PROSPECTUS dated 4 November 2013

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in doubt as to the action you should take in connection with this document or the proposals contained in it, you are recommended to seek your own personal financial advice immediately from your stockbroker, bank manager, solicitor, accountant or other independent financial adviser authorised under the Financial Services and Markets Act 2000, if you are taking advice in the United Kingdom, or from another appropriately authorised independent financial adviser if you are taking advice in a jurisdiction outside the United Kingdom.

The Co-operative Bank p.l.c.

(incorporated with limited liability in England with registered number 00990937)

11 per cent. Subordinated Notes due 2023

Issue price: 100 per cent.

The 11 per cent. Subordinated Notes due 2023 (the **Notes** or the **Bank T2 Notes**) will, subject to successful completion of the Liability Management Exercise (as defined below), be issued by The Co-operative Bank p.l.c. (the **Bank** or the **Issuer**). Interest on the Notes will be payable quarterly in arrear up to the maturity (or earlier redemption) of the Notes. The conditions of the Notes (the **Conditions**) are set out in Appendix B (*Conditions of the Notes*) to this Prospectus.

Unless previously redeemed or purchased and cancelled, the Issuer will redeem the Notes on the tenth anniversary of their date of issue (the **Maturity Date**). The Issuer may, at its option but subject to certain conditions as described under Condition 6.6, redeem all, but not some only, of the Notes at any time prior to the Maturity Date at an amount equal to 101 per cent. of their principal amount plus accrued interest in the event of certain tax changes as described under Condition 6.2 or if the Notes cease to be eligible for recognition as regulatory capital of the Issuer due to a change in law or regulation as described under Condition 6.3.

The Notes are being offered in connection with a liability management exercise being conducted by the Issuer and Co-operative Group Limited (**Co-operative Group**) in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (the **2016 Notes**), the 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**), the 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**), the Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**), the 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**), the 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) (the **2024 Notes**), the 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (the **2033 Notes**) (together the **Dated Notes**), the 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) and other capital securities issued by the Bank (the **Liability Management Exercise** or **LME**) as announced on 4 November 2013 and as more fully described in this Prospectus. The Notes will be issued only upon successful completion (as further described in Section 6 (*Details of the Liability Management Exercise*)) of the Liability Management Exercise. The final principal amount of Notes to be issued (if any) will be announced by the Issuer via the Regulatory News Service operated by the London Stock Exchange.

Application has been made to the Financial Conduct Authority under Part VI of the Financial Services and Markets Act 2000 (the **UK Listing Authority**) for the Notes to be admitted to the Official List of the UK Listing Authority and to the London Stock Exchange plc (the **London Stock Exchange**) for the Notes to be admitted to trading on the London Stock Exchange's regulated market. The London Stock Exchange's regulated market is a regulated market for the purposes of the Markets in Financial Instruments Directive (Directive 2004/39/EC).

The Issuer is rated BB- (long-term) and B (short-term) by Fitch Ratings Ltd. (**Fitch**) and Caa1 (long-term) and NP (short-term) by Moody's Investors Service Limited (**Moody's**). Fitch and Moody's are established in the European Union and are registered under Regulation (EC) No 1060/2009 (as amended) (the **CRA Regulation**). As such Fitch and Moody's are included in the list of credit rating agencies published by the European Securities and Markets Authority on its website (at *http://www.esma.europa.eu/page/List-registered-and-certified-CRAs*) in accordance with the CRA Regulation. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

The denomination of each Note will be £10. The Notes will be issued in both certificated and uncertificated form on the date of issue of the Notes (the **Issue Date**). Investors may hold interests in the Notes either (i) in certificated form outside of Euroclear UK & Ireland Limited (formerly known as CRESTCo Limited) (**CREST**), Euroclear Bank SA/NV (**Euroclear**) and Clearstream Banking, *société anonyme* (**Clearstream, Luxembourg**), (ii) in uncertificated form in CREST, or (iii) in uncertificated form with Euroclear or Clearstream, Luxembourg through CREST.

An investment in the Notes involves certain risks. Prospective investors should have regard to the factors described under the heading "*Risk Factors*" commencing on page 40.

Dealer Managers

HSBC **UBS INVESTMENT BANK**

IMPORTANT NOTICES

About this document

This Prospectus comprises a prospectus for the purposes of Article 5.4 of Directive 2003/71/EC as amended (which includes the amendments made by Directive 2010/73/EU to the extent that such amendments have been implemented in a relevant Member State of the European Economic Area) (the **Prospectus Directive**).

This Prospectus contains important information about the Issuer, the terms of the Notes and details of the Liability Management Exercise pursuant to which the Notes will be issued. This Prospectus also describes certain risks relevant to the Issuer and its businesses, risks relating to the Liability Management Exercise and risks relating to an investment in the Notes.

You should read and understand fully the contents of this Prospectus, including the Appendices and the information incorporated by reference herein, before making any decision whether or not to participate in the Liability Management Exercise.

The Issuer accepts responsibility for the information contained in this Prospectus. To the best of the knowledge of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

Where information has been sourced from a third party, this information has been accurately reproduced and as far as the Issuer is aware and is able to ascertain from information published by that third party, no facts have been omitted which would render the reproduced information inaccurate or misleading. The source of third party information is identified where used.

Neither UBS Limited or HSBC Bank plc, in their capacity as dealer managers in respect of the Notes (the **Dealer Managers**), nor Law Debenture Trustees Limited in its capacity as a trustee in respect of the Notes (the **Trustee**) have independently verified the information contained in this Prospectus. Accordingly, no representation, warranty or undertaking, expressed or implied, is made and no responsibility is accepted by the Dealer Managers or the Trustee as to the accuracy and completeness of the information contained or incorporated in this Prospectus.

This Prospectus does not constitute or form part of any offer or invitation to sell or issue, or any solicitation of any offer to exchange, purchase or subscribe for, any securities other than the securities to which it relates or any offer or invitation to sell or issue, or any solicitation of any offer to purchase or subscribe for, such securities by any person in any circumstances in which such offer or solicitation is unlawful.

None of the Dealer Managers, the Trustee or Computershare Investor Services PLC or Equiniti Limited (the **Registrars**) are able to, and they do not, express any opinion on the merits of the Liability Management Exercise or any component part of the Liability Management Exercise, or make any recommendation or offer any advice regarding whether or not a holder of existing securities of the Bank should participate in the Liability Management Exercise. Each holder must carefully review the applicable documents in connection with the Liability Management Exercise and come to a decision, either on its own or with the assistance of its professional advisers, whether or not it wishes to participate in the Liability Management Exercise.

Use of defined terms in this Prospectus

Certain terms or phrases in this Prospectus are defined in bold formatting and subsequent references to that term are designated with initial capital letters. The meanings of these terms (or an indication of where in this Prospectus the meanings can be found) are set out in Appendix A (*Defined Terms*) to this Prospectus.

Information incorporated by reference in this Prospectus

This Prospectus, including the Appendices, must be read together with all information which is deemed to be incorporated in this Prospectus by reference (see Section 18 (*Information Incorporated by Reference*)).

The Notes are subordinated capital securities of the Bank and are not protected by the Financial Services Compensation Scheme

The Notes will, upon issue, form part of the regulatory capital of the Bank. Banks are required to hold regulatory capital to absorb losses (before depositors and other senior creditors suffer losses) during periods of financial stress. As a provider of capital to the Bank, an investor in the Notes should be prepared to suffer losses on its investment if, in particular, the Bank and/or the financial sector generally approaches or enters into a period of financial stress. Such losses could be manifested in a number of ways, including (without limitation) that the market price of the Notes may fall significantly, the United Kingdom authorities could take action under the Banking Act 2009 (or similar future legislation), or the Bank could enter into an insolvent winding-up, with the result that investors in the Notes could lose all or substantially all of their initial investment in the Notes.

The Notes are not protected by the Financial Services Compensation Scheme (the **FSCS**). As a result, if the Bank does go out of business or becomes insolvent, or if the United Kingdom authorities take action under the Banking Act 2009 (or similar future legislation) to preserve or restore the viability of the Bank, the FSCS will not pay compensation to an investor. Accordingly, in such circumstances, an investor in the Notes may lose some, or the entire amount of, its investment in the Notes.

How to participate in the Liability Management Exercise

Investors are referred to the Consent and Exchange Offer Memorandum (the **Offer Memorandum**) set out in Appendix C (*Consent and Exchange Offer Memorandum*) to this Prospectus for a description of the Liability Management Exercise and how to participate in the Liability Management Exercise.

Participation in the Liability Management Exercise is the only manner in which Notes can be obtained upon issue.

If an investor is unsure as to the meaning or effect of any of the information contained or incorporated by reference in this Prospectus, or as to any action it should take, it should seek independent advice from its financial, legal and/or other advisers as it considers appropriate.

Interpretation

There are a number of references in this Prospectus to Existing Securities (as defined herein) being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of holders of Preference Shares or 13% Bonds who elect the Instalment Repayment Notes option (as further described in this Prospectus), such expressions are used for investors' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which holders would receive any Instalment Repayment Notes. As set out in this Prospectus, holders who opt for Instalment Repayment Notes will actually be selling their Preference Shares or 13% Bonds to Co-operative Group in return for cash consideration which will be payable in twelve equal instalments over twelve years up to (and including) 2025 and it is these instalment payments which will be represented by the Instalment Repayment Notes.

Queries

Questions regarding the terms of the Liability Management Exercise

Questions about the terms of the Liability Management Exercise can be directed to the Dealer Managers at the following contact details:

HSBC Bank plc 8 Canada Square London E14 5HQ United Kingdom Telephone: +44 20 7992 6237 Attention: Liability Management Group Email: coop.exchange@hsbcib.com	**UBS Limited** 1 Finsbury Avenue London EC2M 2PP United Kingdom Telephone: +44 20 7567 0525 Attention: Liability Management Group Email: mark-t.watkins@ubs.com/ mahmoud.abdelaal@ubs.com

Questions regarding participation mechanics in respect of the Liability Management Exercise

Questions of a practical nature regarding how to participate in the Liability Management Exercise should be directed to the Exchange Agent and Information Agent at the following contact details:

Lucid Issuer Services Limited 436 Essex Road London N1 3QP United Kingdom Telephone: 0800 279 7346 (if calling from outside the UK: +44 20 7704 0880) Fax: +44 20 7067 9098 Attention: Sunjeeve Patel / David Shilson / Yves Theis Email: co-op@lucid-is.com

In addition, holders of the Preference Shares may contact Computershare as registrar for the Preference Shares, and holders of the 13% Bonds and 5.5555% Bonds may contact Equiniti as registrar for those bonds, at the following contact details:

Preference Shares	*13% Bonds and 5.5555% Bonds*
Computershare Investor Services PLC Corporate Actions Projects Bristol BS99 6AH United Kingdom	**Equiniti Limited** Corporate Actions Aspect House Spencer Road Lancing West Sussex BN99 6DA United Kingdom
Telephone: 0800 694 0470 (if calling from outside the UK: +44 0117 902 7672)	Telephone: 0800 169 7006 (if calling from outside the UK: +44 121 415 0260)
Lines are open from 8.30 a.m. to 5.30 p.m. (London time) Monday to Friday (except UK public holidays). Calls from UK landlines will not be chargeable. Calls from outside the UK will be charged at the applicable international rate. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. Please note that the telephone operators cannot provide advice on the merits of the Liability Management Exercise or any part of it, nor can they give financial, tax, investment or legal advice.	

TABLE OF CONTENTS

1
SUMMARY

The following is a summary of information relating to the Bank and the Notes.

SUMMARY OF THE NOTES

Summaries are made up of disclosure requirements known as "Elements". These elements are numbered in Sections A-E (A.1 – E.7).

This summary contains all the Elements required to be included in a summary for this type of security and issuer. Because some Elements are not required to be addressed, there may be gaps in the numbering sequence of the Elements.

Even though an Element may be required to be inserted in the summary because of the type of security and issuer, it is possible that no relevant information can be given regarding the Element. In this case a short description of the Element is included in the summary with the mention of "not applicable".

