amounts written off	(88.7)	(180.2)	(268.9)
Unwind of discount allowance	(4.2)	(6.7)	(10.9)
Interest charged on impaired loans	–	0.1	0.1
At the end of the year	**130.1**	**409.8**	**539.9**

1. A review of the Bank's relationships with debt collection agencies in 2014 concluded that the Bank had substantially retained all the risks and rewards associated with such relationships. The related gross receivables of £41.4m and associated allowance of £39.6m have therefore been recognised as at 31 December 2014. The comparative information has not been adjusted on the grounds of materiality. Had the comparative information been adjusted the net Loans and Advances to Customers balance and Total Equity would have increased by £1.8m and £1.8m respectively.

5.2 Credit risk continued

Allowance for impairment

2013

	Specific Retail £m	Specific Corporate £m	Total £m
At the beginning of the year	187.0	456.0	643.0
Charge against profits	63.3	444.2	507.5
Amounts written off	(46.5)	(141.3)	(187.8)
Unwind of discount allowance	(3.6)	(7.1)	(10.7)
Interest charged on impaired loans	–	0.4	0.4
At the end of the year	200.2	752.2	952.4

Allowance for impairment relating to debt securities

The provisions within the Treasury portfolio relate to exposures to institutions and investment in securitisations. During the year there has been no additional impairment recognised.

The following table represents the movement in allowance for impairments relating to debt securities:

Table 25 Allowance for impairment relating to debt securities

	2014 £m	2013 £m
Opening balance	**20.0**	39.0
Charge against profits	**(1.1)**	–
Utilised	**(18.9)**	(18.5)
Other	**–**	(0.5)
Closing balance	**–**	20.0

A number of securities that had previously been fully provided for were sold during the period. Cash proceeds of £1.1m were received, resulting in a £1.1m release of the provision and utilisation of the remaining £18.9m.

Comparison of expected losses to accounting impairment losses

The following table provides a comparison of the expected losses on non-defaulted assets as at 31 December 2013 with the actual charge to the income statement for losses on loans and advances that materialised for the whole portfolio over the subsequent year ending on 31 December 2014, along with comparator data for previous year.

Expected losses for exposures on the IRB approach are derived from underlying IRB models and are a function of PD, Loss Given Default (LGD) and EAD estimates. Expected losses for specialised lending are determined using pre-defined expected loss rates for each of the five PRA supervisory categories. Expected loss is not calculated for exposures on the standardised approach.

IRB models were developed following Basel II requirements and are not directly comparable with accounting impairment losses. In particular expected loss calculations are based on long run estimates of PD and use economic downturn estimates of LGD. In addition LGD represents the loss expectation until finalisation of the workout period while account impairment losses correspond to a single year.

5.2 Credit risk continued

Table 26 Comparison of expected losses to impairment losses

2014

	Expected losses on non-defaulted assets as at 31 December 2013 £m	Impairment losses for 2014 £m
Exposure class		
IRB		
Central government and central bank	**0.0**	**–**
Institutions	**1.1**	**–**
Corporates	**10.1**	**(13.6)**
Securitisations	**–**	**–**
Retail mortgages	**91.6**	**(17.2)**
Qualifying revolving	**22.7**	**(4.9)**
Other retail exposures	**18.8**	**5.3**
Retail SME	**–**	**–**
Total IRB	**144.3**	**(30.4)**
Specialised lending	**66.2**	**(117.4)**
Total	**210.5**	**(147.8)**
Impairment losses on standardised portfolios		**(24.6)**
Net charge (credit) to the income statements (loans and advances to customers and banks)		**(172.4)**

	Expected losses on non-defaulted assets as at 31 December 2012 £m	Impairment losses for 2013 £m
Exposure class		
IRB		
Central government and central bank	–	–
Institutions	2.2	–
Corporates	9.5	58.3
Securitisations	–	–
Retail mortgages	104.8	24.7
Qualifying revolving	29.6	44.3
Other retail exposures	26.1	(5.7)
Total IRB	172.2	121.6
Specialised lending	53.0	334.5
Total	225.2	456.1
Impairment losses on standardised portfolios	–	51.4
Net charge (credit) to the income statements (loans and advances to customers and banks)	–	507.5

5.2 Credit risk continued

5.2.7 Credit risk control

The Credit Risk Management Forum (CRMF) reviews credit risk management information (MI) in depth, for example by risk pool, campaign or key risk splits. In addition, the credit risk second line receives and reviews credit risk MI on a regular basis split by campaign or key characteristic. The CRMF MI is produced on a monthly basis with different MI produced for each asset class. The regular MI covers a broader scope than that provided to the Executive Risk Committee (ERC). Reports include:

- Performance against agreed risk appetite limits and tolerances;
- Sector and obligor concentrations and risk segmentation;
- Monitoring of exposures at risk and in arrears and impairment levels;
- Monitoring of loans under forbearance; and
- Monitoring of IRB model performance.

Early warning indicators are provided where appropriate, and any exceptions highlighted and escalated as necessary.

Retail credit policy

Credit approval and individual limit setting

The Bank's policy on retail secured and unsecured credit is to establish credit criteria that determine the balance between volume growth (generating higher income) and higher arrears and losses, so as to ensure the return is commensurate with the Bank's risk appetite and strategic objectives. Retail credit risk related decisions are based on a combination of defined lending policies and the use of bespoke scorecards derived from historical data. Regular updates are provided to senior management on the performance of the portfolios.

Unsecured lending

Application and behavioural scorecards are used to support new lending decisions and ongoing portfolio management. These scores are used, in combination with policy criteria and an assessment of affordability, to determine whether we will lend to an individual borrower and to set individual limits on the amount we will lend. Application scorecards are used to determine lending decisions to those customers with no existing relationship with the Bank. Behavioural scorecards are used to make lending decisions for existing customers, including credit limit increases/decreases, authorisation decisions and card reissue. Decisions are generally fully automated with manual intervention only required in the event of referrals being triggered or customer appeal. The application and behavioural scorecards used for lending decisions form the main components of the IRB models.

Mortgage lending (credit approval)

Scorecards are also used to assess new mortgage applications. The application models are integral in the assigning of the IRB rating band. The models have all been developed based on the profile of mortgage applicants received by the specific asset class. Each model uses a combination of external credit reference data and information collected as part of the application process. The calculation of the application scores is fully automated within the application processing system. The score is used in association with lending policy and affordability checks to make a decision on whether an application will be approved. More complex higher risk applications or those outside of standard lending policy are referred to more senior underwriters to ensure compliance with policy and to allow expert judgment within agreed levels of authority.

5.2 Credit risk continued

Individual and portfolio limit setting

Portfolio limits are in place for specific lending sectors based on an overall assessment of our appetite for exposure to that sector. This includes an assessment of risk based on the capital requirement of each sector based on the IRB models.

Retail pricing and profitability

The IRB models, or the underlying credit risk models upon which the IRB models are based, are used as inputs to pricing/profitability models across the Retail lending portfolios (both secured and unsecured).

Corporate credit policy

The Bank's policy on new Corporate lending is to consider relatively low risk and senior (not subordinated) exposures from UK customers provided they meet the criteria contained in the corresponding sector strategy, while avoiding excess single name or sector concentrations. During 2014 very little new Corporate lending was undertaken. Individual cases which show signs of unsatisfactory performance are managed through the Strategic Asset Review (SAR). The CRMF and ERC (and by exception the Risk Committee (RC)) receive regular reports on the performance of the portfolio.

Corporate lending and credit approval

Corporate exposures are managed through two distinct divisions. The Core Business and Commercial Banking (BaCB) division represents activity consistent with the strategy and risk appetite of the Bank. The Non-core Co-operative Asset Management (CoAM) division is managed for value and targeted for run down or exit.

First line relationship managers submit recommendations for any new money to be lent which are risk assessed by the second line credit underwriting team which is independent from income generation. The lending discretions for new money are made by the Large Credit Committee (LCC) (mainly Non-core customers due to their size), the SAR groups (Non-core only) or the Small Credit Committee (SCC) (Core business). The CRO, the FD and the CEO are members of the LCC. The CoAM strategy is executed through higher risk (default and watch list) and performing Strategic Asset Review (SAR) groups comprising of first and second line business and credit risk representatives where the majority of decisions are taken to set run-off or exit strategies but occasionally the customers who require additional lending may protect value in the work out of a customer asset. Beyond certain levels of exposure and/or new money, the SAR groups make recommendations to the LCC for the fund decision.

The credit underwriting team uses appropriate rating systems and other tools to analyse the underlying business and the counterparty's management to assess the risk of each lending proposition and its ability to repay the borrowing. Other factors considered include the potential impact of economic changes, availability of supporting collateral, the financial stability of the counterparty and its ability to withstand such change.

5.2.8 Models used

5.2.8.1 Retail models residential mortgages

Probability of Default (PD) models

Underlying scorecards are calibrated to an IRB compliant definition of default to provide a PD for each loan. The definition of default for secured exposures is taken as six months in arrears, but also includes the relevant unlikeliness to pay elements such as bankruptcy and litigation. The application credit score is used for new lending to determine PD up until sufficient internal account performance data is available, at which time the behaviour score will be used to determine PD. The ratings philosophy of the PD models is deemed to be hybrid with the point in time score mapped to a long run average PD grade. The long run grades have been determined using historical data and an assessment of PD performance over an economic cycle.

Loss Given Default (LGD) models

The key components of the LGD models are the Probability of Possession given Default (PPD) and expected shortfall, calibrated to reflect a downturn environment. Any post sale recoveries are excluded from the loss estimate. The expected shortfall calculation uses an estimate of house price at sale, a forced sale discount, projected balances (EAD) and costs, along with time to possession and sale parameters and standard discounting principles.

5.2 Credit risk continued

5.2.8.2 Qualifying revolving and other retail exposures

Probability of Default (PD) models

Underlying business scorecards are calibrated to an IRB compliant definition of default to provide a PD for each loan. The definition of default for unsecured exposures is taken as 90 days past due, but also includes the relevant unlikeliness to pay' elements such as bankruptcy. The application credit score is used for new lending to determine PD up until sufficient internal account performance data is available, at which time the behaviour score will be used to determine PD. The ratings philosophy of the PD models is deemed to be predominantly at point in time and therefore changes in the quality of the portfolio will be reflected via a movement in ratings.

Loss Given Default (LGD) models

These models estimate the average loss percentage of snapshot balances over a 36 month recovery period for the three population segments: default, non-default and charge off. The 36 month LGD is then discounted (using standard discounting principles) and adjusted for recoveries between 36–48 months, cost of collections and downturn stress.

This LGD measure is then used to set the downturn LGD value based on the worst (highest) LGD observed during the development window, which in turn is used to determine capital requirements.

Exposure at Default (EAD)

For credit cards and current accounts, EAD is based on current drawings plus an adjustment for future draw-down and fees. Accounts are segmented into risk pools which are used to determine the level of adjustment (increase in EAD) applied. For loan accounts, the current drawings are taken as the EAD, in line with the guidance set out by the regulatory requirements.

5.2.8.3 Corporate models

A single definition of default is applied across the whole Corporate portfolio (foundation IRB, specialised lending and standardised). This definition is taken as being one or more of the following:

- Where the Bank considers that the borrower is unlikely to repay its credit obligations without recourse by the Bank to actions such as realising security (if held);
- The borrower is past due more than 90 days on any material credit obligation; and/or
- The borrower has committed an act of default; ie bankruptcy, filing for administration, liquidation etc. An additional watch list marker, which is broken down into three stages, is applied to help identify where a situation has not reached the point of default but is one that the SCC or the SAR groups have decided merits closer management.

Probability of Default (PD) models

There are four PD models in use for grading and monitoring exposures to corporates. Two of them (CreditEdge and RiskCalc) are external vendor models which are used industry-wide to rate general corporates. The other two are internally developed and are used to rate Registered Social Landlords (ie Housing Associations) and Business Banking customers. The ratings philosophy of these PD models is defined as 'near point in time models'. The output of all PD models is mapped to the 13 grades of the internally calibrated Master Grading Scale (with a 14th grade indicating default).

Loss Given Default (LGD) models

Capital for customers rated with a PD model is calculated under the foundation IRB approach and therefore regulatory prescribed LGD rates apply (from 35% for senior exposures fully secured by real estate collateral to 45% for senior unsecured exposures).

5.2 Credit risk continued

Supervisory slotting approach

Supervisory slotting criteria are used to analyse and monitor the specialised lending exposures to PFIs and commercial real estate. The PFI and property investment and development 'slotting models' are based on regulatory approaches and their output is mapped to five supervisory categories from strong to default (slotting categories 1–5 respectively) with prescribed risk and expected loss weights.

Overrides

The PD and slotting grades can be overridden by exception in line with policy to ensure that the grades fully reflect all available information.

Standardised approach

Capital for customers not rated with a PD or slotting model is calculated under the standardised approach using regulatory prescribed risk weights.

Exposure at Default (EAD)

EAD across the whole Corporate portfolio is calculated by applying regulatory prescribed credit conversion factors (CCFs).

5.2.8.4 Wholesale model

An IRB model is used to determine PD for Treasury counterparties under foundation IRB, regulatory parameters are used for LGD. The PD model is used for financial institutions. The model consists of two key elements; a statistically driven quantitative rating and a qualitative overlay. The quantitative assessment is based upon bond default statistics. Credit ratings are derived from a variety of information sources including ECAI'S (Moody's and Fitch) based on fundamental credit analysis to assign an appropriate internal rating grade (IRG) 1–9. More conservative, qualitative overlays to counterparties IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

Treasury counterparty limit matrix

<table>
<tr><th rowspan="3">Internal Rating Grade</th><th rowspan="3">PD Band %</th><th colspan="4">External Credit Rating</th></tr>
<tr><th colspan="2">Long term</th><th colspan="2">Short term</th></tr>
<tr><th>Fitch</th><th>Moody's</th><th>Fitch</th><th>Moody's</th></tr>
<tr><td>1</td><td>0.03%</td><td>AAA AA+</td><td>Aaa Aa1</td><td rowspan="2">F1+</td><td rowspan="5">P-1</td></tr>
<tr><td>2</td><td>0.03%</td><td>AA</td><td>Aa2</td></tr>
<tr><td>3</td><td>0.05%</td><td>AA-</td><td>Aa3</td><td rowspan="2">F1+</td></tr>
<tr><td>4</td><td>0.08%</td><td>A+</td><td>A1</td></tr>
<tr><td>5</td><td>0.12%</td><td>A</td><td>A2</td><td>F1</td></tr>
<tr><td>6</td><td>0.28%</td><td>A- BBB+</td><td>A3 Baa1</td><td>F1 F2</td><td>P-2</td></tr>
<tr><td>7</td><td>0.66%</td><td>BBB BBB-</td><td>Baa2 Baa3</td><td>F1 F2</td><td>P-3</td></tr>
<tr><td>8</td><td>2.04%</td><td>BB+ BB BB-</td><td>Ba1 Ba2 Ba3</td><td>B</td><td>NP</td></tr>
</table>

5.2 Credit risk continued

5.2.8.5 Model performance and back testing

This section provides analysis of the performance of IRB models over 2013 and 2014.