Section A – Introduction and warnings		
Element	**Title**	
A.1	**Warning**	This summary should be read as an introduction to the Prospectus. Any decision to invest in the securities should be based on consideration of the Prospectus as a whole by the investor. Where a claim relating to the information contained in the Prospectus is brought before a court, the plaintiff investor might, under the national legislation of the Member States, have to bear the costs of translating the Prospectus before the legal proceedings are initiated. Civil liability attaches only to those persons who have tabled the summary including any translation thereof, but only if the summary is misleading, inaccurate or inconsistent when read together with the other parts of the Prospectus or it does not provide, when read together with the other parts of the Prospectus, key information in order to aid investors when considering whether to invest in such securities.
A.2	**Consent for Financial Intermediaries**	Not Applicable. The Bank has not consented to the use of the Prospectus for any subsequent resale or final placement of securities by financial intermediaries.

Section B – Issuer		
Element	**Title**	
B.1	**Legal and commercial name of the Issuer**	The Co-operative Bank p.l.c. (the **Bank**)
B.2	**Domicile/legal form/ legislation/country of incorporation**	The Bank is a public limited company, incorporated and domiciled in the UK with its registered office situated in England and Wales. The Bank operates under the Companies Act 2006 and is registered by the UK Prudential Regulation Authority (the **PRA**) and the UK Financial Conduct Authority (the **FCA**). The Bank's Firm Reference Number is 121885.

B.4b	**A description of any known trends affecting the Issuer and the industry in which the Issuer operates**	***The Bank*** The Bank is currently facing a number of financial pressures which, following a review of the financial position of the Bank, led the boards of the Bank and Co-operative Group Limited (**Co-operative Group**) to announce on 17 June 2013 that the Bank required an additional £1.5 billion of common equity tier 1 capital, as assessed by the PRA. To meet the capital shortfall, on 4 November 2013 Co-operative Group and the Bank announced details of their comprehensive recapitalisation plan (the **Recapitalisation Plan**) to strengthen the Bank's capital base, which is expected to result in an increase in the common equity tier 1 capital of the Bank of £1.5 billion by the end of 2014. The capital shortfall is a result of continuing losses incurred by the Bank predominantly driven by impairment charges to the carrying value of the Bank's loans, in particular corporate loans acquired as part of the merger with Britannia Building Society (**Britannia**) in 2009. Impairment charges for the six months ended 30 June 2013 were £496.0 million. The Bank also has a high cost base relative to its revenue when compared with its peers. The Bank has an ageing IT platform that has suffered from under-investment in recent years and has failed to integrate Britannia into the Bank's operations, resulting in significant cost duplications in front, middle and back office functions and a significant overlap in the branch network. In addition, the Bank's revenues are impacted by it not having achieved sufficient penetration of its current account customer base and historically pricing certain of its products on terms more generous to customers than the market. In response, the Bank has recently strengthened its management team and has adopted a comprehensive new business strategy that is targeted at addressing the issues identified above, reducing the overall risk profile of the Bank and restoring the Bank to health. Whilst the Bank has already taken a number of actions to try to address the challenges it faces, it is clear that it is in the early stages of turning itself around and that the legacy issues identified above will continue to have an impact on the Bank for some time.
B.5	**Description of Co-operative Group and the Issuer's position within Co-operative Group**	Co-operative Group is the UK's largest mutual business, owned by over 7 million consumer members. It is the UK's fifth biggest food retailer, a leading farmer and a major financial services provider. Among its other businesses are a funeral services provider, a pharmacy chain and a legal services provider. The Bank is currently a subsidiary of Co-operative Banking Group Limited (**Banking Group**) which is itself a subsidiary of Co-operative Group. Co-operative Group is the ultimate holding entity of Banking Group and its subsidiaries.

B.8	**Selected key pro forma financial information**	The unaudited pro forma balance sheet as at 30 June 2013 has been prepared to show the pro forma impact of the liability management exercise being conducted by the Bank and Co-operative Group (the **Liability Management Exercise**), on assets, liabilities, equity and certain capital and leverage ratios, as if it had taken place as at 30 June 2013. It has been prepared for illustrative purposes only in accordance with Annex II of the Prospectus Directive (Directive 2003/71/EC as amended) and should be read in conjunction with the notes set out below. Because of its nature, it addresses a hypothetical situation and therefore does not represent the Bank's actual financial position as at 30 June 2013, nor is it indicative of the results that may or may not be expected to be achieved in the future.

The successful completion of the Liability Management Exercise is expected to be earnings enhancing as a result of interest savings on Existing Securities (as defined below) surrendered in the Liability Management Exercise, net of coupon payments on New Securities issued in the Liability Management Exercise.

Balance sheet as at 30 June 2013

		Adjustments			
	As at 30 June 2013[1]	*Liability Management Exercise*[2]	*Additional New Ordinary Share Offer*[3]	*Expenses of the Exchange Offers*[4]	*Unaudited pro forma*
			(£ millions)		
Cash and balances at central banks	5,402.1	–	125.0	(43.0)	5,484.1
Other assets	41,230.2	–	–	–	41,230.2
Total assets	46,632.3	–	125.0	(43.0)	46,714.3
Liabilities					
Other borrowed funds	1,248.1	(1,042.1)	–	–	206.0
Other liabilities	44,369.5	–	–	–	44,369.5
Total liabilities	45,617.6	(1,042.1)	–	–	44,575.5
Total equity	1,014.7	1,042.1	125.0	(43.0)	2,138.8
Total liabilities and equity	46,632.3	–	125.0	(43.0)	46,714.3

Notes:

(1) The accounting policies adopted in preparing the pro forma balance sheet as at 30 June 2013 are consistent with the accounting policies adopted in preparing the Interim Financial Information. No account has been taken of actual changes in the trading or financial position of the Bank since 30 June 2013.

(2) The Liability Management Exercise is assumed to generate £1,042.1 million of capital on the basis of full participation in the Liability Management Exercise.

(3) £125.0 million of New Ordinary Shares will be issued as a result of the Additional New Ordinary Shares Offer.

(4) The expenses of the Liability Management Exercise to be borne by the Bank are estimated at approximately £51.0 million (inclusive of VAT), of which approximately £8.0 million was recorded in the six months ended 30 June 2013. The remaining balance of approximately £43.0 million will be paid by the Bank out of cash resources. A portion of these expenses may be allocated to the Bank Tier 2 Notes rather than wholly against total equity. This allocation has not yet been determined.

(5) No adjustment has been made to reflect the legally binding and irrevocable commitment, provided to Bank by Banking Group on 4 November 2013, conditional only upon the successful completion of the Liability Management Exercise, to contribute up to £333.0 million of capital to the Bank during 2014.

B.9	**Profit forecast or estimate**	On 29 August 2013, the Bank published its interim results for the six months ended 30 June 2013. The interim results contained the following statement: *"Clearly there are lessons to be learned from the last few years but it is vital that the new management team focuses on navigating the short-term issues and building the strategy that is targeted at returning the business to health in the future. We have already taken a number of actions but it is clear that we are in the early stages of turning the Bank around. Indeed, we do not expect to be profitable for some years and legacy issues will continue to have an impact on the Bank for some time."* The statement above regarding profitability represents a profit forecast under the prospectus rules published by the FCA under Part VI of the Financial Services and Markets Act 2000, as amended (the **Prospectus Rules**). The Directors have considered the above statement and continue to believe that it is valid based on the assumptions below as the Bank will not be profitable in 2013 and 2014 and can give no assurance that the Bank will generate a profit for some years thereafter. **Basis of preparation and principal assumptions** This profit forecast is based on the interim results for the six months ended 30 June 2013, the unaudited management accounts for the eight months ended 31 August 2013, management's forecast for the remaining four months ending 31 December 2013 and management's latest available projections for the financial years ending 31 December 2013 and 2014. The principal assumptions on which the profit forecast is based comprise: (a) assumptions that are within management's control including: • deleveraging of non-core business will be underwritten in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital released from the reduction in risk-weighted assets; and • there will be no material variation to the assumed level of cost reductions and to the assumption that the cost-to-income ratio for the core business, of not less than 60 per cent., is only achieved in the longer term. (b) assumptions that are not within management's control including: • there will be no material change in legislation or regulatory capital and liquidity requirements impacting the Bank's operations; • there will be no material change in the accounting standards applicable to the Bank; • there will be no material change in interest rates affecting the Bank from those currently applicable to the Bank;

		• there will be no material improvement in the economic and general trading environment currently prevailing in the UK; and • there will be no material change to the competitive environment which impacts on consumer preferences. The profit forecast has been properly compiled on the basis of the stated assumptions and using accounting policies which are in accordance with International Financial Reporting Standards and consistent with those used by the Bank in the six months ended 30 June 2013 and which will be applicable for the financial years ending 31 December 2013 and 2014.
B.10	**Audit report qualifications**	The Accountant's Report on the Bank's audited Interim Financial Information for the six months ended 30 June 2013 of KPMG Audit Plc contains an "emphasis of matter" statement relating to going concern. In the opinion of KPMG Audit Plc, the risks associated with the successful execution of the Recapitalisation Plan, the main cornerstone of which is the Liability Management Exercise, indicate the existence of a material uncertainty which may cause significant doubt on the Bank's ability to continue as a going concern. There are no qualifications in the audit reports for the other periods covered by the historical financial information.
B.12	**Selected historical key financial information/significant change/no material adverse change**	The following table sets out the consolidated income statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June (Unaudited)*	
	2012	*2011*	*2010*	*2013*	*2012*
		(£millions)		*(£millions)*	
Income	771.2	817.6	821.8	355.8	385.1
Operating costs – steady state	(568.2)	(548.2)	(555.5)	(303.1)	(282.8)
Operating costs – strategic initiatives	(14.8)	(13.4)	(26.0)	(14.3)	(9.2)
	188.2	256.0	240.3	38.4	93.1
Impairment losses	(468.7)	(114.9)	(95.8)	(496.0)	(91.9)
Operating result	(280.5)	141.1	144.5	(457.6)	1.2
Significant items	(85.1)	(53.3)	(55.5)	(34.6)	(39.3)
Intangible asset impairment	(150.0)	–	–	(148.4)	–
Customer redress (including PPI)	(149.7)	(90.0)	(4.3)	(163.0)	(40.0)
Share of post-tax profits from joint venture	1.2	0.2	0.7	0.3	0.6
Financial Services Compensation Scheme levies	(24.8)	(14.5)	(11.5)	0.1	(0.8)
Fair value amortisation	15.2	86.3	(14.2)	(8.2)	19.7
Profit (loss) before taxation and distributions	(673.7)	69.8	59.7	(811.4)	(58.6)
Profit-based payments to members of Co-operative Group	–	(15.6)	(10.8)	–	–
Profit (loss) before taxation	(673.7)	54.2	48.9	(811.4)	(58.6)

The following table sets out the consolidated balance sheet of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013.

	As at 30 June	*As at 31 December*		
	2013	*2012**	*2011*	*2010*
	(£ millions)	*(£ millions)*		
Assets				
Loans and advances to customers	32,932.9	33,693.7	34,132.3	35,144.1
Cash and balances at central banks	5,402.1	5,433.0	6,696.6	1,735.6
Loans and advances to banks	1,737.5	1,904.1	2,006.5	2,394.1
Investment securities	5,082.6	6,889.8	4,571.0	4,903.1
Derivative financial instruments	804.3	818.8	975.8	975.6
Other assets	672.9	834.0	573.4	428.8
Total assets	46,632.3	49,573.4	48,955.6	45,581.3

	As at 30 June	*As at 31 December*		
	2013	*2012**	*2011*	*2010*
	(£ millions)	*(£ millions)*		
Liabilities				
Amounts owed to customers	34,922.3	36,772.5	36,420.4	34,114.7
Wholesale liabilities	3,517.8	3,612.0	3,302.7	2,938.6
Debt securities in issue	4,610.0	4,713.7	4,164.8	4,212.2
Derivative financial instruments	662.7	967.6	1,087.9	702.4
Other liabilities	656.7	398.8	447.9	564.9
Other borrowed funds	1,248.1	1,258.6	1,258.8	975.4
Total liabilities	45,617.6	47,723.2	46,682.5	43,508.2
Total equity	1,014.7	1,850.2	2,273.1	2,073.1
Total liabilities and equity	46,632.3	49,573.4	48,955.6	45,581.3

Note:

* On 29 August 2013, the Bank published its interim financial report for 2013. The 2012 balance sheet comparatives contained in the interim financial report were represented to reflect that certain deferred tax liabilities cannot be offset against the deferred tax assets. As a result, the 'Other assets', 'Total assets', 'Other liabilities', 'Total liabilities' and 'Total liabilities and equity' each increased by £121.4 million.

The following table sets out the consolidated cash flow statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
	(£millions)			*(£millions)*	
Net cash flows from operating activities	805.2	3,470.2	(1,333.5)	(1,978.9)	(1,654.5)
Net cash flows from investing activities	(2,344.7)	831.9	2,220.6	1,842.2	(194.2)
Net cash flows from financing activities	(34.7)	183.1	128.8	(47.2)	(51.2)
(Decrease) increase in cash and cash equivalents	(1,574.2)	4,485.2	1,015.9	(183.9)	(1,899.9)
Cash and cash equivalents at the beginning of the period	7,888.4	3,403.2	2,387.3	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,314.2	7,888.4	3,403.2	6,130.3	5,988.5

The following table sets out selected consolidated financial information which is unaudited but which has been derived from the Bank's consolidated financial statements for the financial years ended 31 December 2012, 2011 and 2010, and the Bank's interim financial information for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
		(percentages)		*(percentages)*	
Core Tier 1 ratio	8.8	9.6	9.6	4.9	9.6
Loans to deposit ratio	91.6	93.9	102.5	94.3	100.5

Set out below is a description of significant changes to the Bank's financial condition and operating results during each of the periods covered in the tables above. The Bank has experienced challenging market conditions in each of the financial years ended 31 December 2010 (**FY 2010**), 31 December 2011 (**FY 2011**) and 31 December 2012 **(FY 2012**), with the UK economy failing to recover at the speed expected.

The Bank incurred losses of £673.7 million in FY 2012, compared with a profit-before-tax of £54.2 million earned in FY 2011. These losses reflect the continuing economic downturn and prolonged low interest rates which have put pressure on the Bank's margins. In addition, and in line with the rest of the banking industry, the Bank saw an increase in the volume of Payment Protection Insurance (**PPI**) complaints in FY 2012 which resulted in an increased provision for PPI. Significant items of £85.1 million were also incurred in FY 2012, notably more than in FY 2011 (£53.3 million) and FY 2010 (£55.5 million): of these significant items costs, a significant amount was incurred in relation to the bid for the Lloyds Banking Group branches, with the remainder primarily associated with investment in the Bank's transformation and integration programmes. While the non-core business (being those business activities no longer congruent with the Bank's strategy) generated an operating loss in FY 2012, the core business delivered an operating profit, reflecting the strategy and risk appetite of the Bank.

Credit impairments in FY 2012 of £468.7 million were £353.8 million higher than the £114.9 million recorded in FY 2011. This increase relates principally to credit impairment on non-core assets following a reassessment of the carrying value of the customer loan portfolios of the Bank in light of the continued and persistent weakness in the economy.

In FY 2012, total income was £771.2 million, down from £817.6 million in FY 2011, a reduction of £46.4 million. This reduction reflects the cost of retained and incremental funding raised during FY 2012 in challenging market conditions and arose principally in the non-core business.

In FY 2011, profit-before-tax was £54.2 million, an increase of £5.3 million over the £48.9 million recorded in FY 2010. Strategic initiative operating costs decreased by £12.6 million between FY 2010 and FY 2011 following significant strategic investment in the Bank's business in FY 2010. Income in FY 2011 was broadly stable at £817.6 million following the generation of £821.8 million of income in FY 2010.

		The Bank incurred significant losses of £811.4 million for the six months ended 30 June 2013, compared to losses of £58.6 million for the six months ended 30 June 2012. These losses have arisen primarily from significant additional impairment charges, intangible asset impairment and customer redress (including PPI) provisions. The Bank has announced a regulatory capital shortfall of £1.5 billion which it plans to address through the implementation of the Recapitalisation Plan comprising the Liability Management Exercise and a contribution from Banking Group (supported by Co-operative Group). The Bank's impairment charge on loans and advances for the six months ended 30 June 2013 was £496.0 million, up from £91.9 million for the six months ended 30 June 2012. These credit impairments, made up of £165.5 million in the core business and £330.5 million in the non-core business, are the reason for the level of operating loss for the six months ended 30 June 2013. The increase in the overall credit impairment charge is due to various factors, including the Bank's strategy of targeting non-core assets for run down and exit, improvements in the Bank's credit risk management approach and impairments incurred in the ordinary course of business due to changes in customer circumstances. In addition, the losses incurred in the six months ended 30 June 2013 were also driven by a number of significant items including a £148.4 million write-down of IT assets, £163.0 million of additional customer redress provisions and £10 million of costs incurred in connection with the aborted bid for the Lloyds Banking Group branch network. Save as set out in "*Recent events impacting the Issuer's solvency*" below (other than the first paragraph) there has been no significant change in the financial or trading position of the Bank or its subsidiaries since 30 June 2013, the date to which the last historical audited consolidated financial information of the Bank was prepared. Save as set out in "*Recent events impacting the Issuer's solvency*" below (other than the first paragraph) there has been no material adverse change in the prospects of the Bank or its subsidiaries since 30 June 2013.
B.13	**Recent events impacting the Issuer's solvency**	The Accountant's Report to the Bank's audited Interim Financial Information for the six months ended 30 June 2013 of KPMG Audit Plc contains an "emphasis of matter" statement relating to going concern. In their opinion, the risks associated with the successful execution of the Recapitalisation Plan, the main cornerstone of which is the Liability Management Exercise, indicate the existence of a material uncertainty which may cause significant doubt on the Bank's ability to continue as a going concern. The Bank believes that the failure of the Liability Management Exercise will result in the Bank ceasing to be a going concern. ***Current trading*** Consistent with the Bank's unaudited interim results for the period ended 30 June 2013, which were announced on 29 August

		2013, the short term outlook for the Bank continues to be challenging. Monthly revenue and cost trends since 30 June 2013 have remained consistent with those observed in the first half of the year. The average monthly level of impairment charges in July and August has fallen as compared to average monthly levels for the first half of the year. In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns and the Bank raised £1.5 billion of secured wholesale funding. As at 30 September 2013, the encumbrance ratio was 29.8 per cent. The Bank's capital position has not materially changed since 30 June 2013 and the Bank remains dependent on the successful completion of the Liability Management Exercise.
B.14	**Dependence upon other entities in Co-operative Group**	The Bank is dependent on Co-operative Group for the provision of certain administrative services (such as finance, marketing, human resources, some risk functions and, in particular, IT) although the extent of this reliance is expected to be reduced following completion of the Liability Management Exercise as services are likely to be repatriated to the Bank. These arrangements may need to be renegotiated as a result of the successful implementation of the Liability Management Exercise. In addition the Bank is dependent on the strength of the wider Co-operative brand and its reputation with customers and potential customers of the Bank.
B.15	**A description of the Issuer's principal activities**	The Bank's core business (which as at 30 June 2013 had total segment assets of £30,021.8 million) includes the core retail and corporate banking businesses, treasury and certain other businesses. The core retail banking business product offering consists of a range of current accounts and money transmission services, lending and savings products, to individuals, households and certain small businesses in the UK, while the core corporate banking business targets small- and medium-sized businesses. The Bank's strategy is to become a retail and commercial bank focused on retail and small- and medium-sized enterprises and franchise businesses in the UK, built around the Bank's existing brand and franchise strength. The Bank had total assets of £46,632.3 million as at 30 June 2013 (£49,694.8 million as at 31 December 2012). These assets include non-core business asset classes which are not consistent with the Bank's business strategy, are being targeted for run-down or exit, and include non-performing commercial and residential real estate exposures, including non-prime residential mortgages (both income verified and self-certified), buy-to-let and other non-conforming mortgages.

		The Bank has approximately 4.7 million customers, and operates through a network of branches, call centres, ATMs, the internet and digital channels.
B.16	**Controlling shareholders**	The Bank is currently a wholly-owned subsidiary of Banking Group. Co-operative Group is the ultimate holding entity of Banking Group and its subsidiaries. Successful completion of the Liability Management Exercise will involve the issue by the Bank of ordinary shares to a number of existing investors in the Bank, being the holders of the Bank's existing lower tier 2 securities. Upon successful completion of the Liability Management Exercise, Co-operative Group will continue to own (through Banking Group) 30 per cent. of the issued shares of the Bank with the remaining 70 per cent. of the issued shares of the Bank being held by holders of the Bank's existing lower tier 2 securities. The Bank does not anticipate that, following completion of the Liability Management Exercise, any of the holders of the Bank's Dated Notes shall acquire a controlling interest in the Bank simply by participating in the Liability Management Exercise.
B.17	**Solicited credit ratings**	The Bank is rated BB– (long-term) and B (short-term) by Fitch Ratings Ltd. (**Fitch**) and Caal (long-term) and NP (short-term) by Moody's Investors Service Limited (**Moody's**). The Notes will not be rated.

Section C – Securities		
Element	**Title**	
C.1	**Description of Notes**	11 per cent. Subordinated Notes due 2023 (the **Notes**). The International Securities Identification Number (**ISIN**) for the Notes is: GB00BFXW0853.
C.2	**Currency**	British pounds Sterling.
C.5	**Transferability**	Not Applicable. There are no restrictions on the free transferability of the Notes provided that no Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest on that Note.
C.8	**A description of rights attached to the Notes including ranking and limitations to those rights**	The Notes are issued upon terms and conditions (the **Conditions**) which set out the obligations of the Bank and the rights of the Noteholders. ***Status of the Notes*** The Notes will be unsecured and, in accordance with the paragraph below describing rights on a winding-up of the Bank, subordinated obligations of the Bank and will rank equally without any preference among themselves. ***Rights on a winding-up of the Bank*** On a winding-up of the Bank, the Trustee (on behalf of the Noteholders) will have a claim for the principal amount of the Notes together with accrued and unpaid interest which will rank

at least equally with all claims of holders of all other subordinated obligations of the Bank which constitute tier 2 capital of the Bank (or are expressed to rank equally with such instruments).

That claim will, however, be subordinated to the claims of depositors and other unsubordinated creditors of the Bank.

Accordingly, the Noteholders will only recover any amounts under their claims if there are assets remaining once senior-ranking creditors have been paid in full. If the Bank's assets are sufficient to repay senior creditors in full, but are insufficient to repay fully the Noteholders and other creditors whose claims rank alongside the Noteholders' claims, then the Noteholders will lose some of their investment in the Notes.

Rights of enforcement upon default

The Notes will contain the following events of default:

(a) non-payment of principal when due in respect of any of the Notes for a period of seven days;

(b) non-payment of interest when due in respect of any of the Notes for a period of fifteen days; or

(c) the winding-up of the Bank.

In the event of a payment default, Law Debenture Trustees Limited as trustee for the Noteholders (the **Trustee**) may elect to institute proceedings for the winding-up of the Bank. The Trustee may also prove in a winding-up of the Bank on behalf of the Noteholders. If directed in writing by the holders of at least one-fifth in nominal amount of the Notes then outstanding or by an Extraordinary Resolution of the Noteholders, the Trustee shall be obliged to institute such proceedings and/or prove in a winding-up, provided it is indemnified and/or secured and/or pre-funded to its satisfaction (which means it receives assurance that it will receive the funds or be entitled or able to receive the funds to cover any costs that the Trustee incurs).

Noteholders will be unable to take the above enforcement action directly unless the Trustee has become bound to act and fails to do so. Further, no other remedy (including any right of set-off in respect of any amounts owed to the Bank by a Noteholder) is available to the Trustee or the Noteholders. Accordingly, the Noteholders' rights of enforcement available are limited to the above.