The table outlines the estimated and actual performance for Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) by exposure class. All figures reported are taken from the regulatory capital models.

For PD and EAD the calculation shown assesses the non-defaulted portfolio at the start of the period and measures the default emergence over the following year. These are measured on an account weighted basis. For LGD, the calculation shown assesses the losses of the defaulted population, with actuals measured at the end of the period. The estimates are taken from 4 years previous for unsecured (to allow time for recoveries) and 2 years previous for secured (to allow time for the default to progress to sale).

Table 27 Model performance

	PD				EAD	
Exposure Class	**Estimate at 2013 %**	**Actual 2014 %**	Estimate at 2012 %	Actual 2013 %	**Estimate to Actual Ratio 2014 %**	Estimate to Actual Ratio 2013 %
Retail						
* Secured by real estate collateral	**1.93%**	**0.87%**	2.06%	0.93%	**101.55%**	101.46%
* Qualifying revolving retail exposures	**0.95%**	**0.51%**	1.08%	0.69%	**132.47%**	128.26%
* Other retail exposures	**4.81%**	**3.19%**	5.08%	3.37%	**113.29%**	109.05%
Corporate	**1.08%**	**1.27%**	1.10%	1.21%		

	LGD			
Exposure Class	**Estimate at 2013 %**	**Actual 2014 %**	Estimate at 2012 %	Actual 2013 %
Retail				
* Secured by real estate collateral	**19.30%**	**2.35%**	19.80%	3.30%
* Qualifying revolving retail exposures	**75.97%**	**73.25%**	76.61%	75.10%
* Other retail exposures	**78.03%**	**69.68%**	79.16%	71.33%
* Unsecured charged-off	**88.67%**	**86.97%**	90.11%	85.44%

Retail – Unsecured

Note that a small proportion of the Retail Unsecured portfolio is excluded from these comparisons. This covers immaterial products from a capital perspective such as basic bank accounts (approximately 0.35% of Retail Unsecured non-default RWA is excluded as at 31 December 2014).

There are a number of factors that influence the metrics shown, including:

- The conservatism within the estimates in line with regulatory calculations, for example the Unsecured Retail PD models are hybrid models but are predominantly Point-in-Time (PiT) requiring a conservative add-on to PiT estimates. Hence the actual default rates are significantly lower than estimates;
- Unsecured Retail EAD models are similar to the above with substantial layers of conservatism included, especially for Qualifying revolving retail exposures;
- Movements in portfolio risk over time. General improvements in risk are seen across the Retail Bank;
- Regular realignments of the Unsecured Retail PD models to reflect the above; and
- The LGD models are currently performing better than expected. This is due to a mix of portfolio and strategy changes and debt sale activity.

5.2 Credit risk continued

Retail – Secured

As with Unsecured, the actual outcomes for the Secured portfolio are lower than the estimates for all metrics:

- The Secured Retail PDs used within the regulatory capital models are based on long-run averages. Hence the actual default rates are significantly lower than estimates due to the continued low interest rate environment and reducing unemployment;
- Actual and modelled EADs for Secured tend to be very stable, which is demonstrated in the above table;
- The actual LGDs are significantly lower than estimates. They are currently measured 24 months after default, and so actual losses will continue to materialise afterwards. However extending the measurement to 36 months only increases the 2013 actual from 3.3% to 3.9%. The LGD model predicts losses in a downturn environment and therefore assumes a fall in property values. However, over the last 2 years, house prices have increased by over 15% nationally, thus leading to reduced losses; and
- The above table shows the secured LGD estimates from the current LGD model. Due to proposed methodology changes when estimating downturn possession rates, there is an additional overlay applied to the final capital figures. This overlay is not reflected in the above metrics.

Corporate

The Corporate portfolio operates under the Foundation IRB Approach under which EADs and LGDs are not modelled. The Commercial Real Estate (CRE) and Project Finance Initiative (PFI) models use the FIRB Specialised Lending (slotting) methodology which assigns prescribed risk weights and expected losses and as such are not shown. The table also excludes those sectors where the standardised approach is adopted, typically due to low volumes or a low default history of a particular sector.

Overall, corporate year on year actual defaults have remained stable. Actual default rates for 2014 exceed estimated PDs. This is predominantly driven by the low exposure, high volume Business Banking portfolio, which while representing the highest proportion of actual defaults, in terms of volumes, represents only 3.2% of exposures within the portfolios covered by FIRB PD models.

5.2.9 IRB approach

Foundation

Foundation IRB takes EAD values and exposure weighted average risk weight for each exposure class by PD band. Credit ratings are derived from a variety of information sources including ECA's (Moody's and Fitch) based on fundamental credit analysis to assign an appropriate IRG 1–9. More conservative, qualitative overlays to counterparties IRG (downward overrides) may be applied with the supporting credit rationale clearly stated in the appropriate credit review.

The table below analyses EAD for each IRB exposure class by PD band for exposures subject to the IRB and risk weight percentage for each IRB exposure class by PD band for exposures subject to the foundation IRB approach.

5.2 Credit risk continued

Table 28 Foundation IRB EAD by PD band

Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD	RW %	RWA £m	Mapped external rating
2014							
Institutions							
1/2	0.000 to 0.040	–	–	–	–	–	AAA to AA
3	0.040 to 0.060	725.5	0.1	45.0	18%	128.1	AA-
4	0.060 to 0.080	287.2	0.1	45.0	30%	87.6	A+
5	0.080 to 0.200	318.5	0.1	45.0	32%	103.3	A
6	0.200 to 0.300	235.7	0.3	45.0	54%	127.9	A- to BBB+
7	0.300 to 1.000	0.0	0.7	45.0	85%	0.0	BBB to BBB-
8	1.000 to 5.000	0.0	2.0	45.0	125%	0.0	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	Default
Total institutions		1,567.1	0.1	45.0	29%	446.9	
Central governments and central banks							
1/2	0.000 to 0.040	–	–	–	–	–	AAA to AA
3	0.040 to 0.060	2.8	0.1	45.0	12%	0.3	AA-
4	0.060 to 0.080	–	–	–	–	–	A+
5	0.080 to 0.200	–	–	–	–	–	A
6	0.200 to 0.300	–	–	–	–	–	A- to BBB+
7	0.300 to 1.000	–	–	–	–	–	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	Default
Total central governments and banks		2.8	0.1	45.0	12%	0.3	
Corporates							
1	0.000 to 0.030	–	–	–	–	–	A
2	0.030 to 0.060	17.4	0.1	45.0	30%	5.3	A-
3	0.060 to 0.160	480.8	0.1	39.0	44%	209.2	BBB+
4	0.160 to 0.260	467.6	0.2	38.0	56%	260.2	BBB
5	0.260 to 0.400	119.7	0.3	36.2	62%	74.1	BBB-
6	0.400 to 0.650	54.1	0.5	39.3	71%	38.7	BBB-
7	0.650 to 1.100	27.3	0.9	41.3	71%	19.4	BB+
8	1.100 to 1.900	10.3	1.5	41.9	82%	8.5	BB
9	1.900 to 3.300	139.9	3.0	43.2	115%	160.9	BB-
10	3.300 to 10.000	38.3	6.0	39.6	127%	48.6	B
11	10.000 to 15.000	0.8	13.0	41.8	164%	1.2	B-
12	15.000 to 20.000	0.1	18.0	39.9	208%	0.1	CCC+
13	20.000 to 99.999	0.6	22.0	37.2	171%	1.1	CCC
14	100.0	67.2	100.0	37.9	0%	–	Default
Total corporates		1,424.0	5.4	39.0	58%	827.3	

In accordance with CRR Article 150 (Conditions for permanent partial use) the Bank has received permission from the regulator to exempt its exposures to certain counterparty classes, namely central governments (sovereigns) and central banks and multilateral development banks, from the IRB Approach for the purposes of the calculation of both risk-weighted exposure and expected loss amounts instead applying the standardised approach for these exposures. The revised approach was implemented for the purposes of the Bank's regulatory reporting submissions as of January 2014.

5.2 Credit risk continued

Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD	RW %	RWA £m	Mapped external rating
2013							
Institutions							
1/2	0.000 to 0.040	822.4	0.0	44.9	3%	20.6	AAA to AA
3	0.040 to 0.060	812.8	0.1	45.0	18%	147.5	AA-
4	0.060 to 0.080	415.2	0.1	45.0	36%	150.7	A+
5	0.080 to 0.200	307.7	0.1	45.0	29%	88.6	A
6	0.200 to 0.300	478.9	0.3	45.0	61%	290.9	A- to BBB+
7	0.300 to 1.000	2.1	0.7	45.0	149%	3.1	BBB to BBB-
8	1.000 to 5.000	0.0	2.0	45.0	144%	0.0	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	Default
Total institutions		2,839.1	0.1	45.0	25%	701.4	
Central governments and central banks							
1/2	0.000 to 0.040	8,507.7	–	45.0	–	–	AAA to AA
3	0.040 to 0.060	3.1	0.1	45.0	13%	0.4	AA-
4	0.060 to 0.080	–	–	–	–	–	A+
5	0.080 to 0.200	–	–	–	–	–	A
6	0.200 to 0.300	–	–	–	–	–	A- to BBB+
7	0.300 to 1.000	–	–	–	–	–	BBB to BBB-
8	1.000 to 5.000	–	–	–	–	–	BB+ to BB-
9	5.000 to 99.999	–	–	–	–	–	B+ to C
10	100.0	–	–	–	–	–	Default
Total central governments and banks		8,510.8	0.0	45.0	13%	0.4	
Corporates							
1	0.000 to 0.030	45.0	0.0	45.0	10%	4.4	A
2	0.030 to 0.060	11.1	0.1	45.0	29%	3.2	A-
3	0.060 to 0.160	738.1	0.1	37.5	41%	300.6	BBB+
4	0.160 to 0.260	523.2	0.2	41.0	54%	280.1	BBB
5	0.260 to 0.400	200.4	0.3	36.5	59%	118.2	BBB-
6	0.400 to 0.650	240.7	0.5	43.7	73%	176.5	BBB-
7	0.650 to 1.100	83.8	0.9	39.0	75%	62.7	BB+
8	1.100 to 1.900	59.5	1.5	38.5	83%	49.1	BB
9	1.900 to 3.300	63.3	3.0	38.7	113%	71.3	BB-
10	3.300 to 10.000	62.6	6.0	41.6	133%	82.9	B
11	10.000 to 15.000	3.5	13.0	43.5	182%	6.3	B-
12	15.000 to 20.000	3.5	18.0	36.1	169%	5.9	CCC+
13	20.000 to 99.999	0.9	22.0	39.8	193%	1.8	CCC
14	100.0	97.6	100.0	40.6	0%	–	Default
Total corporates		2,133.2	5.2	39.6	55%	1,163.0	

5.2 Credit risk continued

IRB approach: EAD analysed by expected loss (EL) grades

The table below analyses each retail IRB exposure class by EL grade, calculated as expected loss as a percentage of EAD.

Table 29 Retail IRB EAD by EL grade

2014	EL grade 1 £m	EL grade 2 £m	EL grade 3 £m	EL grade 4 £m	EL grade 5 £m	EL grade 6 £m	Default £m	Total £m
IRB Exposures class								
Residential mortgages	**12,795.0**	**1,133.0**	**2,152.5**	**820.0**	**994.7**	**574.4**	**659.2**	**19,128.8**
Qualifying revolving	**435.7**	**608.5**	**301.4**	**112.6**	**420.4**	**261.0**	**23.3**	**2,162.9**
Other retail	**0.0**	**–**	**0.0**	**58.5**	**187.5**	**112.9**	**75.6**	**434.5**
Total retail IRB	**13,230.7**	**1,741.5**	**2,453.9**	**991.1**	**1,602.6**	**948.3**	**758.1**	**21,726.2**

2013	EL grade 1 £m	EL grade 2 £m	EL grade 3 £m	EL grade 4 £m	EL grade 5 £m	EL grade 6 £m	Default £m	Total £m
IRB Exposures class								
Residential mortgages	14,171.7	1,342.2	2,384.1	926.5	1,134.5	737.9	709.4	21,406.3
Qualifying revolving	360.3	724.1	314.1	185.2	463.3	282.7	120.6	2,450.3
Other retail	0.0	–	0.0	100.6	225.6	174.9	77.1	578.2
Total retail IRB	14,532.0	2,066.3	2,698.2	1,212.3	1,823.4	1,195.5	907.1	24,434.8

Definition in gradings for expected loss grade

EL grade 1	EL% < 0.05%
EL grade 2	0.05% =< EL% < 0.07%
EL grade 3	0.07% =< EL% < 0.20%
EL grade 4	0.20% =< EL% < 0.40%
EL grade 5	0.40% =< EL% < 2.00%
EL grade 6	2.00% =< EL% < 100.00%