Taxation

All payments in respect of Notes will be made without withholding or deduction for or on account of taxes imposed by the United Kingdom or any political subdivision or any authority thereof or therein having power to tax, unless such withholding or deduction is required by law. In the event that any such deduction is made, the Bank will, save in certain limited circumstances, be required to pay additional amounts to cover the amounts so deducted.

		Meetings of Noteholders The Conditions contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions will permit defined majorities of the holders present and voting at the relevant meeting to bind all Noteholders, including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The powers afforded to majorities to bind minorities are significant, and could result in material changes to the terms of the Notes, including potentially reducing the amounts of interest and/or principal payable by the Bank, changing the maturity of the Notes, including extending the time to maturity of the Notes, the timing of payments of interest and/or principal in respect of the Notes, mandatory substitution of the Notes with other securities and, in the extreme, the complete abrogation (i.e. annulment) of all rights of the holders under the Notes. ***Governing law*** English law.
C.9	**Interest, redemption, yield and representative**	***Interest*** Interest will accrue from (and including) the date of issue of the Notes at a fixed rate of 11 per cent. per year and will be payable quarterly in arrear every three-month anniversary of the issue date up to and including the date of redemption of the Notes. ***Redemption*** Unless redeemed or purchased and cancelled earlier, the Bank will be required to repay the Notes on the tenth anniversary of the issue date at their principal amount. The Bank will also have the option (subject to PRA approval) to repay the Notes before their final maturity date if there is a change in law or regulation which results in certain adverse tax consequences for the Bank or in the Notes ceasing to be eligible to qualify as regulatory capital of the Bank at an amount equal to 101 per cent. of their principal amount. ***Indication of yield*** The Notes will be issued at 100 per cent. of their principal amount and will pay a fixed rate of interest of 11 per cent. per year to maturity. Accordingly, the yield to an investor who initially subscribes the Notes and holds them to maturity will be 11 per cent. per annum. The yield above is stated as at the issue date on the basis of the issue price and is not an indication of future yield. ***Representative of the Noteholders*** Law Debenture Trustees Limited will be trustee (the **Trustee**) for the Noteholders. As well as taking enforcement action on behalf of the Noteholders as described above, the Trustee may (without the consent of the Noteholders) agree to certain formal, technical or minor modifications to the Notes, to any modification to correct a manifest error or which, in the opinion of the Trustee, is not materially prejudicial to the interests of the Noteholders

		and to waivers of breaches or proposed breaches under the Notes which it considers not to be materially prejudicial to the interests of the Noteholders.
C.10	**Derivative component in the interest payment**	Not Applicable. The Notes will not have a derivative component in the interest provisions.
C.11	**Listing/admission to trading**	Application has been made to the UK Listing Authority for the Notes to be admitted to the Official List and to the London Stock Exchange for the Notes to be admitted to trading on the London Stock Exchange's regulated market upon issue.

Section D – Risks		
Element	**Title**	
D.2	**Key risks specific to the Issuer**	***Risks relating to the Liability Management Exercise*** • Following a review of the capital position of the Bank and discussions with the PRA, it was determined and announced on 17 June 2013 that the Bank requires additional aggregate common equity tier 1 capital of £1.5 billion. Co-operative Group and the Bank have developed the Recapitalisation Plan which is intended to address this capital shortfall. The Recapitalisation Plan includes, amongst other things, the implementation of the Liability Management Exercise. At least £1 billion of this capital requirement is intended to be contributed pursuant to the Liability Management Exercise in 2013. Conditional on completion of the Liability Management Exercise, £333 million of the capital requirement is intended to be contributed by Banking Group during 2014 of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014) and the remaining £163 million by 31 December 2014. The remainder of the common equity tier 1 capital is intended to be generated pursuant to an offer to subscribe for 62,500,000 additional New Ordinary Shares for an aggregate consideration equal to £125 million to Holders of the Dated Notes in accordance with the Scheme (as defined below) and the capital created through interest savings on the Existing Securities exchanged pursuant to in the Liability Management Exercise. Given that the success of the Liability Management Exercise is dependent on the participation of holders of Existing Securities, there is a risk that holders of the Existing Securities will fail to participate in the Liability Management Exercise in sufficient numbers such that the Liability Management Exercise fails. The Liability Management Exercise will only successfully complete if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. In addition, there is the risk that, notwithstanding the fact that the PRA reconfirmed its assessment on 29 August 2013 and on 21 October 2013 that the Bank needed to generate an additional £1.5 billion in common equity tier 1 capital, the PRA concludes that the aggregate £1.5 billion of common equity tier 1 capital to be

		contributed pursuant to the Recapitalisation Plan is inadequate, which may result in either the Bank deciding not to proceed with the Liability Management Exercise or holders of the existing securities electing not to participate in the Liability Management Exercise. Whilst in the event that the Liability Management Exercise is not successfully implemented, with the result that the Bank would fail to raise sufficient common equity tier 1 capital by 31 December 2013, the Bank would take immediate action to try to address the Bank's capital shortfall, the Bank believes that, in such circumstances, the failure of the Liability Management Exercise would result in the Bank becoming subject to a resolution procedure under the Banking Act 2009 (**Banking Act**). In the event that the authorities exercise their powers under the Banking Act or there is market speculation regarding the occurrence of any such event, it is highly probable that the Bank would be materially adversely affected, and the market price of existing securities (if they remain outstanding in such circumstances) would be materially adversely affected. The Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank remains a going concern without the active participation of Co-operative Group and a substantial amount of additional capital. The Bank believes that if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, Holders of existing securities would receive no recovery in respect of their existing securities. As a result, the Bank believes that the outcome of a successful Liability Management Exercise is a substantially more favourable outcome to Holders of any class of existing securities than a resolution of the Bank. • The Bank is exposed to the risk that litigation seeking to challenge the implementation of the Liability Management Exercise could materially impact or prevent the success of the Liability Management Exercise or result in all or part of the Liability Management Exercise being declared unlawful or invalid retrospectively. The success of any such arguments or claims or delay to the implementation of the Liability Management Exercise arising out of any such arguments or claims could result in the failure of the Liability Management Exercise or, if such claims were successful following the implementation of the Liability Management Exercise, could result in the Bank no longer meeting the PRA's requirement that the Bank raise an additional £1.5 billion common equity tier 1 capital. • As a result of the Bank's capital position and its dependency on the success of the Liability Management Exercise, along with other matters and uncertainties, the audit report in respect of the Bank's Interim Financial Information contains an "emphasis of matter" statement to the effect that there is material uncertainty which casts significant doubt on the ability of the Bank to continue as a

going concern. Therefore the Bank believes that the failure of the Liability Management Exercise will result in the Bank ceasing to be a going concern.

Risks relating to the Bank and its business

The Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. Weakness or deterioration in general economic conditions or political instability in the UK or other economies could have a material adverse effect on the Bank's operations, financial condition and prospects.

- ***Risks associated with implementation of the Bank's strategy:*** The difficult situation currently faced by the Bank is unprecedented for the Bank. To improve its financial and operational performance and capital position the Bank has recently adopted a new four to five year business plan. The Bank's newly adopted strategy was developed in a relatively short time-frame, has yet to be implemented and its performance and effectiveness is not yet proven. It is possible that the Bank's strategy may not sufficiently address the Bank's problems or deliver the expected benefits. In addition, the successful implementation of the Bank's strategy requires the simultaneous execution of a number of complex and overlapping changes in a manner that seeks not to negatively impact on the Bank's brand, reputation and customer satisfaction or its relationship with, and ability to retain, its employees. The Bank also does not have a track record of successfully implementing large-scale changes. In addition, notwithstanding the recent strengthening of the board and senior management team, including the appointment of Richard Pym as Chairman of the board and Niall Booker as Chief Executive Officer (amongst others), a number of further appointments are still required. Following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's board and to appoint a new Chief Operating Officer with business transformation experience. Grahame McGirr is currently both head of Co-operative Asset Management and Chief Risk Officer; following completion of the Liability Management Exercise the expectation is that a new Chief Risk Officer will be appointed allowing Grahame McGirr to focus solely on Co-operative Asset Management. In addition, Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank and the Executive Director responsible for the Bank's core business has given notice to terminate his contract and is expected to leave the Bank in March 2014. A replacement will need to be found for Rodney Bulmer. The failure to recruit, or a delay in recruiting, suitable members of the senior management team or the loss of one or more members of senior management without finding suitable replacements may delay or impact on the ability of the

		Bank to successfully implement its strategy, notwithstanding the appointment of additional non-executive directors following completion of the Liability Management Exercise. The Bank is also reliant on the commitment and ability of persons employed by or seconded to the Bank to deliver the strategy and effectively and appropriately implement and support the numerous changes required by the strategy at the same time that significant changes, cost reductions and redundancies are being implemented. As a result, there can be no assurance that the Bank will, over the longer term, be able to successfully implement all or parts of its strategy or implement it when expected or targeted. • In addition, the implementation of the Bank's strategy has a number of specific risks: • The Bank's strategy includes leveraging the Bank's strong and differentiated brand and leading levels of customer satisfaction. The implementation of significant cost reductions, branch closures, redundancies and the reorientation of the Bank's distribution network may have a negative impact on the Bank's brand and levels of customer satisfaction which may, in turn, result in customer attrition. The Bank may also be unsuccessful in achieving the required shift in customer behaviour towards self-service and digital banking such that the Bank will fail to meet its cost saving objectives. Actions taken by the Bank in the implementation of its strategy may inadvertently be, or may be perceived, to be contrary to the principles of the co-operative movement which could negatively impact on the Bank's brand and its relationship with Co-operative Group. • The Bank's strategy also includes improving revenue in its core business in the medium-term through improved pricing of its products, appropriate re-pricing of existing products towards market rates, growing primary account customers in the Bank's key market segments, cross-selling products and growing the volume of higher margin unsecured lending. The Bank's ability to improve revenue in its core business is dependent upon a number of factors, including prevailing macroeconomic conditions (including the level of interest rates), the Bank's relative position versus its competitors and the ability of persons working for the Bank to appropriately cross sell products. • There is also a risk that the recent credit rating downgrades, the Bank's capital shortfall and/or the Bank's disappointing financial results for the six months ended 30 June 2013, continuing press reporting and public scrutiny of the same and of the Recapitalisation Plan and/or actions by the holders of

		the Bank's Existing Securities may, individually or cumulatively, over the longer term have a negative impact on the Bank's brand and reputation. • The Bank's high cost-to-income ratio continues to impact on its profitability and its capital position, and reducing its cost base remains a priority for the Bank. This cost reduction will be delivered through a number of management actions and there is no guarantee that these actions will achieve the intended cost benefits and will be successful or that they will otherwise be delivered on time or when expected. In addition, the reorientation of the Bank's distribution model and its cost reduction programme may negatively impact the Bank's customer service, which may result in customer attrition. • The Bank needs and intends to significantly improve and re-engineer its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks. • The inability of the Bank to deleverage its non-core assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the non-core assets may divert funding from and adversely impact the longer term development and growth of the core business. • A failure or delay in implementing the Bank's strategy or a failure by the Bank to achieve its targets may adversely affect the Bank's business, results of operation, financial position and/or prospects and, in the longer term, its ability to comply with its regulatory capital requirements. • ***Risks associated with implementation of the Bank's non-core business strategy:*** A failure by the Bank to deleverage its non-core assets in a controlled manner in accordance with its strategy may (for example, through greater than currently expected losses from the run-off or sale of non-core assets) negatively impact on the Bank's operating results and financial position (in particular, its net interest margin) and, in the longer term, its ability to comply with its regulatory capital requirements. The failure of the non-core business to deleverage its assets in a controlled manner may also hinder or restrict the longer term development and growth of the core business' business, and divert management attention from the core business. For example, it may restrict the ability of the core business to grow its existing loan portfolios or to expand its growth of other products, such as unsecured lending. In addition,

		notwithstanding the significant impairments already made to the non-core assets, the non-core business also has significant additional impairment risk given the underlying assets, which includes Optimum, a book of predominantly interest-only intermediary and acquired mortgage book assets (as at 30 June 2013, £7.3 billion). Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the non-core assets suffering from more than expected impairments which would adversely impact on the Bank's operating results and financial position (in particular, its net interest margin) and, in the longer term, its ability to comply with its regulatory capital requirements. The non-core business' corporate asset book is also relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total loans outstanding. A significant impairment of any of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position. • ***Risks associated with the 2014 Commitment:*** The commitment of Banking Group to contribute £333 million of common equity tier 1 capital during 2014 (the **2014 Commitment**), in addition to being conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group to fund the commitment (supported by Co-operative Group), which is dependent on certain actions which are partially outside the control of Banking Group. In the event that Banking Group is unable to meet its obligations under the 2014 Commitment and is also unable to draw down on its support from Co-operative Group, Banking Group will be in breach of its obligations under the 2014 Commitment with the consequence that the Bank may have insufficient common equity tier 1 capital by 2014 to meet the PRA's requirements. • ***Risks associated with the Bank's requirement to maintain adequate regulatory capital, and with future changes to its regulatory capital requirements:*** The Bank is required to maintain adequate regulatory capital and capital ratios at all times. The Bank may require further capital and liquidity to meet new international capital and liquidity requirements (such reforms being commonly referred to as Basel III) as implemented in the EU through the introduction of the Prudential Requirements Regulation (the **PRR**) and a further iteration of the Capital Requirements Directive (the **PRD** and together with the PRR, **CRD IV**) beyond the level that the Bank has currently forecast and taken account of as part of the development of the Recapitalisation Plan and/or the implementation of (i) ring-fencing in the UK as currently proposed in the Financial Services (Banking Reform) Bill (the **Banking Reform Bill**) and (ii) the minimum requirement for eligible liabilities under the provisions of the European Commission's legislative

		proposal for a directive providing for the establishment of an EU-wide framework for the recovery and resolution of credit institutions and investment firms (the **RRD**) could also potentially impact the capital position of the Bank and require additional regulatory capital to be raised by the Bank. The actual impact of CRD IV on the Bank's capital requirements is also dependent on the European Banking Authority's technical standards, a large number of which are yet to be finalised. Based on its current understanding of how CRD IV will be implemented in the UK, the Bank believes it will, following the completion of the Recapitalisation Plan, be in compliance with the requirements of CRD IV upon their implementation. However, the risk that the final content of these technical standards may differ materially from current expectations cannot be excluded. There is also a risk of the introduction by the PRA of higher regulatory capital requirements on major UK banks. These risks that the final content of these technical standards may differ from the Bank's current expectations and/or that the PRA introduces higher regulatory capital requirements on the Bank than currently anticipated are not currently quantifiable and so have not been accounted for by the Bank. As a result, the Bank may become subject to regulatory capital requirements not currently anticipated or provided for. In addition, the regulatory position of the Bank may, in the future, be adversely affected by a currently unanticipated adverse economic and market environment and/or increasing interest rates in the UK or elsewhere, which may: (i) result in a deterioration in the quality of the Bank's assets; (ii) adversely impact the Bank's access to funding and capital, and (iii) negatively impact on unemployment, house prices and other factors, each of which may lead to lower than anticipated profits and higher than anticipated impairments. • The Bank is not compliant with its Individual Capital Guidance (**ICG**), although the Bank does meet its Pillar 1 requirements. The Bank has discussed, and agreed, with the PRA the Bank's recently adopted four to five year business plan which contemplates that the Bank will meet its ICG by the end of the plan period. The Bank's business plan envisages that the Bank will raise approximately £400 million by way of additional tier 2 capital during the business plan period. • Effective management of the Bank's capital is critical to its ability to operate and grow its business and to pursue its strategy. Any change that limits the Bank's ability to manage effectively its balance sheet and capital resources could have a material adverse impact on its business, financial condition, results of operations, liquidity and/or prospects. In the event that the impact of any of the new Basel III regulatory capital and liquidity requirements is greater than is currently anticipated by management, and if the Bank, as a consequence, were to suffer a shortage of

		regulatory capital, the Bank would expect to enter into discussions with the PRA and consider what actions to take in light of such circumstances, taking into account the regulatory capital position and requirements of the Bank at that time. Any such discussions with the PRA could take some time before agreement is reached. Any such actions, or any delay in implementing such actions or in agreeing them with the PRA, may have a material adverse effect on the Bank and its business. Possible actions might include accelerating the non-core business's asset disposal plan. Failure by the Bank to maintain adequate regulatory capital could lead to an inability of the Bank to support its business operations and implement its strategy, meet regulatory requirements, implement its investment plans, raise (in the medium term) further capital, make distributions, and could result in further changes to its credit ratings. Such consequences could, in turn, have a material adverse effect on the Bank's business, operating results, financial condition and prospects. A regulatory capital shortfall may result in the Bank being subject to a resolution procedure under the Banking Act. • ***Liquidity risk:*** The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail and corporate deposits and, to a lesser extent, unsecured wholesale funding (these being the principal sources of the Bank's funding) become limited and/or more expensive. This may result in an inability to operate in the ordinary course, and/or a failure to meet liquidity requirements, and/or may adversely impact the Bank's business and/or the implementation of its strategy. Given that the Bank's main source of funds is deposits, the Bank faces the risk of not being able to replace funds when they are withdrawn or, should a significant number of depositors seek to withdraw their funds, of not being able to meet its obligations to fund such withdrawals, repay lenders in accordance with its financing arrangements or fulfil commitments to lend. However, notwithstanding the steps that the Bank has taken to maintain its levels of total liquidity, given the reliance by the Bank on its customer deposits to provide funding for the Bank, any severe decline in customer confidence in the Bank could increase the amount of deposit withdrawals in a short space of time or over a sustained period. Given the relative size of the Bank's deposit base as compared with its other sources of funding, the Bank is particularly exposed to any serious loss of confidence by its depositors. Should the Bank experience an unusually high level of withdrawals which exceed the Bank's ability to manage through the application of its liquidity controls and contingency planning, this may have an adverse effect on the Bank's day-to-day operations, maintain the Bank's planned lending which may have an adverse effect on the Bank's business, results and financial position and could, in extreme circumstances, prevent the Bank from meeting its financial

		obligations as they fall due, meeting its regulatory minimum liquidity requirements or fulfilling its commitments to lend. In such circumstances, the Bank may be subject to a resolution procedure under the Banking Act. The credit rating downgrade experienced by the Bank has: (i) led to sub-investment grade ratings on the Bank's senior debt leading to a significant reduction in the demand for these types of instrument; (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding; and (iii) increased the Bank's collateral requirements used in the clearing systems. In addition, the total amount of the Bank's corporate deposits also fell by approximately £1.4 billion in the first half of 2013, probably caused by the credit rating downgrade. To a lesser extent, the Bank's regulatory capital shortfall, its disappointing results for the six months ended 30 June 2013, and the continued press attention and speculation to which the Bank is subject have also affected the Bank's funding profile and the cost to the Bank of raising new funding. This continued impact on access to funding and increased cost of funding may, over the longer term, have adverse effects on the Bank's business, financial performance or future prospects and/or adversely affect the Bank's ability to achieve its strategic objectives. • In addition, whilst the Bank's retail deposit base has remained broadly stable (in appropriate circumstances, the Bank has managed its retail offering to mitigate against the risk of depositors withdrawing funds), a failure by the Bank to achieve its strategy, a deterioration in the Bank's operating results or financial position, or the continued press attention and speculation to which the Bank is subject may in extreme circumstances result in a severe decline in customer confidence which could result in the withdrawal of retail funds. • ***Credit risk:*** The Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. These risks have been enhanced by the period of significant turbulence and uncertainty affecting the global economy and the global financial system, and the Eurozone in particular (including the risk of a break-up of the single European currency). The Bank continues to be exposed to these risks and their consequences, including lower consumer confidence, high levels of unemployment, interest rate volatility and increased cost of credit, which may result in significantly lower revenues and/or greater than expected losses which could have a material adverse effect on the Bank's operations, financial condition and prospects. • ***Changes in laws and regulations and regulatory risk:*** The Bank is subject to wide-ranging legal and regulatory

		(including liquidity and capital) requirements and supervision. There is a risk that changes to the legal and regulatory environment may result in additional compliance costs (including the raising of further capital and/or liquidity) and diversion of management time and resources, which may adversely affect the Bank's business, strategy and prospects. In addition, failure to comply with such requirements may result in investigations, disciplinary action, fines, reputational damage and the revocation of the Bank's licences, permissions or authorisations which could have a material adverse effect on the Bank's operations, financial condition and prospects. Known future changes in legislation include the new capital regime commonly known as Basel III which will be implemented in the UK pursuant to CRD IV (as described above) and which will be effective from 1 January 2014. • ***Risk of litigation against the Bank:*** The Bank faces the risk that the past, current or future actions of the Bank (including in respect of the implementation of the Recapitalisation Plan, and the Liability Management Exercise of which it is a part) may result in litigation. The Bank is currently co-operating with enquiries received from the Conduct Committee of the Financial Reporting Council relating to the Bank's disclosures in its 2012 annual report and the accounts of the Bank's regulatory capital position, amongst other matters, and the FCA with respect to the Bank's compliance with the FCA's Disclosure and Transparency Rules. In addition, on 12 July 2013, Co-operative Group and the Bank announced the launch of an independent review, to be chaired by Sir Christopher Kelly, into the events that led to the recent announcement of the Recapitalisation Plan to address the Bank's £1.5 billion capital shortfall, the decision to merge the Bank with Britannia in 2009 and the proposed acquisition of the Lloyds TSB branches (the **Kelly Review**). The Kelly Review will include an analysis of strategic decision-making, management structures, culture, governance and accounting practices and aspects of the role of the Bank's auditors. The intention is to present the findings of the Kelly Review to Co-operative Group's members at its annual general meeting in May 2014. The Bank may face additional investigations or proceedings arising out of the Kelly Review. Any of these risks, should they materialise, could have an adverse impact on the Bank's operations, financial results, condition and prospects, and the confidence of the Bank's customers in the Bank, as well as taking a significant amount of management time and resources away from the implementation of the Bank's strategy. • ***Conduct risk:*** The Bank is exposed to risks relating to the mis-selling of financial products, acting in breach of legal or regulatory principles or requirements and giving negligent advice. Any failure to manage these risks

		adequately could lead to significant liabilities and/or reputational damage. In addition, the Bank faces both financial and reputational risk where legal or regulatory proceedings are brought against it or members of its industry generally, or where complaints are made against it or members of the industry generally to the Financial Ombudsman Service or another relevant body. Sustained conduct reputational damage could affect the Bank's operations, financial condition and prospects. • ***Pensions:*** The main Co-operative Group pension scheme is The Co-operative Pension Scheme (Pace) (**Pace**), in which the Bank participates. At present there is an actuarial deficit in Pace: the most recent actuarial report indicated that there was a funding deficit of £715 million as at 5 April 2013. Contributions towards the deficit are agreed between the Co-operative Group and the scheme trustee following the advice of the independent scheme actuary. However, Co-operative Group has undertaken to agree with the Bank its proportion of the employer contributions in Pace (if not agreed, the matter will be referred to an independent third party). CFSMS is the employer in relation to the Britannia Scheme and charges the Bank for any payments due to the scheme in respect of members employed by CFSMS and working for the Bank. In addition, the Bank has provided guarantees in respect of the Britannia Scheme under which the Bank may become liable to contribute towards that scheme. However, Co-operative Group has undertaken to procure that if CFSMS is not controlled by the Bank, CFSMS will not take or omit to take any action without the Bank's prior agreement if the result would be to increase the Bank's liabilities or contributions in respect of the Britannia Scheme. The most recent actuarial report indicated that the funding deficit in the Britannia Scheme as at 5 April 2013 was £61 million. There are risks associated with the pension schemes due to the value of the asset portfolios and returns from them being less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities. In addition, Pace is a non-segregated, hybrid pension scheme in which several Co-operative Group companies participate, including the Bank. On an on-going basis, each employer is responsible for funding a proportion of the Pace liabilities. In addition, an exit debt is payable where an employer exits Pace and this liability is a material risk for the Bank if it exits Pace following the LME. However Co-operative Group has undertaken not to exercise its powers without the Bank's prior written approval except (i) where the Bank is in breach of the rules of Pace, (ii) where required by law or (iii) where all other employers cease participation at the same time so that a liability of this type does not arise. There are other circumstances in which funding from an employer may be required for liabilities relating to members' service with another employer. In particular, where other employers in Co-operative Group have ceased