5.2 Credit risk continued

Table 30 Retail IRB RWA by PD grade

2014 Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD %ages	RW %	RWA £m
Residential mortgages						
1	0.000 to 0.040	3,402.8	0.0	7%	1%	28.2
2	0.041 to 0.070	4,368.5	0.1	11%	2%	85.3
3	0.071 to 0.310	2,641.2	0.2	10%	4%	98.7
4	0.311 to 1.000	3,808.0	0.6	10%	10%	390.3
5	1.001 to 3.000	2,786.0	1.6	13%	36%	1,006.4
6	3.001 to 15.320	684.7	6.7	18%	93%	636.6
7	15.321 to 99.999	772.0	43.2	14%	87%	669.8
8	100.0	665.6	100.0	19%	210%	1,400.5
Total residential mortgages		19,128.8	5.9	11%	23%	4,315.8
Qualifying revolving						
1	0.000 to 0.040	435.7	0.0	74%	2%	9.5
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	624.6	0.1	81%	5%	28.1
4	0.121 to 0.310	285.9	0.2	80%	10%	28.4
5	0.311 to 0.500	245.2	0.4	80%	17%	42.4
6	0.501 to 1.000	68.5	0.7	80%	25%	17.1
7	1.001 to 5.000	352.2	2.0	79%	52%	183.9
8	5.001 to 10.000	104.1	6.2	82%	120%	124.8
9	10.001 to 20.000	15.2	13.3	80%	184%	28.1
10	20.001 to 50.000	5.7	37.1	80%	249%	14.3
11	50.000 to 99.999	2.5	60.3	79%	221%	5.5
12	100.0	23.3	100.0	90%	90%	20.9
Total qualifying revolving		2,162.9	2.1	79%	23%	503.0
Other retail						
1	0.000 to 0.040	0.0	0.0	75%	8%	0.0
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	–	–	–	–	–
4	0.121 to 0.310	3.1	0.3	82%	43%	1.3
5	0.311 to 0.500	55.4	0.4	82%	55%	30.6
6	0.501 to 1.000	0.0	0.6	74%	62%	0.0
7	1.001 to 5.000	229.8	2.1	79%	103%	236.1
8	5.001 to 10.000	56.3	9.2	78%	136%	76.3
9	10.001 to 20.000	2.3	16.3	80%	174%	4.0
10	20.001 to 50.000	6.9	37.3	80%	223%	15.3
11	50.000 to 99.999	5.2	62.9	79%	190%	9.8
12	100.0	75.5	100.0	89%	130%	98.3
Total other retail		434.5	21.2	81%	109%	471.7

5.2 Credit risk continued

2013 Internal grades	PD range %	Exposure value £m	Average PD %	Average LGD %ages	RW %	RWA £m
Residential mortgages						
1	0.000 to 0.040	3,721.5	0.0	7%	8%	30.2
2	0.041 to 0.070	4,822.0	0.1	13%	2%	90.5
3	0.071 to 0.310	2,553.9	0.2	13%	4%	96.8
4	0.311 to 1.000	4,004.6	0.6	16%	15%	613.4
5	1.001 to 3.000	3,911.7	1.7	20%	33%	1,307.1
6	3.001 to 15.320	984.8	6.4	20%	71%	695.4
7	15.321 to 99.999	748.7	40.1	19%	102%	760.7
8	100.0	659.1	100.0	21%	142%	932.7
Total residential mortgages		21,406.3	5.2	15%	21%	4,526.8
Qualifying revolving						
1	0.000 to 0.040	360.2	0.0	74%	2%	7.9
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	890.4	0.1	81%	5%	41.7
4	0.121 to 0.310	148.7	0.2	80%	9%	13.8
5	0.311 to 0.500	342.5	0.5	78%	17%	58.1
6	0.501 to 1.000	64.5	0.7	83%	24%	15.8
7	1.001 to 5.000	343.9	2.3	80%	59%	202.9
8	5.001 to 10.000	145.3	6.2	82%	120%	174.4
9	10.001 to 20.000	20.3	13.5	79%	179%	36.2
10	20.001 to 50.000	10.6	33.8	80%	246%	26.1
11	50.000 to 99.999	3.3	63.7	80%	212%	6.9
12	100.0	120.6	100.0	89%	105%	126.0
Total qualifying revolving		2,450.3	6.1	80%	29%	709.8
Other retail						
1	0.000 to 0.040	0.0	0.0	75%	11%	0.0
2	0.041 to 0.070	–	–	–	–	–
3	0.071 to 0.120	–	–	–	–	–
4	0.121 to 0.310	10.9	0.3	82%	43%	4.6
5	0.311 to 0.500	89.1	0.4	81%	55%	49.0
6	0.501 to 1.000	0.1	0.6	74%	61%	0.1
7	1.001 to 5.000	282.3	2.7	78%	112%	315.7
8	5.001 to 10.000	102.1	9.2	78%	134%	137.3
9	10.001 to 20.000	3.9	15.9	80%	171%	6.6
10	20.001 to 50.000	7.5	34.2	80%	219%	16.5
11	50.000 to 99.999	5.7	62.9	78%	187%	10.7
12	100.0	76.6	100.0	90%	105%	80.2
Total other retail		578.2	17.4	80%	107%	620.7

5.2 Credit risk continued

5.2.10 Standardised approach

Analysis of exposures calculated in accordance with the standardised approach

For those Exposures at Default (EAD) subject to the standardised approach a significant portion is unrated. There are some rated exposures to institutions within the Basel defined, immaterial portfolio. For standardised exposures that are rated, the nominated ECAI or export credit agency for these is Moody's. The Bank complies with the credit quality assessments scale in allocating external credit ratings to the credit quality steps as defined by the PRA.

The table analyses exposures post credit conversion factor (CCF) and net of provisions subject to the standardised approach by associated credit quality step.

The Bank complies with the credit quality assessments scale in allocating external credit ratings to the credit quality steps as defined by the PRA within Supervisory Statement 10/13: http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/standardappr1013.pdf.

Table 31 EAD calculated under the standardised approach

2014

	Credit Quality Step							
	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m	Unrated £m	Total £m
Central governments and central banks	–	–	–	–	–	–	8,084.4	8,084.4
Regional governments or local authorities	–	–	–	–	–	–	25.8	25.8
Administrative bodies and non-commercial	–	–	–	–	–	–	71.9	71.9
Multilateral development banks	83.9	–	–	–	–	–	504.3	588.2
Institutions	70.1	65.0	–	–	–	–	9.7	144.8
Corporates	–	–	–	–	–	–	135.8	135.8
SME	–	–	–	–	–	–	808.6	808.6
Retail	–	–	–	–	–	–	130.7	130.7
Secured by mortgages on immovable property	–	–	–	–	–	–	32.6	32.6
Exposures in Default	–	–	–	–	–	–	52.8	52.8
Other items	74.5	–	0.1	–	–	–	967.9	1,042.5
Total standardised approach	228.5	65.0	0.1	–	–	–	10,824.5	11,118.1

2013

	Credit Quality Step							
	1 £m	2 £m	3 £m	4 £m	5 £m	6 £m	Unrated £m	Total £m
Central governments and central banks	–	–	–	–	–	–	–	–
Regional governments or local authorities	–	–	–	–	–	–	135.8	135.8
Administrative bodies and non-commercial	–	–	–	–	–	–	97.6	97.6
Multilateral development banks	20.0	–	–	–	–	–	–	20.0
Institutions	140.2	95.0	–	–	–	–	79.4	314.6
Corporates	–	–	–	–	–	–	1,237.3	1,237.3
SME	–	–	–	–	–	–	–	–
Retail	–	–	–	–	–	–	84.4	84.4
Secured by mortgages on immovable property	–	–	–	–	–	–	27.0	27.0
Exposures in Default	–	–	–	–	–	–	74.7	74.7
Other items	1.0	–	–	–	–	–	1,167.0	1,168.0
Total standardised approach	161.2	95.0	–	–	–	–	2,903.2	3,159.4

Corporate standardised exposures have decreased since last year as the Bank continues with its deleveraging strategy.

5.2 Credit risk continued

5.2.11 Supervisory slotting approach

The Corporate sector includes a specialised lending portfolio, consisting of lending to Private Finance Initiatives (PFIs) and property investment and development. For the specialised lending portfolio, the supervisory slotting approach is used. The table analyses exposure (EAD) (including undrawn commitments after CCF) by slotting category.

Table 32 Specialised lending by slotting category

	2014 £m	2013 £m
Slotting category		
Strong	**104.0**	126.1
Good	**1,844.8**	2,510.8
Satisfactory	**106.1**	252.8
Weak	**140.4**	103.0
Default	**872.1**	1,502.6
Total	**3,067.4**	4,495.3

Slotting models are used to analyse and monitor specialised lending exposures to property which are assigned to PRA supervisory categories with predefined risk weights. The exposures have reduced since last year as the Bank has begun implementing its deleveraging strategy.

5.2.12 Securitisations

Investments in securitisations

The Bank has a total Asset Backed Securitisation (ABS) exposure of £1.6bn, a decrease of £0.2bn from £1.8bn in 2013. The assets are generally debt instruments that are held until they mature, although they may be sold or used as collateral for short term borrowing (repos) in response to needs for liquidity or changes in interest rates.

The Bank has no direct exposure to US sub-prime assets. The portfolio consists of a range of individual transactions where maximum exposures are limited according to their respective rating levels and the size of the transaction. The Treasury Credit Risk team acts as a second line of defence in monitoring changes in the credit risk of our ABS exposure, with external market analysis being supplemented by discussions with the portfolio manager. The Treasury and Markets Risk team performs a similar second line of defence role with regard to market risk of the ABS portfolio. AB's are assessed using the ratings based approach, under foundation IRB, where risk weight percentages are applied to each deal depending on the external rating, seniority and granularity of the instrument. Notwithstanding the risk banding allocation, all transactions where no value adjustment is held continue to meet their payment obligations. There were no securitised revolving exposures held during the reporting period.

Originated securitisations

Securitisation is the process by which a group of assets, usually loans, are aggregated into a pool, and sold to bankruptcy remote special purpose entities (SPEs). The pool of mortgage loans is used to back the issuance of new securities, allowing the credit rating of the securities to be separated from the credit rating of the original company. The Bank has established securitisation structures as part of its funding activities, using residential mortgage loans as the underlying asset pool. Securitisations provide a diverse source of funding for the Bank. However, the majority of the risks and rewards in respect of the underlying mortgage loan pools are retained by the Bank. SPEs are included as subsidiaries in the consolidated financial statements with the Bank continuing to recognise securitised assets as loans and advances to customers on the balance sheet, and income from the securitised assets being recognised as income.

The Bank has experience of issuing securitisations under various programmes. Securitisation is used to increase the diversification of funding sources and manage maturity mismatch risk.

The Bank has only acted as mortgage originator, servicing and administration agent and liquidity facility provider (in Leek Finance Number Eighteen plc and Leek Finance Number Nineteen plc only) in respect of its own securitisations. The Bank does not provide bridging loans nor does it act as underwriter or dealer in its securitisations. All transactions are approved at Board level and benefit from relevant accounting and legal advice to ensure compliance with regulatory and statutory requirements.

Furthermore, the Bank does not provide implicit support for its securitisations including Calico.

The table overleaf shows the initial funded amount and value, at the balance sheet date, of the first loss pieces and liquidity facilities in respect of securitisations sold to third party investors, subject to the qualifications documented in the following paragraphs.

5.2 Credit risk continued

This table discloses 'first loss pieces' which represent subordinated loans advanced by the Bank (in respect of Leek Finance Number Seventeen, Leek Finance Number Eighteen and Leek Finance Number Nineteen), or variable funding notes subscribed to by the Bank (in respect of Silk Road Finance Number One, Number Two and Number Three):

Table 33 Originated securitisation exposures

	Retained notes initial percentage	Initial funded amount £m	2014 Value £m	2013 Value £m
First loss piece				
Leek Finance Number Seventeen plc	–	23.0	**28.0**	28.0
Leek Finance Number Eighteen plc	–	23.0	**27.0**	27.0
Leek Finance Number Nineteen plc	–	18.0	**18.0**	18.0
Silk Road Finance Number One plc	45%	116.0	**116.0**	116.0
Silk Road Finance Number Two plc	–	22.0	**–**	22.0
Silk Road Finance Number Three plc	–	19.0	**19.0**	19.0
Liquidity Facilities				
Leek Finance Number Eighteen plc	–	–	**14.4**	15.0
Leek Finance Number Nineteen plc	–	–	**14.0**	15.0
Total		221.0	**236.4**	260.0

The table below shows the value of securitised notes sold to third party investors issued and outstanding:

Table 34 Securitised notes sold to third party investors

	Total notes issued £m	Date of issuance	2014 Notes outstanding £m	2013 Notes outstanding £m
SPE Company				
Leek Finance Number Seventeen plc	1,168.0	01 April 2006	**404.0**	431.0
Leek Finance Number Eighteen plc	1,048.0	01 October 2006	**481.0**	515.0
Leek Finance Number Nineteen plc	833.0	01 April 2007	**466.8**	497.0
Silk Road Finance Number One plc	1,375.0	01 February 2010	**728.0**	1,074.0
Silk Road Finance Number Two plc	728.0	01 July 2011	**–**	433.0
Silk Road Finance Number Three plc	650.0	01 August 2012	**351.7**	489.9
Calico Finance Number One Limited	117.0	01 January 2013	**117.0**	117.0
Total	5,919.0		**2,548.5**	3,556.9

Silk Road Finance Number Two plc was repaid during 2014. In addition the Bank repaid Silk Road Finance Number One in the first quarter of 2015.

Where relevant, the 2014 and 2013 notes outstanding figures are based on multiplying outstanding foreign currency note balances outstanding by the foreign exchange rates at issue.

Leek Finance Number Twenty plc (Leek 20), Leek Finance Number Twenty One plc (Leek 21) and Leek Finance Number Twenty Two plc (Leek 22) notes issued in July 2008, October 2008 and January 2009 respectively were fully retained by the Bank. As at 31 December 2014, an aggregate amount of £1.7bn of AAA Leek 20, Leek 21 and Leek 22 notes are outstanding, a proportion of which are deployed in bi-lateral funding arrangements. Furthermore, the Bank retained £1.5bn of AAA notes issued by Cambric Finance Number One plc (Cambric) in December 2012 (£0.7bn outstanding at 31 December 2014). Detailed disclosures around each remaining active securitisation are published each quarter on the Bank's website http://www.co-operativebank.co.uk/investorrelations

In January 2013, the Bank transferred a portion of the risk in its portfolio of Platform originated (predominantly Optimum) mortgages to third party investors via the issuance of £117m of funded notes issued by Calico. The Bank received funded credit protection from third party investors on a residential mortgage portfolio of approximately £1.8bn. The structure conforms to all relevant provisions of CRR for significant risk transfer. A capital improvement is generated from a reduction in the total calculated Risk Weighted Assets (RWAs) as a result of the mezzanine securitisation tranche risk transfer. Other than in respect of Calico, no outstanding securitisation affords the Bank regulatory capital relief.

5.2 Credit risk continued

Securitisation exposures

It should be noted that all of the Bank's securitisations are traditional, and are non-trading book, and that the Bank acts only as an originator or investor.

Capital requirements for all of the Bank's exposures to securitisations, both as originator and as investor, are calculated using the external ratings based method. The following table shows the exposure at default and capital requirement broken down by external ratings grade. Capital requirement is shown gross of any provision offsets.

Please note that the Bank no longer has any exposures to resecuritisations.