		to participate in the pension scheme without satisfying their liabilities (for example due to insolvency) the Bank's share of the deficit could include liabilities relating to those other employers, up to the level of the entire buy-out deficit in the scheme. These additional liabilities could have an adverse impact on the Bank's operations, financial condition and prospects. • ***Information technology:*** The Bank needs and intends to progressively re-engineer its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks. Any failure in systems as a result of not mitigating the IT risks, or in the period prior to such remediation being completed, could adversely affect the Bank's ability to conduct its business and lead to regulatory focus on the Bank, which may impact on the Bank's operations, financial condition and prospects. The Bank is also, and will continue to be, dependent on the use of third-party IT, software, data and service providers, including Co-operative Group. A failure on the part of either Co-operative Group or a third party to provide the agreed services could have an adverse impact on the Bank's operations, financial condition and prospects.
D.3	**Key risks regarding the Notes**	• ***The Notes are not protected by the Financial Services Compensation Scheme (FSCS):*** Unlike a bank deposit, the Notes will not be protected by the FSCS. As a result, if the Bank does go out of business or becomes insolvent, or if the United Kingdom authorities take action under the Banking Act (or similar future legislation) to preserve or restore the viability of the Bank, the FSCS will not pay compensation to an investor. Accordingly, in such circumstances, an investor in the Notes may lose some, or the entire amount, of its investment in the Notes. • ***The Notes are subordinated obligations of the Bank:*** The Notes will constitute unsecured and subordinated obligations of the Bank. On a winding-up or dissolution of the Bank, claims in respect of the Notes would rank behind the claims of all depositors and other unsubordinated creditors of the Bank. In a winding-up, the assets of the Bank would be applied first in satisfying all senior ranking claims in full, and payments would be made to holders of the Notes, proportionately with payments made to holders of any other equally ranking instruments (if any), only if and to the extent that there were any assets remaining after satisfaction in full of all such senior ranking claims. • ***The Notes may become subject to provisions enabling the UK authorities to convert the Notes to equity or write-down or write-off the principal amount of the Notes, and/or the UK authorities may exercise existing powers under the Banking Act:*** There are current proposals both in the European Union (through the RRD) and in the United Kingdom (such proposals were announced by HM Treasury on 1 October 2013) which, if implemented in the United

		Kingdom, will enable the UK authorities to convert an instrument issued by the bank from one form or class to another (for example, a debt instrument into equity), to write down or write off instruments such as the Notes in certain circumstances relating to preserving or restoring the stability of the financial systems in the UK, the protection and enhancement of public confidence in the stability of the banking systems of the UK and/or the protection of depositors. If implemented in the United Kingdom, the use of any such powers could result in Noteholders losing some, or potentially all, of their investment in the Notes, even if the Bank does not become insolvent. In addition, the UK authorities already have considerable powers under the Banking Act to resolve a bank which is failing (or likely to fail) the threshold conditions for its authorisation to conduct banking business. These powers include, but are not limited to, the power to modify or annul the effect of an instrument or to convert securities from one form or class to another through the making of a share transfer instrument or order in respect of a bank. If the United Kingdom authorities take action under the Banking Act, Noteholders may also lose some or potentially all of their investment in the Notes. • ***Rights of enforcement in respect of the Notes are limited:*** The only events of default under the terms of the Notes are failure to pay interest or principal when due and the winding-up of the Bank. Further, the Noteholders will have limited rights to enforce default, and will only have direct rights of enforcement in the event that the Trustee representing the Noteholders fails to act having become bound to do so. • ***The conditions of the Notes contain provisions which may permit their modification without the consent of all investors:*** The terms of the Notes provide for the calling of meetings of Noteholders at which, subject to certain requirements regarding the conduct of the meeting, a specified majority of the holders present and voting may approve amendments to the terms of the Notes in a manner which will bind all holders (whether or not present at the meeting and/or voting in favour) and such amendments could have a material adverse effect on the Notes and/or the rights of Noteholders under the Notes. • ***There can be no assurance that a secondary market in the Notes will develop:*** The Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. The market price of Notes can go down as well as up, and Noteholders may be unable to sell their Notes, or may only be able to sell them at a loss.

<table>
<tr><th colspan="3">Section E – Offer</th></tr>
<tr><th>Element</th><th>Title</th><th></th></tr>
<tr><td>E.2b</td><td>Reasons for the Offer and use of proceeds when different from making profit and/or hedging certain risks</td><td>The offer of the Notes forms part of the Liability Management Exercise, which is being conducted in order to raise at least £1 billion of common equity tier 1 capital for the Bank as part of its wider Recapitalisation Plan to generate £1.5 billion of common equity tier 1 capital. The Recapitalisation Plan is being implemented to ensure that the Bank has sufficient common equity tier 1 capital to meet its regulatory obligations, to minimise the risk of being resolved under the Banking Act and to ensure it can continue as a going concern.

Common equity tier 1 capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses. As a direct result of the recent global financial crisis, the PRA, in line with banking regulators around the world, is requiring UK banks to bolster their capital resources so that the banks, and the UK banking system generally, is better able to withstand future losses and financial shocks.

As the Notes are being offered in connection with an exchange for the Dated Notes of the Bank and 5.5555% Bonds of the Bank, the issue of the Notes will not generate cash proceeds. However, the Notes are being offered in exchange for the Dated Notes of the Bank and the 5.5555% Bonds of the Bank at a discount to the Bank’s book value for those securities, which will generate common equity tier 1 capital to the extent that the liability is reduced to less than such book value.</td></tr>
<tr><td>E.3</td><td>Terms and conditions of the offer</td><td>The offer of the Notes (also referred to in this section as the Bank T2 Notes) is part of the Liability Management Exercise.

The Notes will be issued at the issue price (which is 100% of the principal amount of the Notes) only upon successful completion of the Liability Management Exercise, and no Notes will be issued if the Liability Management Exercise does not successfully complete.

If the Liability Management Exercise is successful and settles on 18 December 2013, the maximum principal amount of Notes which may be issued is expected to be £206,000,000.

The final principal amount of Notes to be issued (if any) will be announced by the Bank via the Regulatory News Service (RNS) operated by the London Stock Exchange, which announcement is currently expected to be made on or around 12 December 2013 or, in the event that any meeting pursuant to the Proposals (as defined below) is adjourned, is currently expected to be made on or around 30 December 2013.

Introduction
The Liability Management Exercise is being conducted in respect of the Preference Shares, the 13% Bonds, the 5.5555% Bonds and the Dated Notes (each as defined below) (together, the Existing Securities).</td></tr>
</table>

		Holders who are eligible to participate in the Exchange Offers for the Preference Shares, 13% Bonds and 5.5555% Bonds in accordance with applicable securities laws are referred to below as **Eligible Holders**. The Liability Management Exercise consists of the Exchange Offers, the Proposals and the Scheme described below. The **Exchange Offers** consist of: • an invitation to Eligible Holders of the Bank's outstanding 9.25 per cent. Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) (the **Preference Shares**) and 13 per cent. Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) (the **13% Bonds**) to either: (a) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or (b) offer to sell their Preference Shares and 13% Bonds to Co-operative Group for cash consideration payable in twelve equal instalments over twelve years and represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; and • an invitation to Eligible Holders of the Bank's outstanding 5.5555 per cent. Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) to offer to exchange their 5.5555% Bonds for Bank T2 Notes. The **Proposals** consist of the convening of meetings of the holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to vote on resolutions which, if passed, will, amongst other things (i) enable the Bank to mandatorily effect the exchange (or transfer to Co-operative Group), of any remaining Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable) on the same economic terms as the terms of the relevant Exchange Offer(s) and (ii) result in holders agreeing to certain waivers and releases in favour of the Bank, Co-operative Group, their respective directors and certain other persons. In addition, the holders of the Preference Shares will be asked to vote on a resolution which, if passed, will enable the Bank to purchase and cancel any share capital of the Bank (which would include Preference Shares) from time-to-time without any further consent of such holders being needed. It is a term of the Exchange Offers that any holder who offers to exchange (or sell to Co-operative Group) its Preference Shares, 13% Bonds or 5.5555% Bonds in the Exchange Offers will also vote in favour of the resolutions proposed at the relevant meeting. If such resolutions are passed and implemented by the Bank they will

		bind all holders of the relevant Existing Securities, including those who did not vote in favour of the Proposals. The **Scheme** is a scheme of arrangement under Part 26 of the Companies Act 2006. Pursuant to the Scheme, the holders of seven series of lower tier 2 subordinated bonds of the Bank (the **Dated Notes**) will vote on proposals which, if approved by the requisite statutory majorities and sanctioned by the court and if the Settlement Condition is satisfied, will result in all of the Dated Notes (and accrued but unpaid interest on the Dated Notes up to a specified record date) being exchanged for a combination of Bank T2 Notes and new ordinary shares in the Bank (**New Ordinary Shares**). The holders of the Dated Notes will also be entitled to elect to subscribe for 62,500,000 additional New Ordinary Shares for an aggregate consideration equal to £125 million, pursuant to, and on the terms of, the Scheme and, to the extent any such additional New Ordinary Shares are not subscribed, certain holders of Dated Notes have agreed to purchase them. ***Conditionality of the Liability Management Exercise*** The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013. In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise (i) each of the Proposals in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds must be approved by the Holders thereof at meetings convened for the purposes of voting on such Proposals (and, in the case of the Preference Shares, a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and the Proposals must be capable of being implemented in accordance with their terms, and (ii) the Scheme must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme meeting and sanctioned by the Court, an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House and the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition) (together referred to as the **Settlement Condition**). ***Offer period*** The offer period for the Liability Management Exercise is expected to commence on 4 November 2013 and end at 4.30 p.m. (London time) on 6 December 2013 (or such later date and time to which the Bank and Co-operative Group may extend the offer period by publication of a supplement to the Prospectus). However, in order to incentivise holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to participate in the Liability Management Exercise early, if the Early Participation Threshold is achieved by 4.30 p.m. (London time) on 29 November 2013

		(the **Early Participation Deadline**), all such holders will (if the Liability Management Exercise settles) receive more Bank T2 Notes or Group Notes on the exchange (or sale) of their Preference Shares, 13% Bonds and 5.5555% Bonds than if the Early Participation Threshold is not achieved by the Early Participation Deadline. The **Early Participation Threshold** will be achieved by the Early Participation Deadline only if, by that time, at least 75 per cent. of the aggregate nominal amount outstanding of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds has been validly offered for exchange (or sale) and/or otherwise validly voted in favour of the Proposals (and not revoked). Settlement of the Liability Management Exercise (the date on which, if the Settlement Condition is satisfied, Existing Securities will be exchanged or sold) is currently expected to be on 18 December 2013. The Bank and Co-Operative Group are entitled to amend the timetable at their discretion (subject where relevant to the approval of the Court in relation to the Scheme), and will announce any amendments by publication of a supplement to the Prospectus. ***Offer Terms*** *Preference Shares* Eligible Holders of Preference Shares are being invited either: • to offer to transfer their Preference Shares to Co-operative Group in exchange for Final Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of Preference Shares exchanged, (i) £601 in principal amount of Final Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £551 in principal amount of Final Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding); or • to offer to sell their Preference Shares to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025 and which will be represented by Instalment Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of Preference Shares sold to Co-operative Group, (i) £1,110 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £1,060 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding). Such holders will also receive a cash amount equal to accrued but unpaid dividends on their Preference Shares from 30 November 2013, up to the Settlement Date.