Table 35 Securitisation exposure by rating grade

		Senior and granular		Non-senior and granular		Non-senior and non-granular		Resecuritisation	
2014	**Credit quality step**	**Exposure £m**	**Capital Requirement £m**	**Exposure £m**	**Capital Requirement £m**	**Exposure £m**	**Capital Requirement £m**	**Exposure £m**	**Capital Requirement £m**
AAA or A1/P1	**1**	**1,094.9**	**6.5**	**17.9**	**0.2**	**–**	**–**	**–**	**–**
AA	**2**	**7.0**	**0.0**	**156.6**	**2.0**	**–**	**–**	**–**	**–**
A+	**3**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
A or A2/P2	**4**	**–**	**–**	**143.5**	**2.4**	**–**	**–**	**–**	**–**
A-	**5**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
BBB+	**6**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
BBB	**7**	**–**	**–**	**71.6**	**4.6**	**–**	**–**	**–**	**–**
BBB-	**8**	**–**	**–**	**22.4**	**1.9**	**24.1**	**1.1**	**–**	**–**
BB+	**9**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
BB	**10**	**–**	**–**	**–**	**–**	**24.2**	**8.7**	**–**	**–**
BB-	**11**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Rated below BB- or A3/P3	**12**	**–**	**–**	**34.3**	**25.2**	**27.3**	**21.7**	**–**	**–**
Total		**1,101.9**	**6.5**	**446.3**	**36.3**	**75.6**	**31.5**	**–**	**–**

		Senior and granular		Non-senior and granular		Non-senior and non-granular		Resecuritisation	
2013	Credit quality step	Exposure £m	Capital Requirement £m	Exposure £m	Capital Requirement £m	Exposure £m	Capital Requirement £m	Exposure £m	Capital Requirement £m
AAA or A1/P1	1	1,252.6	7.1	17.9	0.2	–	–	–	–
AA	2	7.0	0.0	161.0	2.0	–	–	–	–
A+	3	–	–	–	–	–	–	–	–
A or A2/P2	4	–	–	146.0	2.5	–	–	–	–
A-	5	–	–	–	–	–	–	–	–
BBB+	6	–	–	–	–	–	–	–	–
BBB	7	–	–	71.6	4.6	–	–	–	–
BBB-	8	–	–	22.4	1.9	41.1	2.5	–	–
BB+	9	–	–	–	–	–	–	–	–
BB	10	–	–	–	–	24.5	8.8	–	–
BB-	11	–	–	–	–	–	–	–	–
Rated below BB- or A3/P3	12	–	–	35.4	35.4	27.3	27.3	9.7	9.7
Total		1,259.6	7.1	454.3	46.6	92.9	38.6	9.7	9.7

Ratings based upon the lower of Fitch and Moody's assigned counterparty credit ratings and mapped on an equivalency basis.

The bank risk weights securitisation positions within credit quality step 12 at 1,250% rather than deducting from capital. CRD IV allows either treatment.

Currently the Bank has no outstanding assets awaiting securitisation.

5.2 Credit risk continued

5.2.13 Approach to validation

Model governance standards apply to ratings models to ensure that principal risks faced by the Bank are appropriately managed under the Risk Management Framework. All model developments and material adjustments are subject to assessment against this framework, which incorporates all relevant requirements from CRR. Model governance standards are set in the Model Risk Control Standards and governed by the Model Risk Forum (MRF). The co-ordination of all model risk resides with the MRF reporting directly to Executive Risk Committee (ERC).

The Model Risk Control Standards require that:

- The materiality of any given model is measured based on the potential impact of the risk being modelled;
- Expected performance standards should be set for the new model against which its actual performance can be benchmarked;
- Results and methods should be fully documented;
- Data used must comply with the overarching Bank Data Standards;
- An independent review is required prior to approval;
- Models must undergo a post-implementation review;
- Models must be approved through the appropriate approval governance process, both at inception and throughout their life cycle;
- A monitoring frequency is agreed; and
- Models must be logged on the Bank's Model Inventory.

Model development, re-calibration and monitoring requirements in line with these control standards are governed through the Model Working Group reporting up to the MRF.

Model risk is a high priority for the Bank and is an area of focus. The development and embedding of the framework described above is behind target. A strategic project has been established to improve governance over model risk and the wider CRR.

5.2.14 Credit risk mitigation

Retail and Corporate

The Bank uses collateral and guarantees to mitigate credit risk. Collateral is regularly revalued and guarantees reviewed to ensure continuing effectiveness. The majority of collateral held is residential real estate collateral for retail mortgages and either residential or commercial real estate collateral held against corporate lending.

Property collateral for corporate lending is categorised as security for property development or investment customers (ie 'property' lending) or owner occupied premises to secure mainstream loan and overdraft facilities. For general lending, in addition to taking charges over property assets owned by the company, other security is taken in modest proportion to the total portfolio. This includes debentures or floating charges (supported by tangible security, where appropriate, including property, life policies and stocks and shares) and cash cover. Where exposures are agreed on a secured basis, security cover is recognised only where:

- The security is legally enforceable and is of a tangible nature and type;
- An appropriate, recent and reliable valuation is held; and
- A prudent margin is applied to the valuation, for the type of security involved.

Third party unsupported guarantees are generally excluded. Any shortfall of security for an exposure is regarded as unsecured and assessment includes this element of residual risk.

5.2 Credit risk continued

Treasury

Treasury credit risks are managed in accordance with limits and asset quality measures which are set out in the credit risk policy and more specifically in the Treasury Credit Risk Control Standard which govern the types of wholesale related exposure that the Bank can take. To complement this, a specific Treasury Credit Risk Management Forum approves limits to individual counterparties within the parameters established by the Treasury Credit Risk Control Standard. Ongoing asset quality monitoring is undertaken by the Treasury credit risk team.

Reports relating to the Treasury credit portfolio are sent to the ERC on a monthly basis. The TCRMF receives regular reports on the performance of the portfolio, changes to the counterparty watch list and problem counterparty information. Limits on exposures to counterparties, known as Total Potential Limits (TPL), are established within the operating internal rating grades 1–9 (IRG 10 representing the default state), each having an associated PD using counterparty limit matrix. All Treasury counterparties are subject to review, which includes comprehensive analysis of the counterparties financial performance, rating status (both external and internal) in order to ensure that the approved credit limits remain at an appropriate level given the credit risk. Where appropriate, more frequent reviews will be undertaken for those counterparties perceived to be higher risk or in light of significant material changes or events that impact their rating.

Table 36 IRB exposures covered by collateral

	2014		2013	
	Exposure value covered by collateral after haircut £m	**Exposure value covered by guarantee after haircut £m**	Exposure value covered by collateral after haircut £m	Exposure value covered by guarantee after haircut £m
Central governments and central banks	**–**	**2.8**	–	3.1
Institutions	**623.3**	**–**	1,469.1	–
Corporates	**–**	**–**	31.9	–
Totals	**623.3**	**2.8**	1,501.0	3.1

Collateral held as at 31 December 2014 represents the value of cash collateral held in relation to repurchase agreement (repo) activity and cash and debt securities held in relation to derivative activity after the application of applicable regulatory haircuts as prescribed under CRR Articles 223 and 224 (Financial Collateral Comprehensive Method).

The significant decrease in the Bank's collateralised exposures observed between year end 2013 and 2014 primarily results from the maturity of two term funding repo transactions during 2014, these having previously been cash collateralised at the aggregated level of £787.7m as at 31 December 2013.

5.3 Liquidity and funding risk

The Bank's Liquidity Risk Management Framework helps the Bank to manage its liquidity risk, the Liquidity Risk Management Framework covers the Bank's risk appetite to how liquidity risk is identified, measured, monitored, managed and reported. In addition to this the Contingency Funding Plan (CFP) is maintained detailing the procedures and a range of available actions that the Bank could take in the event of a liquidity or funding stress scenario.

The Board expresses its appetite for liquidity and funding risk in its Risk Appetite Statement. ALCO has delegated responsibility for oversight and management of liquidity and funding risks to which the Bank is exposed to the Liquidity Management Forum (LMF).

The liquidity risk appetite is defined with reference to survival periods (which measures the ability of liquid assets and resources to support the Bank if it was to enter a defined stress scenario), adherence to strategic liquidity risk measures and compliance with all regulatory liquidity risk limits.

As per the risk appetite statement defined above, the Bank addresses the points raised in the risk appetite statements questions as per the below:

- What constitutes survival?
  The Bank defines survival as ensuring that buffer liquidity never falls below the stressed regulatory minimum requirement. This is a higher benchmark than extinguishing all liquidity (insolvency) as the Board wishes to maintain regulatory confidence that the Bank can always meet its liabilities.

The Bank analyses two applicable survival periods, one that envisages using contingent liquidity that provides sufficient time for the Bank to assess whether the franchise has altered considerably and further recovery options should be considered. The other survival period only uses liquid assets in ensuring that the Bank has time to raise additional liquidity by the contingency funding detailed within its CFP.

- What is the severity of the stress scenario?
  The framework for the liquidity risk appetite includes provision for a change in the stress scenario, selected from a range of options. The chosen scenario allows ALCO and the Board to most appropriately reflect the liquidity risks facing the Bank in the liquidity risk appetite.

5.3 Liquidity and funding risk continued

ALCO and the Board review the internal assessment of the Bank, and set the liquidity requirement for the following 12 month forecast horizon.

Liquidity risk policies are developed by the Liquidity Management Forum (LMF), ALCO and the Board. The Bank's liquidity management policies are reviewed and approved annually by the RC (on behalf of the Board) and compliance is reviewed by LMF, ALCO and the Board. The Bank's policy is to have sufficient funds available at all times to meet demands from depositors, to fund agreed advances, to meet other commitments as and when they fall due, and to ensure the Board's risk appetite is met.

The Bank monitors its liquidity position on a daily basis via liquidity risk metrics. The LMF oversees the operational liquidity management and convenes at least once a month. A range of indicators, details of cash flows and media coverage are monitored to attempt to detect early signs of liquidity stress either in the market or events that are specific to the Bank. The LMF, ALCO and the Board discuss the actual liquidity position and projected position incorporating business plans. More frequent meetings are held if necessary, ie when the markets have a heightened period of stress or liquidity shortage. In the event that the CFP is deployed following endorsement from ALCO, then the CEO will convene the Crisis Management Team (CMT) which will become the main management committee that assumes responsibility for delivering the CFP, engaging other business areas of the Bank and third parties.

The liquidity position is reported at least monthly to ALCO and the Board. The Bank also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed, and regularly assesses its funding position. The Bank's Liquidity Management Framework is designed in line with FCA and PRA BIPRU regulations and industry guidelines. This will further be updated to reflect the changing European regulation.

The Bank has implemented metrics to control the composition of liquidity resources, which are designed to manage the risk of concentrated cash flow maturities.

The strategic measures approved by the Board include:

- Customer loan/deposit ratio, 96% (2013: 95%) – the ratio of customer loans to customer deposits;
- Encumbrance ratio, 27% (2013: 27%) – the ratio of assets used in secured funding and long term repurchase agreements divided by total assets; and
- Internal liquidity stress tests – the survival period of the Bank under an applicable stress scenario.

In the year to 31 December 2014, the Bank increased its liquid asset ratio to 17.4% at the balance sheet date (2013 restated: 16.1%). This liquid asset ratio improvement is due to a reduction in total assets, this has yet to be offset by reduction in liabilities. The Bank continues to proactively manage its liquidity position, above its liquidity risk appetite. Liquidity levels are expected to reduce in 2015 in line with its liquidity risk appetite measure.

Table 37 Bank's Liquidity portfolio

	31 December 2014 £m	31 December 2013 £m
Operational balances with central banks	**4,487.4**	5,076.3
Gilts	**1,246.7**	789.5
Central government and multilateral development bank bonds	**819.5**	1,112.2
Total primary liquid assets	**6,553.6**	6,978.0
Other liquid assets	**14.3**	22.4
Contingent liquidity	**5,552.5**	4,193.0
Total liquidity	**12,120.4**	11,193.4
Average Balance	**12,015.8**	9,357.2

The Bank uses any combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while other liquidity is used for creating longer term liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. The overall quantum of liquid assets remained stable in 2014 supported by an injection of cash through the capital raising in May 2014. The secondary liquidity portfolio reflects own assets eligible for discounting at central banks and has remained stable in 2014.

5.3 Liquidity and funding risk continued

Funding and liquidity strategy focuses in maintaining a high percentage of liquid assets that are eligible to be included in the LAB. The remaining bonds are set out in the table below:

Table 38 Non-buffer assets

	31 December 2014 £m	31 December 2013 £m
Short term deposits	–	–
Other public sector securities	2.5	2.8
Floating rate notes	31.0	2.5
Fixed rate notes	–	–
Other securities and commodities	–	–
Total non-buffer assets	**33.5**	5.3

Wholesale funding is used to supplement retail and commercial deposits by raising longer term funds (over one year in duration) and to diversify the source of funds to support the business plan of the Bank. The Bank has a variety of long term wholesale funding sources outstanding, including securitisations, covered bond and euro medium term notes, as shown in the table below:

Table 39 Long term wholesale funding sources

	31 December 2014 £m	31 December 2013 £m
Preference shares, PSBs, and subordinated debt	196.4	196.3
Secured funding	2,440.9	4,339.5
Repos	500.6	2,119.3
Market borrowing	46.0	56.6
MTNs	832.9	884.0
Total wholesale funding	**4,016.8**	7,595.7

The reduction of the wholesale funding reflects the repayment of secured funding liabilities in 2014.

The Bank has repo transactions of £500m which are secured by own issued retained securitisation notes, which are not recognised on the balance sheet.

Table 40 Contractual wholesale funding by maturity

	31 December 2014 £m	31 December 2013 £m
Repayable in less than 1 month	84.8	2,010.3
Repayable between 1 and 3 months	324.1	67.8
Repayable between 3 and 12 months	389.8	157.2
Repayable between 1 and 5 years	580.8	1,800.8
Repayable in more than 5 years	2,637.3	3,559.6
Total external funding	**4,016.8**	7,595.7

The credit rating downgrades by the rating agencies in 2013 have led to sub-investment grade ratings on the Bank's senior debt, leading to a reduction in potential primary and secondary demand for such unsecured instruments.

In response to the Bank's corporate downgrade of 2013, in early 2014, the Bank installed third party back-up servicing and back-up cash management, and other changes into each of its covered bond and securitisation programmes to comply with rating agency criteria. The programme changes were effected through successful noteholder consent exercises and preserved then prevailing covered bond and securitisation programme note ratings. In February 2014, Moody's confirmed the current ratings of all securitisation programme notes (removing the review for downgrade statuses), with the exception of Leek Finance Number Eighteen class Ca and Cc notes (which remained on review for downgrade due to cross currency derivative counterparty to which this transaction maintains exposure).

5.3 Liquidity and funding risk continued

Liquidity gap

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk, however management recognise that customer behaviour differs to contractual maturity, therefore as part of the Bank's planning process, estimates for the behavioural runoff of customer assets and liabilities over time are estimated. The assumptions used to create these estimates and the estimates themselves are approved by ALCO as part of its responsibility to approve the Bank's financial plans.

Gross cash flows include interest and other revenue cash flows. The following table is an analysis of gross undiscounted contractual cash flows of financial assets and liabilities held at the balance sheet date.

Table 41 Contractual cash flows

31 December 2014 Contractual cash flows	Carrying value £m	Gross nominal flow £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m
Assets							
Cash and balances at central banks	4,765.3	4,765.3	4,765.3	–	–	–	–
Loans and advances to banks	1,608.4	1,608.4	1,238.4	370.0	–	–	–
Loans and advances to customers[1]	25,849.3	33,816.8	947.2	308.6	1,520.9	8,193.7	22,846.4
Investment securities							
Loans and receivables	18.1	21.8	–	–	0.1	0.6	21.1
Available for sale	3,167.5	3,366.2	89.1	166.9	117.4	1,703.8	1,289.0
Fair value through income or expense	1,236.9	1,268.6	1.5	9.0	66.8	1,166.1	25.2
Derivative financial instruments	470.7	766.3	10.9	13.1	48.2	370.8	323.3
Other assets	466.7	–	–	–	–	–	–
Total recognised assets	37,582.9	45,613.4	7,052.4	867.6	1,753.4	11,435.0	24,505.0
Liabilities							
Deposits by banks	615.4	619.9	103.9	336.8	2.9	176.3	–
Customer accounts	29,614.0	29,974.1	19,117.1	933.6	7,130.5	2,606.2	186.7
Customer accounts – capital bonds	263.8	213.7	8.4	59.2	86.4	59.7	–
Debt securities in issue	3,443.6	4,379.3	94.2	745.3	478.5	2,400.8	660.5
Derivative financial instruments	551.7	1,088.4	14.1	26.4	123.5	390.4	534.0
Other borrowed funds	196.4	410.1	1.9	4.5	17.1	90.8	295.8
Other liabilities	883.5	–	–	–	–	–	–
Total recognised liabilities	35,568.4	36,685.5	19,339.6	2,105.8	7,838.9	5,724.2	1,677.0
Unrecognised loan commitments	3,017.5	3,017.5	2,872.6	85.3	–	59.6	–
Total liabilities	38,585.9	39,703.0	22,212.2	2,191.1	7,838.9	5,783.8	1,677.0

i) Includes loans and advances held for sale of £323.4m – see note 15 for further details.

5.3 Liquidity and funding risk continued

Table 41 Contractual cash flows

31 December 2013 Contractual cash flows	Carrying value £m	Gross nominal flow £m	Less than 1 month £m	1-3 months £m	3-12 months £m	1-5 years £m	Over 5 years £m
Assets							
Cash and balances at central banks	5,418.8	5,418.8	5,418.8	–	–	–	–
Loans and advances to banks	1,594.4	1,594.4	1,594.4	–	–	–	–
Loans and advances to customers	30,392.4	44,312.3	1,419.0	452.9	2,810.1	11,852.5	27,777.8
Investment securities	–	–	–	–	–	–	–
Loans and receivables	23.6	28.4	7.0	0.1	0.1	2.9	18.3
Available for sale	2,732.4	3,137.3	67.9	137.0	101.9	1,092.4	1,738.1
Fair value through income or expense	1,743.4	1,890.1	6.6	13.7	198.4	1,637.0	34.4
Derivative financial instruments	555.8	265.8	2.0	7.7	26.7	23.7	205.7
Other assets	923.0	–	–	–	–	–	–
Total recognised assets	43,383.8	56,647.1	8,515.7	611.4	3,137.2	14,608.5	29,774.3
Liabilities							
Deposits by banks	2,757.5	2,991.9	1,833.0	41.2	153.3	964.4	–
Customer accounts	32,463.3	33,349.4	21,144.6	1,796.5	2,213.3	8,195.0	–
Customer accounts – capital bonds	538.1	536.4	10.2	94.7	146.4	285.1	–
Debt securities in issue	4,207.6	5,391.0	75.4	34.1	628.1	3,964.0	689.4
Derivative financial instruments	538.6	1,031.2	13.7	34.5	106.6	354.4	522.0
Other borrowed funds	196.3	433.6	–	5.7	17.0	91.0	319.9
Other liabilities	913.9	–	–	–	–	–	–
Total recognised liabilities	41,615.3	43,733.5	23,076.9	2,006.7	3,264.7	13,853.9	1,531.3
Unrecognised loan commitments	4,003.6	4,003.6	3,578.5	–	–	425.1	–
Total liabilities	45,618.9	47,737.1	26,655.4	2,006.7	3,264.7	14,279.0	1,531.3

5.4 Market risk

Market risk is the risk of loss as a result of the value of financial assets or liabilities (including off-balance sheet instruments) being adversely affected by movements in market rates or prices. This loss can be reflected in the near term earnings by changing net interest income, or in the longer term because of changes in the economic value of future cash flows.

The main source of market risk within the Bank is driven by mismatches between the repricing profiles of asset and liability customer products and certain characteristics embedded within these products and basis risk. The Bank no longer has a trading book although the treasury function does create both Market risk and Currency risk through its various portfolio management activities.

5.4.1 Market risk management framework

Market risk management is the responsibility of the Treasurer delegated on a day-to-day basis to Asset and Liability Management (ALM) and Treasury Risk, who are responsible for monitoring current and emerging market risks, and for ensuring compliance with the Bank's market risk appetite. The Treasury Markets team is responsible for managing the Treasury portfolios and carrying out hedging activities to minimise interest rate risk exposure. Treasury ALM department ensures that the other interest rate risk in the banking book (IRRBB) is identified, modelled, reported, monitored and hedged effectively.

5.4.2 Market risk appetite

The Bank's primary objective is to minimise the sensitivity at product, balance or business level of net interest income and its economic value of its equity base to changes in interest rates. This is translated into a maximum amount of capital that the Bank deems necessary to hold to support the level of market risk exposure and the risk that those exposures may pose to the Bank's future financial performance.

The Bank assesses each of the market risk drivers and establishes a set of limits. In order to quantify the amount of capital the Bank requires against each source of market risk, an internal assessment of a rate stress based on historical interest rate data is applied to the limit position. In this context the market risk appetite is expressed an overarching amount of capital at risk. The overarching risk appetite is underpinned by a number of primary and secondary risk metrics. Primary risk metrics are set against each of the key drivers of market risk and adherence to these limits is central to maintaining market risk within overall appetite. Secondary risk metrics are also used which provide operational early warning indicators which may impact exposure which is assessed via primary risk metrics.

5.4.3 Primary risk metrics and sources of market risk

The key drivers of market risk that the Bank faces and the metrics used to manage those risks are:

5.4.3.1 Interest rate risk

The primary risk metric employed by the Bank to manage directional interest rate risk and yield curve risk is the sensitivity of the Bank's net interest rate exposure to a one basis point parallel shift in interest rates (PV01). Limits are set at an overall level for directional interest rate risk and against individual time buckets for yield curve risk.

A key assumption within the calculation of the PV01 is the treatment of the non-interest bearing balances. The Bank periodically analyses its portfolio of non-interest bearing, non-maturity deposits in order to identify a stable 'core' element compared to the more volatile and transitory balances. A behavioural duration is applied to the former while the latter are assumed to reprice within one month. Similar assumptions are made for other non-interest bearing balance sheet items such as non-dated capital all of which are approved by the Bank's ALCO. The Bank also includes predicted prepayments of its mortgage and reduction in its fixed-term deposit portfolios within the PV01 metric.

Risk limits are formally calculated at least monthly. Interest rate risk and effectiveness of hedging are monitored daily using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly tranche meetings. The treasury team undertakes hedges for interest rate risk using derivative instruments and investment securities to external wholesale markets.

5.4.3.2 Basis risk

The definition of basis risk is the risk of loss as a result of the balance sheet being adversely affected by the movement between different index rates.

Basis risk is managed using an earnings at risk based metric focusing in detail on the sensitivity of changes in interest rates on net interest income over a one year period. The assumed potential loss of earnings is based on historical rate movements and captures the period of stress which commenced in 2007. The estimated earnings at risk are then expressed as a percentage of the forecasted net interest income over the next 12 months.

Basis Risk is monitored by BMRF and ALCO monthly with action taken as required.

5.4 Market risk continued

5.4.3.3 Swap spread risk

Swap spread risk is defined as the risk between the fixed rate element of the swap agreement and the benchmarked treasury instrument that the organisation is exposed to.

The Bank manages Swap spread risk by calculating on a daily basis the sensitivity of its hedged fixed rate bond portfolio to a one basis point divergence in yields between the fixed rate bond and its hedge (PV01).

5.4.3.4 Foreign exchange risk

The Bank's exposure to foreign exchange risk is limited to customer hedging transactions and positions entered via natural customer flow only. Therefore, to manage this risk and overall maximum notional net sterling position limit is set for both intraday and overnight exposures. This is supported by applying sub-limits to currencies by tier to reflect their liquidity.

5.4.3.5 Other sources of market risk

- Yield Curve Risk – The sensitivity to the relative movement of interest rates at different maturities on the yield curve;
- Prepayment Risk – The risk that an asset or liability repays more quickly or slowly than anticipated resulting in a mismatch between the asset, liability and associated hedge;
- Pipeline Risk – The risk that the sales profile for new fixed rate products do not match hedging assumptions, resulting in a mismatch between amount of product sold and that hedged, which can result in a hedge rebalancing cost;
- Explicit Option Risk – The sensitivity to overall direction of interest rates, speed of change of interest rates and market prices for positions which contain explicit options eg caps, floors, swaptions;
- Repricing and Implicit Optionality in Products – The risk that options embedded or implied within retail or commercial products have an impact on market value or earnings with changing interest rates; and
- Credit Spread Risk – The sensitivity to changes in the credit spread on wholesale assets.

The table illustrates the PV01, Basis Risk, Swap spread and FX risk metrics on the Bank's balances. The PV01 is primarily driven by the non-sensitive balances offset by corresponding asset or derivative positions. The Basis risk is primarily driven by product mix and product pricing.

Table 42 PV01, Basis Risk, Swap spreads and FX risk metrics on the Bank's balances

	31 December 2014	31 December 2013
Total PV01 (£k)	**(141.4)**	194.7
Average PV01 for the year (£k)	**17.6**	95.0
Maximum PV01 for the Period	**167.8**	298.4
Minimum PV01 for the Period	**(141.4)**	(56.9)
Average Basis Risk (% of annual NII)	**4.4%**	4.1%
Swap Spread PV01 (£k)	**(1,235.4)**	(1,511.4)
Average Swap Spread PV01 (£k)	**(1,256.3)**	(1,478.1)
FX Notional (£m)	**(0.6)**	(2.4)
Average FX Notional (£m)	**(0.1)**	(1.1)
Net greater 12 month Core Bank Gap position	**(1,601.0)**	(802.0)
Average Net greater 12 month Core Bank Gap position	**(1,268.0)**	(376.0)

On 11 December 2014 the Bank signed a sale agreement committing to the disposal of £323m (base purchase price of £313m, which includes accrued interest) of corporate assets. As part of this agreement the Bank also agreed to re-assign a number of derivatives linked to the assets within the agreement at a fixed price. As a result, the Bank unwound the opposing derivatives to protect its economic risk position. On completion of the transaction in 2015, the PV01 position would be c£200k higher.

The Treasury balance sheet is predominately based in GBP, however it has smaller exposure in other currencies. The interest rate risk broken down by currency for this exposure is as follows:

5.4 Market risk continued

Table 43 Interest rate risk

	2014		2013	
	1 basis point increase in interest rates £	1 basis point decrease in interest rates £	1 basis point increase in interest rates £	1 basis point decrease in interest rates £
Wholesale Banking Book	**(175,188.4)**	**175,438.9**	(14,334.6)	14,679.2
By currency:				
– GBP	**(174,419.1)**	**174,669.5**	(13,790.9)	14,135.5
– US Dollars	**(563.9)**	**564.0**	(778.6)	778.6
– Euros	**(204.3)**	**204.3**	154.0	(154.0)
– Others	**(1.1)**	**1.1**	80.9	(80.9)
Total Treasury	**(175,188.4)**	**175,438.9**	(14,334.6)	14,679.2

5.5 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed processes, people and systems within the Bank or from external events.

Operational risk remains elevated due to the weak control environment and manual processes in the Bank. The improvement of operational risk processes is key to the Bank's turnaround. Further information can be found in the Risk management and Principal Risks and Uncertainties sections of the Annual Report and Accounts.

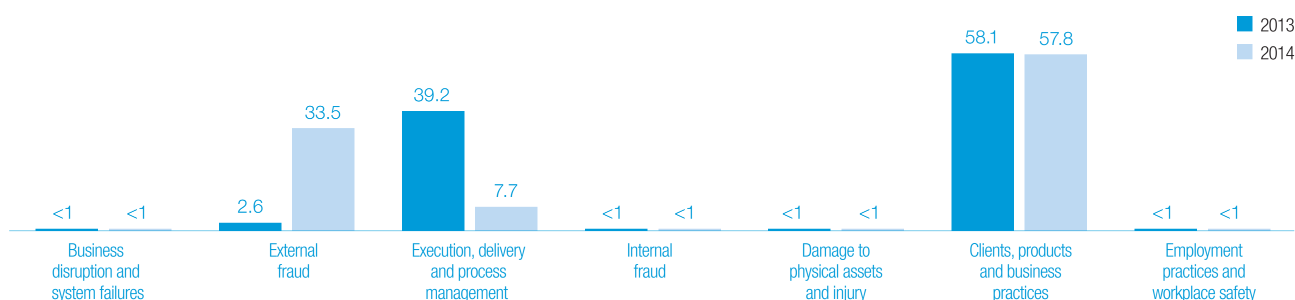
Operational Risk Framework

The management of operational risk is designed to assist the Bank in understanding its operations in the light of a Board-approved risk appetite, particularly with regards to reducing capital requirements, maintaining the Bank's reputation as a trusted provider of financial services and meeting regulatory expectations. The framework was concluded to be ineffective in early 2013 and continues to be embedded in line with good practice and regulatory guidelines. The revised methods and approaches continue to be embedded within the business and remain under review as to their effectiveness and efficiency.