		The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise). Under the terms of the Preference Shares, the Bank will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each holder in lieu of cash payment (**Additional Preference Shares**). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday). However, if the Liability Management Exercise successfully completes, then upon transfer to Co-operative Group of those Additional Preference Shares, the relevant holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash (in pounds sterling) equal to the cash dividend which the Bank would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares. *The references above to an exchange (or sale) of £1,000 in nominal amount of Preference Shares are for illustrative purposes only. Holders of Preference Shares will be able to offer to exchange (or sell) Preference Shares in any whole multiple of £1, subject to a minimum of £2 if such holder elects the Final Repayment Notes option. There is no minimum offer amount for the Instalment Repayment Notes option.* *13% Bonds* Eligible Holders of 13% Bonds are being invited either: • to offer to transfer their 13% Bonds to Co-operative Group in exchange for Final Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of 13% Bonds exchanged, (i) £844 in principal amount of Final Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £794 in principal amount of Final Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding); or • to offer to sell their 13% Bonds to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025 and which will be represented by Instalment Repayment Notes. Holders electing this option will receive, per £1,000 in nominal amount of 13% Bonds sold to Co-operative Group, (i) £1,560 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is achieved by the Early Participation Deadline; or (ii) £1,510 in principal amount of Instalment Repayment Notes if the Early Participation Threshold is not achieved by the Early Participation Deadline (in each case subject to rounding).

Such holders will also receive a cash amount equal to accrued but unpaid interest on their 13% Bonds from 31 July 2013 up to the Settlement Date.

Upon successful completion of the Liability Management Exercise the Bank will also pay to all holders of the 13% Bonds the deferred interest payment originally scheduled for 31 July 2013.

The specified denomination of each 13% Bond is £1,000. Accordingly, 13% Bonds must be offered for exchange (or sale) in principal amounts equal to £1,000 or a whole multiple of £1,000.

5.5555% Bonds

Eligible Holders of the 5.5555% Bonds will be invited to offer to exchange their 5.5555% Bonds for Bank T2 Notes at the following exchange ratios:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, £530 in principal amount of Bank T2 Notes for every £1,000 in principal amount of 5.5555% Bonds exchanged; or
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, £480 in principal amount of Bank T2 Notes for every £1,000 in principal amount of 5.5555% Bonds exchanged.

Such holders will also receive a cash amount equal to accrued but unpaid interest on their 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date.

The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully completes, the Bank will (in addition to the accrued interest referred to in the paragraph above) pay the deferred interest payment originally scheduled for 14 December 2013.

The specified denomination of each 5.5555% Bond is £1,000. Accordingly, 5.5555% Bonds must be offered for exchange in principal amounts equal to £1,000 or a whole multiple of £1,000.

Dated Notes

Holders of the Dated Notes will, if the Scheme is sanctioned and implemented, be entitled to receive Bank T2 Notes and New Ordinary Shares in exchange for their Scheme Claim at approximately the following exchange ratio:

- £102.63 in principal amount of Bank T2 Notes and 115 New Ordinary Shares for every £1,000 of its Scheme Claim.

A holder's claim in the Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme

		Record Date; provided that a Holder's Scheme Claim in respect of any Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the sterling equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00. The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled. The Scheme Record Date (the **Scheme Record Date**) is currently expected to be 10 December 2013. The principal amount of Bank T2 Notes and the number of New Ordinary Shares which such holder will receive will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. The holders of the Dated Notes will also be entitled to elect to subscribe for 62,500,000 additional New Ordinary Shares for an aggregate consideration of £125 million pursuant to, and on the terms of, the Scheme. ***Delivery of Bank T2 Notes, Group Notes and New Ordinary Shares*** The Bank T2 Notes, Group Notes and New Ordinary Shares will be capable of being held and traded (i) in uncertificated form in CREST; (ii) in uncertificated form in Euroclear and Clearstream, Luxembourg (via CREST); and (iii) in certificated form outside the clearing systems. Eligible Holders of Preference Shares, 13% Bonds and 5.5555% Bonds and holders of Dated Notes who offer to exchange or sell their securities in Euroclear, Clearstream, Luxembourg or CREST will (subject as provided under "*Holding Period in respect of Dated Notes*" below) receive interests in their new Bank T2 Notes, Group Notes and/or New Ordinary Shares (as the case may be) in the same securities account as that in which they currently hold their Preference Shares, 13% Bonds, 5.5555% Bonds or Dated Notes (as applicable). Where holders currently hold Preference Shares, 13% Bonds or 5.5555% Bonds in certificated form outside Euroclear, Clearstream, Luxembourg and CREST, any Bank T2 Notes and Group Notes (as applicable) to be delivered to them will be delivered in certificated form outside Euroclear, Clearstream, Luxembourg and CREST. ***Holding Period in respect of Dated Notes*** If any holder of Dated Notes fails to comply with certain procedures in connection with the Scheme, the Bank T2 Notes and New Ordinary Shares to which such holder would become entitled pursuant to the Scheme will be transferred to Lucid Issuer Services Limited in its capacity as holding period trustee (the **Holding Period Trustee**).

		The relevant Bank T2 Notes and New Ordinary Shares will be held on trust by the Holding Period Trustee pending: (a) confirmation for or on behalf of the relevant holder of the Dated Notes that it or its Designated Recipient is eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the Holding Period Trustee will transfer the relevant Bank T2 Notes and New Ordinary Shares to the relevant holder of the Dated Notes or its Designated Recipient; (b) confirmation for or on behalf of the relevant holder of the Dated Notes that it is not eligible to receive the Bank T2 Notes and the New Ordinary Shares, at which time the relevant Bank T2 Notes and New Ordinary Shares will be sold by or on behalf of the Holding Period Trustee and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the relevant holder of the Dated Notes; and (c) the date falling 36 months following the Scheme Settlement Date, at which time the Holding Period Trustee will sell or procure the sale of the Bank T2 Notes and New Ordinary Shares not already distributed or sold as described in paragraphs (a) and (b) above and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the Bank. **Designated Recipient** means a person nominated by a holder of Dated Notes to receive the New Ordinary Shares and Bank T2 Notes which such holder is entitled to receive pursuant to the terms of the Scheme.
E.4	**Material Interests to the Offer, including conflicting Interests**	The Bank is as, at the date of this Prospectus, a subsidiary of Banking Group. Following completion of the Liability Management Exercise, Banking Group is expected to have a 30 per cent. holding in the Bank's ordinary shares. As a result, Banking Group and, indirectly, Co-operative Group, are expected to continue to be able to exercise influence over matters requiring shareholder approval. HSBC Bank plc (**HSBC**) has been appointed as a dealer manager and adviser to the Bank, and UBS Limited (**UBS**) has been appointed as a dealer manager, to facilitate the Liability Management Exercise. HSBC will be paid fees and expenses by the Bank in connection with the Liability Management Exercise. Each of UBS and HSBC and their respective affiliates may also have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform other services for, the Bank and its affiliates in the ordinary course of business.
E.7	**Estimated expenses charged to the investor by the Issuer**	Not applicable. There are no expenses to be charged to the investor (being the Existing Holders) by the Bank.

2

RISK FACTORS

The following section contains a description of certain factors which the Bank believes may affect its ability to fulfil its obligations under the Notes.

The factors include risks relating to the Bank's business and financial condition, the specific features of the Notes and how they will be held by investors, and risks relating to the markets generally which could impact the market price of Notes.

In addition, the following section describes certain risks associated with the Liability Management Exercise, including risks which relate to the possible consequences for holders of Existing Securities in the event that the Liability Management Exercise is not successfully implemented.

RISK FACTORS

Holders and other prospective investors should carefully consider the factors and risks associated with the Liability Management Exercise, any investment (whether by way of the Scheme or otherwise) in the Notes, the Bank's business and the financial services industry in the United Kingdom (the ***UK****) in which the Bank operates, together with all the other information contained in this document and all of the information incorporated by reference into this document, including, in particular, the risks and uncertainties described below. Holders and other prospective investors should note that the risks relating to the Liability Management Exercise, the Bank, the financial services industry in the UK and the Notes summarised in the section of this Prospectus headed "Summary" are risks that the Bank believes to be the most essential to an assessment by a Holder of whether to consider an investment in the Notes. However, as the risks which the Bank faces relate to events and depend on circumstances that may or may not occur in the future, Holders should consider not only the information on key risks summarised in the section of this Prospectus headed "Summary" but also, among other things, the risks and uncertainties described below.*

This section describes the risk factors which are considered by the Bank to be material to the Bank and the decision to participate in the Liability Management Exercise or otherwise decide to make an investment in the Notes. However, these risk factors should not be regarded as a complete and exhaustive statement or explanation of all potential risks and uncertainties which Holders may face when making a decision with respect to participation in any part of the Liability Management Exercise (including making a decision in respect of the Scheme or otherwise) or any other investment in respect of Notes and should be used as guidance only. There may be other risks and uncertainties which are currently not known to the Bank or which the Bank currently does not consider to be material. Should any of the risks described below, or any other risks or uncertainties, occur this could, individually or cumulatively, have a material adverse effect on the Bank's business, results of operation, financial condition or prospects which in turn would be likely to cause the price of the Notes to decline and, as a result, a Holder could lose some or all of its investment. Holders should consider carefully whether or not to participate in any part of the Liability Management Exercise such that they will acquire Notes (including making a decision in respect of the Scheme or otherwise) is suitable for them in the light of the information contained in this Prospectus and their personal circumstances. The risk factors, amongst other things, consider the implications for Holders in the event that the Liability Management Exercise fails, which would occur if sufficient numbers of Holders decided not to participate in the Liability Management Exercise, such that not all of the Existing Securities would be able to be exchanged (or purchased) by the Bank or Co-operative Group pursuant to the Liability Management Exercise.

This section of the Prospectus is divided into three main sections – "Risks Relating to the Liability Management Exercise", "Risks Relating to the Bank and its Business" and "Risks Relating to the Notes".

RISKS RELATING TO THE LIABILITY MANAGEMENT EXERCISE

The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009. In such circumstances, Holders of Existing Securities could potentially have no recovery at all in respect of their investment in the Existing Securities.

Background to the Liability Management Exercise

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid by 31 January 2014) and the remaining £163 million by 31 December 2014.

On 17 June 2013, the PRA made the following statement:

"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5 billion in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative Group to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion of Common Equity Tier 1 Capital following the announcement of the Bank's interim results for the six month period ended 30 June 2013. The PRA also reconfirmed that this requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress. The Liability Management Exercise is intended to generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 Capital by the end of 2013. Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged or sold pursuant to the Liability Management Exercise.

The contributions that a successful Liability Management Exercise would provide by the end of 2013 would increase the Bank's Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496.0 million incurred for the six month period ended 30 June 2013 and potential impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

The Liability Management Exercise is expected to generate at least £1 billion of the £1.5 billion of Common Equity Tier 1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital; and
- second, to the extent that Existing Securities are exchanged or issued for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), Common Equity Tier 1 Capital will also be generated as a consequence of that discount (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

See the Offer Memorandum, which is appended to and forms part of this Prospectus, for full terms of the Liability Management Exercise, including a description of the Existing Securities which are the subject of the Liability Management Exercise.

Overview of principal risks to the implementation of the Liability Management Exercise

The principal risks to the successful implementation of the Liability Management Exercise are:

- The failure of Holders to participate in the Liability Management Exercise in sufficient numbers such that the Liability Management Exercise fails.
- Any of the HM Treasury, the Bank of England, the FCA and/or the PRA (the **Authorities**) concluding that the aggregate £1.5 billion of Common Equity Tier 1 Capital to be contributed pursuant to the Recapitalisation Plan is inadequate to meet the Bank's regulatory capital requirements and that, as a result, further steps are required to be taken by the Bank to generate additional Common Equity Tier 1 Capital or additional total capital. Should the Authorities reach such a conclusion, the Bank may decide not to proceed with the Liability Management Exercise and/or Holders may elect not to participate in the Liability Management Exercise, with the consequence that the Liability Management Exercise is not successfully implemented.
- The Bank and/or the Co-operative Group becoming involved in disputes and legal proceedings in respect of the Liability Management Exercise. Such disputes or proceedings could be brought or

raised during the implementation of the Liability Management Exercise following publication of this Prospectus with the objective of preventing the implementation of all or part of the Liability Management Exercise and/or could be brought after the Liability Management Exercise has been implemented with the objective of seeking a declaration that all or part of the Liability Management Exercise was unlawful and invalid. Further information on the risk of litigation is contained in the risk factor titled "*Litigation seeking to challenge the implementation of the Liability Management Exercise or certain aspects of it could materially impact or prevent the successful implementation of the Liability Management Exercise or result in all or part of the Liability Management Exercise being declared to be unlawful and invalid retrospectively*."