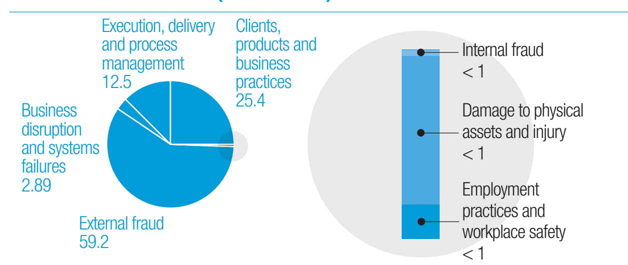
Operational risks are identified, managed and mitigated through on-going risk management practices including material risk assessments, risk event reporting, operational loss data analysis, a detailed risk control self-assessment process, monitoring of key risk metrics, and scenario analysis. Significant operational risks are reported through an appropriate governance structure with regular meetings to monitor the development and effectiveness of the Risk Management Framework and the management of significant risks within the Bank.

Risk events and net losses

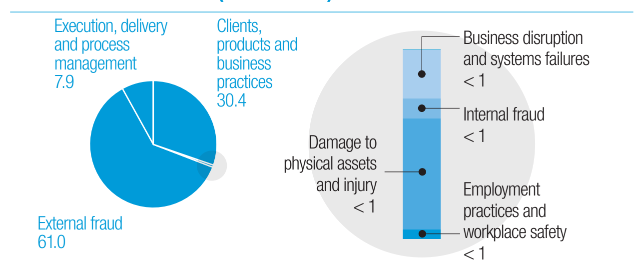
Risk events: net losses (as a % of total)



Number of risk events 2014 (as a % of total)



Number of risk events 2013 (as a % of total)



5.5 Operational risk continued

The above analysis presents the Bank's operational risk events by Basel II Level 1 risk event category as this aligns with industry best practice.

In 2014, as in the previous year the Clients, Products and Business Practices category was the largest loss category, accounting for 58% of the total net losses. Significant items within the category are provisions in respect of Packaged Accounts (£7.3m), Breaches of PSR (£1.7m) and Customer Redress Payments (£3.2m).

External Fraud accounted for 34% of the total net losses and the majority (59%) of the number of individual events. These events are driven by financial crime and include credit and debit card fraud, malware attacks, phishing, cheque frauds and mortgage frauds.

There is a significant reduction in net losses of 96% in comparison to 2013 which is largely due to the Conduct Risk charges that were included in 2013 figures. Embedding of the Operational Risk Framework has also resulted in reductions in losses through individual events. During 2014 net adjustments have been made to the previous provisions totalling in excess of £75m, and the 2013 Operational Loss data has been restated to reflect these changes.

The revised risk event management process which was implemented in 2013 has been embedded through 2014 and oversight has been provided by the Operational Risk Forum and the Executive Risk Committee.

An operational risk event is defined within the Bank as any situation which has or could have resulted in a financial loss, loss of an asset or data, a breach in regulatory/legal requirements, customer detriment or business disruption. This could be due to inadequate or failed processes, people, systems or external events. A standard threshold is used for the reporting of events.

As part of the process a review and analysis of risk events are performed to ensure that any required improvements to processes and/or controls and any learnings are implemented in order to help prevent reoccurrence.

5.6 Reputational risk

Reputational risk is the risk of damage to how the Bank's brand and image are perceived by its internal or external stakeholders as a result of its conduct, performance, or the impact of operational failures or other external issues.

This is discussed further in the Risk Management and Principal Risks and Uncertainties sections of the Annual Report and Accounts.

5.7 Strategic and business risk

Strategic and business risk is the risk that the Bank's plans cannot be carried out because of changes, either internal to the company or external (eg recession), in the markets in which it operates.

The size, complexity and execution risk associated with the Bank's plan may exacerbate this risk.

This is discussed further in the Risk Management and Principal Risks and Uncertainties sections of the Annual Report and Accounts.

5.8 People risk

People risk is the risk associated with inappropriate employee behaviour (such as the risk that employees act outside of the Bank's policies), inadequate people capability (the risk that people do not support the business strategy), capability and frameworks, resulting in customer or financial detriment, and legal or regulatory censure.

Despite progress on retention and recruitment, the Bank is dependent on its Directors, senior management team and skilled personnel and the loss of one or more Directors or members of senior management or the loss of or failure to recruit and retain skilled personnel may have an adverse effect on the Bank's business, operating results, financial condition and prospects and its ability to achieve its strategy.

5.9 Regulatory risk

Regulatory risk is the risk of fines, public censure, limitation on business, or restitution costs arising from failure to understand, interpret, implement and comply with UK and EU regulatory requirements. Demonstrating compliance with all applicable regulatory requirements is essential for the Bank to remain in business.

Management of regulatory risk entails ongoing compliance with existing obligations and early identification and effective management of changes in legislative and regulatory requirements that may affect the Bank.

The Bank's operations, including its subsidiaries and associates, are subject to a significant body of rules and regulations that are a condition for authorisation to conduct banking and financial services business. These apply to business operations and affect financial returns and include reserve and reporting requirements and prudential and conduct of business regulations. These requirements are set by the European Central Bank and the principal regulatory authorities that supervise the Bank in the jurisdictions in which it operates. The requirements reflect global standards developed by, among others, the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions. They also reflect requirements of or derived from EU legislation.

Further details on regulatory risk can be found in the Risk Management section and Principal Risks and Uncertainties section of the Annual Report and Accounts.

5.10 Conduct risk

Conduct risk is the risk that the Bank's operations will result in unfair treatment of its customers and so the Bank will have to pay compensation.

Conduct risk is the risk that the Bank's behaviours, offerings or interactions may result in unfair outcomes for customers. Its effective management helps build trust with customers and other stakeholders and promotes a fair outcome/focused business through the implementation of an appropriate policy and suite of standards properly communicated to trained staff.

The Bank manages conduct risk in a way that is consistent with its overall risk appetite and aligns with its strategy. The concept of conduct risk is in part derived from elements of the FCA's rules and guidance that are concerned with the conduct of business regulation. However, it also encompasses the principle of treating customers fairly and putting customers at the centre of what we do; it is outcome driven. Conduct risk may arise from any aspect of the way the Bank's business is conducted, a key criteria for the Bank being whether the outcome is fair for its customers. When assessing conduct risk there will often be a closely linked regulatory requirement.

At the end of 2014, the Bank has conduct risk provisions of £436.1m, to cover the costs relating to PPI mis-selling, breaches of the Consumer Credit Act, interest rate swap mis-selling, and other provisions, further detail of which is provided in note 33 to the accounts.

This is discussed further in the Risk Management and Principal Risks and Uncertainties sections of the Annual Report and Accounts.

5.11 Pension risk

Pension risk is the risk that the Bank will be required to pay more than expected into its employees' pensions schemes in order that the schemes can pay the pensions to which its employees, former employees and retirees are entitled as they fall due.

Pension risk is the potential for loss due to having to meet an actuarially assessed shortfall in the pension schemes in which the Bank participates. The risk assessment is focused on obligations to the major pension schemes, ensuring that the Bank's funding obligation to these schemes is comfortably within our financial capacity.

Controls are applied to mitigate these risks and a monthly pension risk report is made to ALCO and ERC to monitor pension risk and decide if further action is necessary. These reports take account of the risk reporting delivered to pension scheme trustees. The Bank is able to engage directly with the Trustees of the Britannia Pension Scheme and can influence the Trustees of Pace though its relationship with the participating employer, The Co-operative Group.

The Finance Director chairs a Pension Steering Group and pension risk is discussed at a number of Executive and Board Committees on a regular basis.

On 20 November 2014, following a detailed review of current pension arrangements, and as part of an extensive review of the risks and costs faced by the business at this time, the Bank announced it was entering into a period of consultation with all Bank contracted colleagues and the Trades Unions relating to proposed pension changes. The consultation period has now ended and the Bank is now working through all of the feedback received. Further discussions will be held with the Trade Unions. The final outcome is expected to be known by the end of March 2015. The pension changes are planned to go live in Q3 2015.

The high level proposed changes include a move to defined contribution pension options for all colleagues for future service and remove all defined benefit options for future service, including ending the link to final pensionable salary for Pace and Britannia Pension Scheme members where that benefit still exists for certain long serving colleagues.

This is discussed further in the Risk Management section, Principal Risks and Uncertainties section and note 35 of the Annual Report and Accounts.

Glossary

Item	Description
Application score	The credit score calculated on the application data alone. Typically, data provided on an application form and/or credit reference data.
Asset Backed Security (ABS)	Securities that represent an interest in an underlying pool of referenced assets. The referenced pool can comprise any assets which attract a set of associated cash flows but are commonly pools of residential or commercial mortgages but could also include leases, credit card receivables, motor vehicles, student loans.
Asset and Liability Committee (ALCO)	This committee is chaired by the Chief Executive Officer and is primarily responsible for overseeing the management of market, liquidity and funding risks. Its responsibilities include identifying, managing and controlling the Bank balance sheet risks in executing its chosen business strategy, overseeing and monitoring relevant risk control frameworks and recommending to CEO and ERC relevant risk policies and detailed risk appetite limits for approval.
Asset Valuation Correlation (AVC)	The Asset Value Correlation increases the correlation factor used in the RWA calculation to allow for the potential for losses from intra-bank lending.
Basel II	A statement of best practice issued by the Basel Committee on Banking Supervision, that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive, and was implemented in the UK via the FSA Handbook.
Basel 2.5	Basel 2.5 was an interim strengthening of requirements laid out in Basel II, with changes focussing on trading book and securitisations. Basel 2.5 was implemented within the UK in 2011 via the FSA's policy statement PS11/12. References to Basel II within these disclosures in accordance with Basel 2.5.
Basel III	A strengthening of the requirements laid out in Basel II, to be phased into the Bank from 2014 ahead of full implementation by 2022. Basel III is implemented within the UK through CRD IV.
Bank Market Risk Forum (BMRF)	This committee reviews, challenges and monitors the market risk profile for the Bank, in line with policy and within the risk appetite.
Basis Points (bps)	One hundredth of a per cent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.
Behaviour score (behavioural scorecard)	A credit risk scoring system for retail customers assessing the performance of an existing customer's account. Typically using data from previous performance of a customer's account and/or credit reference data.
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 at http://fshandbook.info/FS/html/PRA
Board Audit Committee (BAC)	The committee which provides oversight in relation to financial reporting, internal control, regulatory compliance, external and internal audit across the Bank.
Board Risk Committee (BRC)	This committee provides oversight and advice to the Bank Board on current and potential risks and the overall risk framework, including risk appetite, risk tolerance and management strategies.
British Banker's Association (BBA)	The BBA is the UK's leading association for the banking sector, representing the interests of more than 240 member organisations with a worldwide presence in 180 countries. Their membership includes retail banks, wholesale institutions, challenger banks and private banks.
Business and Commercial Banking (BaCB)	The Non-core segment of the Bank which specialises in lending to businesses.
Calico	Calico Finance Number One Limited
Capital Requirements	Capital required under Pillar 1. Capital requirements are 8% of Risk Weighted Assets.
Capital Requirements Regulation (CRR)	CRR is a European regulation that will apply directly to UK financial institutions. Broadly, it implements the Pillar 3 aspects of Basel III in relation to capital adequacy and new liquidity requirements.
Capital Resources	Regulatory capital held that is eligible to meet capital requirements.
Capital Management Forum (CMF)	This committee reviews, challenges and monitors the capital adequacy of the Bank, in line with capital policy and within risk appetite.
Chief Executive Officer (CEO)	Chief Executive Officer
Chief Risk Officer (CRO)	Chief Risk Officer
Collective Impairment	Impairment is measured collectively where a portfolio comprises assets with a homogenous risk and where appropriate statistical techniques are available.
Common Equity Tier 1 Capital (CET1)	A CRD IV regulatory measure of financial (capital) strength. Common Equity Tier 1 Capital is the highest quality of capital and comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets as well as other regulatory adjustments, including the full amount of expected loss over provisions, are deducted from Common Equity Tier 1 Capital for the purposes of capital adequacy.

Item	**Description**
Common Equity Tier 1 (CET1) ratio	Common Equity Tier 1 Capital divided by Risk Weighted Assets.
Co-operative Asset Management (CoAM)	The segment that comprises Non-core assets managed for run down or exit.
Co-operative Financial Services Management Services Limited (CFSMS)	CFSMS provides supplies and services on behalf of fellow subsidiary undertakings within The Co-operative Group.
Core Tier 1 Capital	A Basel II regulatory measure of financial (capital) strength. Core Tier 1 Capital comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 Capital and other regulatory adjustments may be made for the purposes of capital adequacy.
Core Tier 1 Ratio	Core Tier 1 Capital divided by Risk Weighted Assets.
Counterparty Credit Risk	The risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
CRD III	The 3rd edition of the Capital Requirements Directive implemented Basel 2.5 within the EU.
CRD IV	This encompasses both the Capital Requirements Directive and Capital Requirements Regulation (CRR) as well as the PRA's Policy Statement PS7/13: Strengthening capital standards. CRD IV implements Basel III within the European Union (including the UK) and is a strengthening of the requirements laid out in Basel II, with phased implementation from 2014, ahead of full implementation by 2022.
Credit Conversion Factor (CCF)	The CCF is an estimate of the proportion of undrawn commitments expected to have been drawn down at the point of default, and is used within the calculation of EAD.
Credit Default Swap (CDS)	An arrangement whereby the credit risk of an asset (the reference asset) is transferred from the buyer to the seller of protection. A credit default swap is a contract where the protection seller receives premium or interest related payments in return for contracting to make payments to the protection buyer upon a defined credit event. Credit events normally include bankruptcy, payment default on a reference asset or assets, or downgrades by a credit rating agency.
Credit quality assessment scale	Published by the FSA in accordance with the Capital Requirements Regulations 2006 which maps the external credit rating provided by eligible ECAIs and ECAs to credit quality steps.
Credit quality steps	A credit quality step in a credit quality assessment scale as set out in BIPRU 3.4 (Risk weights under the standardised approach to credit risk) and BIPRU 9 (Securitisation).
Credit Risk	The current or prospective risk to earnings and capital arising from a borrower's failure to meet the terms of any contract with the Bank or their failure to perform as agreed.
Credit Risk Management Forum (CRMF)	This committee advises and supports the Credit Risk Director. It designs the credit risk control implementation approach and risk control framework. It reviews the Bank's credit risk policy and credit measurement methodologies, defines and recommends the credit risk appetite and limits and reviews and challenges the Bank's credit risk processes and procedures.
Credit Risk Mitigation	Reduction of credit risk by application of credit risk mitigants. The Bank utilises collateral and guarantees as credit risk mitigation.
Credit Valuation Adjustment (CVA)	Capital calculation introduced by CRD IV for changes in market value for counterparty risk relating to derivative transactions.
Default	Circumstances in which Probability of Default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with Basel II. This is defined as where the customer reaches a predefined arrears status or where the Bank may consider the borrower is unlikely to repay its credit obligation in full without recourse by the Bank to actions such as realising security.
Draw down risk	The risk to a lender that a customer will withdraw additional funds up to their maximum facility limit.
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. Expected loss equals Exposure at Default multiplied by Probability of default and Loss Given Default. Expected loss percentage equals expected loss divided by Exposure at Default.
Encumbrance	Encumbrance is an impediment to use of assets, for example a claim against a property by another party. Encumbrance usually impacts the transferability of the asset and can restrict its free use until the encumbrance is removed.
Enhanced Disclosure Task Force (EDTF)	The Enhanced Disclosure Task Force (EDTF) is a private sector group established by the Financial Stability Board (FSB) and composed of members representing both the users and preparers of financial reports. It released a report in October 2012 that included thirty-two recommendations for improving bank risk disclosures in the areas of usability, risk governance and risk management, capital adequacy, liquidity and funding, market risk, credit risk and other risks.
Executive Committee (ExCo)	This committee manages the business in line with the Board risk appetite statement. It also maintains oversight of risk management processes and management information.

Item	Description
Executive Risk Committee (ERC)	ERC provides a mechanism to ensure that the Bank's risk management is reviewed, challenged, approved and embedded within the Bank.
Export Credit Agencies (ECA)	Export Credit Agencies are private or quasi-governmental institutions that act as intermediaries between national governments and exporters to issue export financing. The financing can take the form of credits (financial support) or credit insurance and guarantees (pure cover) or both, depending on the mandate the ECA has been given by its government. ECAs can also offer credit or cover on their own account.
Exposure	The maximum loss the Bank might suffer if: (a) a customer (or counterparty) or a group of connected
Exposure at Default (EAD)	A Basel II Pillar 1 parameter – the amount estimated to be outstanding at the time of default. EAD calculated under the standardised approach is always reported post credit conversion factors and provisions. Under the IRB approach the EAD includes undrawn commitments after credit conversion factors.
External Credit Assessment Institution (ECAI)	An External Credit Assessment Institution is a credit rating agency eg Moody's, Standard and Poor's, and Fitch. A credit rating agency (CRA) is a company that assigns credit ratings for issuers of certain types of debt obligations as well as the debt instruments themselves.
FD	Finance Director
Financial Services Authority (FSA)	An independent body that regulates the financial services industry in the UK. The FSA was replaced as the UK's financial regulator on 1 April 2013 by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
Forbearance	The Bank, for reasons relating to the actual or apparent financial stress of a borrower, grants a concession whether temporarily or permanently to that borrower. A concession may involve restructuring the contractual terms of a debt (such as an extension of the maturity date or any weakening of the security structure or adjustment/non enforcement of covenants) or payment in some form other than cash, such as an equity interest in the borrower.
Foundation IRB	Foundation internal ratings based approach (see IRB), uses standard LGD and EAD parameters but PD is estimated by the Bank.
General Prudential sourcebook (GENPRU)	Part of the Prudential Regulation Authority (PRA) handbook setting out prudential requirements. Available to view at http://fshandbook.info/FS/html/PRA
Impaired Loans	Loans where the Bank does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.
Impairment Allowance	A loss allowance held on the balance sheet as a result of the raising of a charge against profit from the incurred loss inherent in the lending book. An impairment loss allowance may be either individual or collective.
Individual Capital Guidance (ICG)	The PRA's statement as to the regulatory capital it expects the Bank to hold.
Individually Impaired	Impairment is measured individually for assets that are individually significant with risk.
Individual Liquidity Adequacy Assessment (ILAA)	The Bank's assessment of its liquidity risks, controls and quantification of liquid assets required to survive severe financial shocks through the use of stress tests prescribed by the PRA.
Individual Liquidity Guidance	The regulatory minimum amount of liquidity that the Bank is required to hold.
Interest Rate Risk (IRR)	The variability in value borne by an interest bearing asset, such as a loan or a bond, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa.
Internal Capital Adequacy Assessment Process (ICAAP)	The Bank's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
Internal Rating Grade (IRG)	For Corporate exposures the Bank has adopted an Internal Rating Based approach in accordance with Basel II guidelines. Exposures are sanctioned based on an assessment of the risks and are allocated a Risk Grade or Rating extracted from a suite of Basel compliant models. These models have been implemented with outputs calibrated to reflect the Corporate portfolio or PRA slotting standards as appropriate. For Treasury exposures individual counterparties may be allocated credit ratings obtained from External Credit Assessment Institutions. These ratings combined with expert judgment drive the formulation of internal rating grades ranging from 0 to 10 and associated Probability of Default (PDs). These internal rating grades form the basis of the Treasury Counterparty Limit Matrix.
Internal Ratings Based (IRB) approach	A Basel II approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the Standardised Approach and may be Foundation or Advanced. IRB approaches may only be used with PRA permission.
Large Credit Committee (LCC)	The LCC supports the CEO and has the responsibilities of sanctioning large counterparty transactions and managing large exposure positions.
Leverage Ratio	A CRD IV measure, calculated as the ratio of Tier 1 Capital to total exposures. Total exposures include on-balance sheet items, off-balance sheet items and derivatives. The leverage ratio is a supplementary measure to the risk-based capital requirements and is intended to constrain the build-up of excess leverage in the banking sector.

Item	**Description**
Liability Management Exercise (LME)	Core part of the Bank's recapitalisation plan in June 2013. The LME involved existing debt and preference shareholders exchanging their holding for a combination of equity shares and new lower Tier 2 debt instruments as well as issuing new shares for cash.
Liquidity Coverage Ratio	Liquidity ratio that will be introduced under CRD IV, measuring highly liquid assets against stressed net cash outflows over a 30 day period.
Liquidity Management Forum (LMF)	This forum enables more detailed discussion on all aspects of Bank liquidity risk management, monitoring and control including operational issues in respect of covered bond and residential mortgage backed security funding activities. It also recommends actions to ensure the Bank's liquidity position remains in line with agreed levels.
Loss Given Default (LGD)	A Basel II Pillar 1 parameter – an estimate of the actual loss that would occur in the event of default expressed as a percentage of the EAD.
London Interbank Offered Rate (LIBOR)	The interest rate participating banks offer to other banks for loans on the London market.
Long Run Average Probability of Default (LRA PD)	A LRA PD is reflective of the long run average default rates expected over a full economic cycle. Also referred to as long run PD.
Loan To Value (LTV)	A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Bank calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).
Market Risk	Risk that the values of assets and liabilities, earnings and/or capital may change as a result of changes in market prices of financial instruments. The majority of the Bank's market risk arises from changes in interest rates.
Master Grading Scale	Brings together the respective expected default frequency (EDF) from Moody's KMV RiskCalc and Moody's KMV CreditEdge models to produce a Basel II compliant Corporate Banking PD.
Minimum Capital Requirement	The minimum amount of regulatory capital that the Bank must hold to meet the Pillar 1 capital requirements for credit, market and operational risk.
Mortgage Backed Security (MBS)	Securities that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future interest and/or principal mortgage payments.
Model Risk Forum (MRF)	This forum provides oversight and challenge of model governance across the Bank in support of the Enterprise Risk Director.
Model Validation	The process of assessing how well a credit risk model performs.
Multilateral Development Banks (MDBs)	Supranational institutions which provide financial support and professional advice for economic and social development activities in developing countries. The term MDBs typically refers to the World Bank Group and Regional Development Banks.
Net Stable Funding Ratio	Liquidity ratio that will be introduced under CRD IV, measuring the proportion of long term assets which are funded by long term or stable funding.
Net Present Value (NPV)	The present value of the expected future cash in and out flows on an asset or liability.
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This encompasses the effectiveness of risk management techniques and controls to minimise these losses.
Operational Risk Forum (ORF)	This committee is chaired by the Operational Risk Director. It monitors significant operational risks and controls as well as the management actions taken to mitigate them to an acceptable level and/or transfer them.
Over-the-Counter (OTC) Derivatives	Derivatives contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange traded products, they can be tailored to fit specific needs.
Basel II IRB Permission Application Pack (PAP)	A financial institution planning to use the IRB approach for calculation of its credit risk capital requirement needs to apply for permission from the PRA. The information submitted should at least include: 1. Cover letter requesting the approval; 2. Description of/approach to the control environment; IT infrastructure; validation; data standards; reconciliations/performance monitoring; IRB rating systems (including models); outputs; 3. Documentation of above; 4. Implementation plan (including roll-out); 5. Self-assessment.
Past Due Items	When a counterparty has failed to make a payment when contractually due.
Probability of Default (PD)	Probability of Default, a Basel II Pillar 1 parameter under IRB approach, estimate of the probability that a borrower will default in next 12 months.
Pillar 1	Pillar 1 Capital is a prescribed measure of capital required by a bank representing the minimum capital requirements. The Pillar 1 capital ratio is calculated using regulatory capital and RWA. The total capital ratio must be no lower than 8%.

Item	Description
Pillar 2	Pillar 2 is the Basel II terminology for the internal capital adequacy assessment process, which reviews the capital calculation derived within the Pillar 1 work and calculates the additional capital required through various economic cycles, in addition to other risks not covered under Pillar 1.
Pillar 3	Pillar 3 covers market discipline. Market discipline takes the form of standard disclosure requirements that are intended to provide information about a bank's exposure to risks and risk assessment processes. The aim is to provide a means of disclosure comparable between banks.
Point in time (PiT)	Point in time refers to Basel II modelling approach which assesses the risk of an account at a single point in time.
Potential Future Exposure (PFE)	An add-on to derivative exposure for potential future exposure.
Private Finance Initiatives (PFIs)	Private Finance Initiatives.
Provisions	Collective provision balance.
Probability of Possession Given Default (PPD)	Probability of Possession Given Default is the probability that a proportion of mortgages (secured accounts) will to go to repossession.
Prudential Regulation Authority (PRA)	The FSA was replaced as the UK's financial regulator on 1 April 2013 by two new regulatory bodies: the PRA and the FCA. The PRA a subsidiary of the Bank of England is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
Prudent Valuation Adjustment (PVA)	A deduction under CRD IV from Common Equity Tier 1 capital where the prudent value financial assets measured at fair value is materially lower than the fair value recognised in the Annual Report.
Perpetual Subordinated Bonds (PSBs)	Bonds with no maturity date that do not require the issuer to redeem.
PV01	Daily calculation of the effect on the net present value (NPV) of Treasury portfolios to both parallel and specific point of yield curve stress testing (ie non-linear yield curve shifts). Analysis includes daily parallel shifts in yield curve rates of +/– 100 bps with the resultant change in NPVs representing the potential change in portfolio values.
Qualifying revolving	Qualifying Revolving Retail Exposure eg overdraft or credit cards.
Ratings Based Method	The calculation method used by the Bank for exposures to securitisations as defined under the IRB approach. The approach uses risk weightings based on ECAI ratings, the granularity of the underlying pool and the seniority of the position.
Rating systems	System for implementing scorecards and ranking customers/accounts by risk. May also include decision systems which use the ratings as a key input.
Regulatory Capital	The capital that the Bank holds in accordance with the PRA handbook.
Regulatory Risk Forum (RRF)	The RRF supports the Regulatory Risk Director in carrying out his/her responsibilities.
Repurchase Agreement (Repo)/Reverse Repurchase Agreement (Reverse Repo)	A repurchase agreement that allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a security to the lender subject to a commitment to repurchase the asset at a specified price on a given date. For the party selling the security (and agreeing to repurchase it in the future) it is a repo; for the party on the other end of the transaction (buying the security and agreeing to sell in the future) it is a reverse repurchase agreement or reverse repo.
Residential Mortgage Backed Securities (RMBS)	Securities that represent an interest in an underlying pool of residential mortgages.
Residual Maturity	The remaining period for an exposure from the reporting date to its maturity.
Retail SME	Loans extended to small businesses and managed as retail exposures are eligible for retail treatment under Basel II, provided the total exposure of the Bank to a small business borrower (on a consolidated basis where applicable) is less than €1m. Small business loans extended through or guaranteed by an individual are subject to the same exposure threshold.
Retail	The segment that comprises customer focused products and services for individuals, sole traders and small partnerships. This includes mortgages, credit cards, consumer loans, current accounts and savings products.
Retail Advanced IRB Approach	Internal Ratings Based approach for Retail customers stipulated within Basel II allowing a more sophisticated and risk sensitive approach to calculate credit risk. More advanced than Foundation IRB approach as PD, LGD and EAD parameters are derived by the Bank.
Risk grade	Credit risk score or output from a rating system or Basel II Pillar 1 model.
Risk Weighted Asset (RWA)	Risk Weighted Asset or Risk Weighted Assets, amount of exposure deemed 'at risk' according to PRA prescribed calculation for Pillar 1 capital requirement.
Securities Financing Transaction (SFT)	Loaning of a stock, derivative, or other security to a third party.

Item	Description
Securitisation	A process by which a portfolio of retail mortgages is used to back the issuance of new securities by an SPE. The Bank has established securitisation structures as part of its funding and capital management activities (see 'Special Purpose Entities (SPEs)').
Securitisation Position	An exposure to a securitisation.
Scorecard	A set of questions (called characteristics) that provide the most predictive information on future account performance. The account receives points (or weighting) for each question depending on the answer. These points are then added together to create a score.
Slotting approach	An approach applied to specialised lending exposures to calculate Pillar 1 capital requirement and EL. For each of five risk categories that may be assigned to a specialised lending customer, a set percentage based on the slotting category is applied to the account exposure value to derive capital requirement and expected loss.
Small Credit Committee (SCC)	The SCC is a sub-committee of the LCC and its core purpose is to independently sanction new and increased lending over set limits of authority.
Special Purpose Entities (SPE)	Entities that are created to accomplish a narrow and well defined objective. For the Bank this includes: 1. Various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Bank; and 2. Covered Bond Limited Liability Partnerships created in order to act as guarantors for issues of covered bonds.
Specialised lending	A specific Basel portfolio type which are Corporate exposures which possess the following characteristics: 1. The exposure is to an entity which was created specifically to finance and/or operate physical assets; 2. The contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and 3. The primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.
Standardised approach	Under Basel II, the basic method of calculating Pillar 1 capital requirements based on supervisory defined factors which are applied to exposure values based on external credit ratings of the customer.
Strategic Asset Review Forum (SAR)	A forum established at the discretion of the LCC and SCC for CoAM and non-performing facilities. Its function is to set strategies on a case by case basis and sanction within its authority.
Strategic Transactions Committee (STC)	Chaired by the CEO, the STC reviews, challenges and approves (where permitted within the authority delegated by the Board) strategic transactions designed to achieve the deleveraging of the balance sheet in line with the strategy outlined by the Board for the Non-core assets within the CoAM business.
Stress testing	Assessing the risk of a portfolio using a "what if" approach to represent various economic changes, for example, a rise in unemployment.
The Bank	The Co-operative Bank plc and its subsidiaries.
The Board	The Board of Directors. They manage the Bank's business performance in line with its purpose, givens, visions and values.
Tier 1 capital	A regulatory measure of financial (capital) strength. Tier 1 is divided into Core Tier 1 and other Tier 1 capital. Core Tier 1 capital comprises share capital and associated share premium, and general reserves from retained profits. The book values of goodwill and intangible assets are deducted from Core Tier 1 capital and other regulatory adjustments may be made for the purposes of capital adequacy. Qualifying capital instruments such as perpetual subordinated bonds are included in other Tier 1 capital.
Tier 1 capital Ratio	Tier 1 capital divided by Risk Weighted Assets.
Tier 2 capital	Tier 2 capital comprises the Bank's property valuation reserve, qualifying subordinated notes and collective impairment allowance (for exposures treated on a Basel II standardised basis). Certain regulatory deductions may be made for the purposes of assessing capital adequacy.
Total Potential Limit (TPL)	For Treasury exposures – the maximum aggregate exposure (Total Potential Limit) extended to any single counterparty. For Retail/Corporate customers – the total exposure up to and including any shadow limits which a customer could utilise.
Trading book	In relation to the Bank's business or exposures, means its proprietary positions in financial instruments: 1. Which are held for resale and/or are taken on by the firm with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices or from other price or interest-rate variations; and 2. Taken in order to hedge other elements of the trading book.

Item	Description
Value adjustments	Individual impairment balance.
Value at risk (VaR)	VaR measures the daily maximum potential gain or loss due to past market volatility. The VaR methodology employed is historical simulation using a time series of 1 year to latest day. Confidence level of 95% with a one day holding period.
Write off	When all economical avenues to recover an unsecured debt have been exhausted, the Bank permanently closes the loan account, ie it is written off. This final step sits at the end of a time frame within which the Bank attempts to manage the debt's recovery.
Wrong way risk	This type of risk occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty.

Appendix 1 – Capital Resources

	2014		2013	
	Transitional Rules £m	**Fully Loaded £m**	Transitional Rules £m	Fully Loaded £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves				
Capital instruments and the related share premium accounts	**1,759.5**	**1,759.5**	1,059.3	1,059.3
of which: Instrument type 1	**–**	**–**	–	–
of which: Instrument type 2	**–**	**–**	–	–
of which: Instrument type 3	**–**	**–**	–	–
Retained earnings	**(36.7)**	**(36.7)**	731.7	731.7
Accumulated other comprehensive income (and other reserves)	**493.6**	**493.6**	409.0	409.0
Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	**–**	**–**	–	–
Minority interests (amount allowed in consolidated CET1)	**6.1**	**10.6**	6.9	12.1
Independently reviewed interim profits net of any foreseeable charge or dividend	**–**	**–**	–	–
Common Equity Tier 1 (CET1) capital before regulatory adjustments	**2,222.5**	**2,227.0**	2,206.9	2,212.1
Common Equity Tier 1 (CET1) capital: regulatory adjustments	**–**	**–**	–	–
Additional value adjustments (negative amount)	**(0.4)**	**(0.4)**	(2.1)	(2.1)
Intangible assets (net of related tax liability) (negative amount)	**(103.7)**	**(103.7)**	(110.7)	(110.7)
Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	**–**	**–**	–	–
Fair value reserves related to gains or losses on cash flow hedges	**(59.0)**	**(59.0)**	(13.1)	(13.1)
Negative amounts resulting from the calculation of expected loss amounts	**(191.5)**	**(191.5)**	(238.3)	(238.3)
Any increase in equity that results from securitised assets (negative amount)	**–**	**–**	–	–
Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	**–**	**–**	–	–
Defined-benefit pension fund assets (negative amount)	**–**	**–**	–	–
Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings of the CET1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	**–**	**–**	–	–
of which: qualifying holdings outside the financial sector (negative amount)	**–**	**–**	–	–
of which: securitisation positions (negative amount)	**–**	**–**	–	–
of which: free deliveries (negative amount)	**–**	**–**	–	–
Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	**–**	**–**	–	–
Amount exceeding the 15% threshold (negative amount)	**–**	**–**	–	–
of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	**–**	**–**	–	–
of which: deferred tax assets arising from temporary differences	**–**	**–**	–	–
Losses for the current financial year (negative amount)	**(236.4)**	**(236.4)**	(768.4)	(768.4)

	2014		2013	
	Transitional Rules £m	**Fully Loaded £m**	Transitional Rules £m	Fully Loaded £m
Foreseeable tax charges relating to CET1 items (negative amount)	**–**	**–**	–	–
Regulatory adjustments applied to CET1 in respect of amounts subject to pre-CRR treatment	**–**	**–**	–	–
Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	**(24.6)**	**–**	–	–
of which: filter for unrealised loss 1	**–**	**–**	–	–
of which: filter for unrealised loss 2	**–**	**–**	–	–
of which: filter for unrealised gain 1	**–**	**–**	–	–
of which: filter for unrealised gain 2	**–**	**–**	–	–
Amount to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre-CRR	**–**	**–**	–	–
Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)	**–**	**–**	–	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(615.6)**	**(591.0)**	(1,132.6)	(1,132.6)
Common Equity Tier 1 (CET1) capital	**1,606.9**	**1,636.0**	1,074.3	1,079.5
Additional Tier 1 (AT1) capital: instruments	**–**	**–**	–	–
Capital instruments and the related share premium accounts	**–**	**–**	–	–
of which: classified as equity under applicable accounting standards	**–**	**–**	–	–
of which: classified as liabilities under applicable accounting standards	**–**	**–**	–	–
Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	**–**	**–**	–	–
Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	**22.9**	**2.3**	21.7	2.4
of which: instruments issued by subsidiaries subject to phase out	**–**	**–**	–	–
Additional Tier 1 (AT1) capital before regulatory adjustments	**22.9**	**2.3**	21.7	2.4
Additional Tier 1 (AT1) capital: regulatory adjustments	**–**	**–**	–	–
Direct and indirect holdings by an institution of own AT1 instruments (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Direct, indirect and synthetic holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	**–**	**–**	–	–
Regulatory adjustments applied to additional tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	**–**	**–**	–	–
Residual amounts deducted from AT1 with regard to deduction from CET1 capital during the transitional period pursuant to Article 472 of Regulation (EU) No 575/2013	**–**	**–**	–	–
Of which items to be detailed line by line e.g. Material net interim losses, intangible, shortfall of provisions to expected losses etc	**–**	**–**	–	–
Residual amounts deducted from AT1 with regard to deduction from T2 capital during the transitional period pursuant to Article 472 of Regulation (EU) No 575/2013	**–**	**–**	–	–
Of which items to be detailed line by line e.g. Reciprocal cross holdings in Tier 2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities etc	**–**	**–**	–	–

	2014		2013	
	Transitional Rules £m	**Fully Loaded £m**	Transitional Rules £m	Fully Loaded £m
Amount to be deducted from or added to AT1 capital with regard to additional filters and deductions required pre-CRR	**–**	**–**	–	–
Of which:…. Possible filter for unrealised losses	**–**	**–**	–	–
Of which:…. Possible filter for unrealised gains	**–**	**–**	–	–
Of which:…	**–**	**–**	–	–
Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	**–**	**–**	–	–
Total regulatory adjustments to Additional Tier 1 (AT1) capital	**–**	**–**	–	–
Additional Tier 1 (AT1) capital	**22.9**	**2.3**	21.7	2.4
Tier 1 capital (T1 = CET1 + AT1)	**1,629.8**	**1,638.3**	1,096.0	1,081.9
Tier 2 (T2) capital: instruments and provisions	**–**	**–**	–	–
Capital instruments and the related share premium accounts	**196.4**	**196.4**	196.3	196.3
Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	**–**	**–**	–	–
Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	**0.8**	**3.0**	0.9	3.2
of which: instruments issued by subsidiaries subject to phase out	**–**	**–**	–	–
Credit risk adjustments	**52.2**	**52.2**	63.9	63.9
Tier 2 (T2) capital before regulatory adjustments	**249.4**	**251.6**	261.1	263.4
Tier 2 (T2) capital: regulatory adjustments	**–**	**–**	–	–
Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)	**–**	**–**	–	–
Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	**–**	**–**	–	–
Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	**–**	**–**	–	–
Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	**–**	**–**	–	–
Total regulatory adjustments to Tier 2 (T2) capital	**–**	**–**	–	–
Tier 2 (T2) capital	**249.4**	**251.6**	261.1	263.4
Total capital (TC = T1 + T2)	**1,879.2**	**1,889.9**	1,357.1	1,345.3
Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (ie CRR residual amounts)	**34.3**	**34.3**	11.7	11.7
Of which… items not deducted from CET1 (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line =, eg Deferred tax assets that rely on future profitability net of related tax liability, indirect holdings of own CET1, etc)	**21.0**	**21.0**	0.0	0.0
Of which… items not deducted from AT1 (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line =, eg Reciprocal cross holdings in T2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities etc)	**13.3**	**13.3**	11.7	11.7
Items not deducted from T2 items (Regulation (EU) No 575/2013 residual amounts) (items to be detailed line by line eg Indirect holdings of own T2 instruments, indirect holdings of non-significant investments in the capital of other financial sector entities, indirect holdings of significant investments in the capital of other financial sector entities etc)	**–**	**–**	–	–

	2014		2013	
	Transitional Rules £m	**Fully Loaded £m**	Transitional Rules £m	Fully Loaded £m
Total risk weighted assets	**12,632.2**	**12,632.2**	15,073.7	15,073.7
Capital ratios and buffers	**–**	**–**	–	–
Common Equity Tier 1 (as a percentage of total risk exposure amount)	**13%**	**13%**	7%	7%
Tier 1 (as a percentage of total risk exposure amount)	**13%**	**13%**	7%	7%
Total capital (as a percentage of total risk exposure amount)	**15%**	**15%**	9%	9%
Institution specific buffer requirement (CET1 requirement in accordance with Article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	**4%**	**7%**	4%	7%
of which: capital conservation buffer requirement	**0%**	**3%**	0%	3%
of which: countercyclical buffer requirement	**0%**	**0%**	0%	0%
of which: systemic risk buffer requirement	**0%**	**0%**	0%	0%
of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer	**0%**	**0%**	0%	0%
Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**7%**	**7%**	1%	1%
Amounts below the thresholds for deduction (before risk weighting)	**–**	**–**	–	–
Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**–**	**–**	–	–
Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**5.3**	**5.3**	4.7	4.7
Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)	**21.0**	**21.0**	0.0	0.0
Applicable caps on the inclusion of provisions in Tier 2	**–**	**–**	–	–
Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**–**	**–**	–	–
Cap on inclusion of credit risk adjustments in T2 under standardised approach	**21.6**	**21.6**	26.1	26.1
Credit risk adjustments included in T2 in respect of exposures subject to internal ratings-based approach (prior to the application of the cap)	**123.0**	**123.0**	118.9	118.9
Cap for inclusion of credit risk adjustments in T2 under internal ratings-based approach	**52.2**	**52.2**	63.9	63.9
Capital instruments subject to phase-out arrangements (only applicable between 1 January 2014 and 1 January 2022)	**–**	**–**	–	–
Current cap on CET1 instruments subject to phase out arrangements	**–**	**–**	–	–
Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)	**–**	**–**	–	–
Current cap on AT1 instruments subject to phase out arrangements	**–**	**–**	–	–
Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)	**–**	**–**	–	–
Current cap on T2 instruments subject to phase out arrangements	**–**	**–**	–	–
Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)	**–**	**–**	–	–

Appendix 2 – Capital Instruments Template

		11% Subordinated Notes due 2023
1	Issuer	The Co-operative Bank plc
2	Unique identifier	GB00BFXW0853
3	Governing laws of the instrument	English
	Regulatory treatment	
4	Transitional CRR rules	Tier 2
5	Post-transitional CRR rules	Tier 2
6	Eligible at solo/(sub-)consolidated/solo & (sub-) consolidated	Solo and Consolidated
7	Instrument type (types to be specified by each jurisdiction)	Subordinated Debt
8	Amount recognised in regulatory capital (£m)	196.4
9	Nominal amount of instrument	206000000
9a	Issue price	100
9b	Redemption price	100
10	Accounting classification	Liability – amortised cost
11	Original date of issue	20/12/2013
12	Perpetual or dated	dated
13	Original maturity date	20/12/2023
14	Issuer call	No
15	Optional call date, contingent call dates and redemption amount	101 tax call, 101 regulatory call
16	Subsequent call dates, if applicable	N/A
	Coupons/dividends	
17	Fixed or floating dividend/coupon	Fixed
18	Coupon rate and any related index	0.11
19	Existence of a dividend stopper	No
20a	Fully discretionary, partially or mandatory (in terms of timing)	Mandatory
20b	Fully discretionary, partially or mandatory (in terms of amount)	Mandatory
21	Existence of step up or other incentive to redeem	No
22	Noncumulative or cumulative	N/A
23	Convertible or non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	N/A
25	If convertible, fully or partially	N/A
26	If convertible, conversion rate	N/A
27	If convertible, mandatory or optional conversion	N/A
28	If convertible, specify instrument type convertible into	N/A
29	If convertible, specify issuer of instrument it converts into	N/A
30	Write-down features	None contractual Statutory bail-in
31	If write-down, write-down trigger(s)	N/A
32	If write-down, full or partial	N/A
33	If write-down, permanent or temporary	N/A
34	If write-down, description of write-up mechanism	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	Senior Unsecured
36	Non-compliant transitioned features	No
37	If yes, specify non-compliant features	N/A

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