In the event that the Liability Management Exercise is not successfully implemented, the Bank would fail to comply with the PRA's stated requirement that the Bank raise an additional £1 billion of Common Equity Tier 1 Capital by 31 December 2013. In addition, Banking Group's undertaking to contribute £333 million additional Common Equity Tier 1 Capital in 2014 would terminate as it is conditional upon the success of the Liability Management Exercise. Co-operative Group will not provide any capital contribution to meet the Bank's regulatory capital shortfall unless the Liability Management Exercise is successfully implemented (i.e. all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise).

Consequences of a failure of the Liability Management Exercise

Whilst in the event of the Liability Management Exercise being unsuccessful the Bank would take immediate action to try to address the Bank's capital shortfall, including holding urgent discussions with the PRA, the Bank believes that, in such circumstances, the failure of the Liability Management Exercise would result in the Bank becoming subject to a resolution procedure under the Banking Act 2009 (the **Banking Act**). In the event that the Authorities exercise their powers under the Banking Act or there is market speculation regarding the occurrence of such an event, it is highly probable that the Bank would be materially adversely affected and the market price of Existing Securities would be materially adversely affected. The Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank remains a going concern without the active participation of Co-operative Group and a substantial amount of additional capital. The Bank believes that if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, Holders of Existing Securities would receive no recovery in respect of their Existing Securities. As a result, the Bank believes that the outcome of a successful Liability Management Exercise is a substantially more favourable outcome to Holders of any class of Existing Securities than a resolution of the Bank. For further information on the consequences for Holders of a resolution of the Bank see "*Part C – Potential consequences of Holders failing to support the Liability Management Exercise*" in Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*).

Failure of Holders to participate in the Liability Management Exercise

The Liability Management Exercise will only be successfully completed if (and is therefore conditional upon) the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise. If this condition is not satisfied, the Liability Management Exercise will not be implemented and, furthermore, Banking Group will not be required to contribute £333 million of Common Equity Tier 1 Capital in 2014.

Part of the Liability Management Exercise will be conducted by way of the Scheme in respect of the Dated Notes. The Bank intends to propose that Holders of the Dated Notes should vote on the Scheme as a single class of creditors. In order to approve the Scheme, a majority in number of Holders of the Dated Notes, representing at least 75 per cent. in value of the Holders of the Dated Notes present in person or by proxy and voting at the Scheme Meeting, will need to approve the Scheme. Even if the Scheme is approved at the Scheme Meeting, it is possible for a person with an interest in the Scheme (whether a Holder or otherwise) to object to the Scheme and to attend or be represented at the Court hearing to sanction the Scheme in order to make representations that the Scheme should not be approved and to appeal against the granting of the Court order sanctioning the Scheme. Therefore, it is possible that objections will be made at or before the Court hearing or that an appeal will be made against the granting of the order by the Court and that any such objections or appeal will delay or possibly prevent the implementation of the transactions contemplated by the Scheme.

In order for the Scheme to become effective under English law, it must receive the sanction of the Court and the Court order must be lodged with the Registrar of Companies. The Court will not sanction the Scheme unless it is satisfied that the class of Holders of the Dated Notes (as creditors in respect of the Scheme) has been properly constituted and, as a matter of discretion, the Court considers that it is proper to sanction the Scheme. There can be no assurance that the Court will sanction the Scheme. If the Court does not sanction the Scheme, or approves it subject to conditions or amendments which (i) the Bank and other relevant parties deem unacceptable or (ii) would have (directly or indirectly) a material adverse effect on the interests of any Holders and such conditions or amendments are not approved by the Holders, the Scheme will not become effective and the transactions contemplated by the Scheme will not be implemented.

In connection with the Scheme, Holders of Dated Notes are entitled to elect to subscribe for Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, and it is a condition of the Scheme that, in connection with the Additional New Ordinary Shares Offer, an amount equal to or greater than £125,000,000 is placed in an escrow account. Should such sum not be placed in the escrow account, then a condition to the Scheme will not be satisfied and the Scheme will not become effective. In connection therewith, the Bank has entered into an agreement (the **Purchase Agreement**) with certain Holders of the Dated Notes to subscribe for Additional New Ordinary Shares not taken up by other Holders of the Dated Notes (should the amount which Holders of the Dated Notes elect to subscribe for be less than £125 million). The Purchase Agreement is subject to certain conditions precedent described in paragraph number 20.9 "*Purchase Agreement*" in Section 20 (*Additional Information*).

Should Holders of Dated Securities not participate in the Additional New Ordinary Shares Offer (or, having elected to participate, not transfer funds to the escrow account) such that the total amount placed in escrow is less than £125,000,000, and should, in such circumstances, the conditions to the Purchase Agreement not be satisfied (or, at the election of the Holders, such conditions not be waived) such that such Holders of Dated Notes are not required to subscribe for the Additional New Ordinary Shares not taken up, then the above mentioned condition is likely not to be satisfied and that the Scheme will not become effective.

If the Scheme is approved by the requisite majorities of the Holders of Dated Notes and sanctioned by the Court and implemented, all outstanding Dated Notes (including Dated Notes held by Holders who did not vote in favour of the Scheme) will be exchanged for a combination of New Ordinary Shares and Bank T2 Notes. If, however, the Scheme is not approved, sanctioned and implemented, none of the Dated Notes will be exchanged in the Liability Management Exercise and the Liability Management Exercise will fail. The implementation of the Scheme is conditional upon the Settlement Condition having been satisfied.

The remaining part of the Liability Management Exercise is being conducted by way of the Exchange Offers in respect of the Bank's Preference Shares, 13% Bonds and 5.5555% Bonds (as each are defined in Section 6 (*Details of the Liability Management Exercise*) and the Proposals.

Eligible Holders of Preference Shares and 13% Bonds are being invited to either:

(a) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or

(b) offer to sell their Preference Shares and 13% Bonds to Co-operative Group for cash consideration which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group,

as described in Section 6 (*Details of the Liability Management Exercise*).

Eligible Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new lower tier 2 11 per cent. Subordinated Notes due 2023 to be issued by the Bank (the **Bank T2 Notes**) as described in Section 6 (*Details of the Liability Management Exercise*).

In conjunction with the Exchange Offers, the Bank is also convening separate meetings of the Holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds, respectively, in order for the relevant Holders to vote on resolutions which, if successful, would enable the Bank to mandatorily effect the exchange or transfer to Co-operative Group of all securities of the relevant series which are not exchanged or sold in the Exchange Offers, on the same economic terms as those upon which securities of the relevant series are exchanged or sold in the Exchange Offers. The resolution at each meeting will be passed if the relevant meeting is quorate and if the Holders of at least three quarters of the relevant securities present and voting vote in favour of the resolution. Details of the requisite quorum for each meeting can be found in Appendix C (*Consent and Exchange Offer Memorandum*).

The Liability Management Exercise will only successfully complete if the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise.

In order for that to happen, all of the following must occur:

(i) the Proposal in respect of the Preference Shares must be (A) approved by the Holders of the Preference Shares at the meeting convened for such Holders to vote on such Proposal (and a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and (B) capable of being implemented in accordance with the terms of that Proposal;

(ii) the Proposal in respect of the 13% Bonds must be (A) approved by the Holders of the 13% Bonds at the meeting convened for such Holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal;

(iii) the Proposal in respect of the 5.5555% Bonds must be approved by (A) the Holders of the 5.5555% Bonds at the meeting convened for such Holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal; and

(iv) (A) the Scheme must be approved by the requisite majority of the holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court; (B) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (C) the Scheme must become unconditional in accordance with its terms.

The Authorities concluding that the aggregate £1.5 billion of Common Equity Tier 1 Capital to be contributed pursuant to the Recapitalisation Plan is inadequate to meet the Bank's regulatory capital requirements.

Since January 2013 and up to the date of this Prospectus, the Bank has been in close and continual contact with the Bank of England, the FCA and the PRA and has discussed in detail with the Bank of England, the FCA and the PRA the Recapitalisation Plan and the Bank's capital and financial position. On 17 June 2013, the PRA announced, following detailed discussions with the Bank and Co-operative Group, that it was the PRA's assessment that the Bank needed to generate an additional £1.5 billion in Common Equity Tier 1 Capital. The PRA reconfirmed its assessment, on 29 August 2013, following the announcement by the Bank of its interim results for the six-month period ended 30 June 2013 and taking into account the Bank's losses for such period. In addition, the PRA reconfirmed that the additional Common Equity Tier 1 Capital requirement of £1.5 billion remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress.

Notwithstanding these detailed discussions between the Bank and the Bank of England, the FCA and the PRA and the announcements by the PRA on 29 August 2013 confirming its assessment that £1.5 billion in Common Equity Tier 1 Capital is sufficient, there remains a risk, whether due to changes in circumstances or otherwise, that the Authorities decide that the Bank is required to generate more than £1.5 billion of Common Equity Tier 1 Capital. Should the Authorities reach such a conclusion, the Bank may decide not to proceed with the Liability Management Exercise and/or Holders may elect not to participate in the Liability Management Exercise, with the consequence that the Liability Management Exercise is not successfully implemented.

Resolution procedure under the Banking Act 2009

Should the Liability Management Exercise not be successful the Directors consider it likely that the Bank will be subject to a resolution procedure under the Banking Act (see *"Part C – Potential consequences of Holders failing to support the Liability Management Exercise"* in Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*)).

The Banking Act empowers the Authorities, where a bank is failing (or likely to fail) the threshold conditions (which relate to conducting its business in a prudent manner, which is assessed by reference to its financial and non-financial resources and structural arrangements) for its authorisation to conduct banking business, to impose the special resolution regime (the **SRR**) on relevant entities. The SRR consists of three stabilisation options, a bank insolvency procedure and a bank administration procedure, which may be commenced by the Authorities. The three stabilisation options could, for example, include the taking of the Bank into temporary public ownership, or the sale of some or all of the Bank's assets to a private sector purchaser or bridge bank, which may involve the residual part of the Bank being run off as a "bad bank".

The stabilisation options available to the Authorities are described in paragraph 2.6 titled "*Recovery and resolution regime*" in Section 17 (*Supervision and Regulation*).

In addition, the Authorities have the power under the Banking Act to require the exchange of Existing Securities into equity for so long as the Existing Securities remain outstanding.

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for Holders if the Liability Management Exercise is not successfully implemented during 2013. The Bank has no other source available to it to raise the required additional capital. As stated in the Bank's Interim Financial Information, if the Liability Management Exercise is not successfully implemented the Bank will cease to be a going concern and, as a result, is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA) and the relevant Authorities may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied that the Bank, in particular, has appropriate financial and non-financial resources, including that the Bank has made appropriate provisions for its liabilities. In addition, the Resolution Authorities may also exercise powers to resolve the Bank even where it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining: that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen, and that the Bank would be subject to a resolution procedure under the Banking Act. The Bank therefore believes that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank becoming subject to a resolution procedure under the Banking Act.

In the event that the Resolution Authorities exercise their powers under the Banking Act or there is market speculation regarding the occurrence of any such event, it is highly probable that the Bank would be materially adversely affected, and the market price of Existing Securities would be materially adversely affected. The Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank remains a going concern without the active participation of Co-operative Group and a substantial amount of additional capital. The Bank believes that if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, the Holders of Existing Securities would receive no recovery. Part C of Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) sets out a description of the hypothetical position that Holders would be likely to face if the Bank were to be resolved. As a result, the Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to Holders of all classes of Existing Securities than a resolution of the Bank.

Litigation seeking to challenge the implementation of the Liability Management Exercise or certain aspects of it could materially impact or prevent the successful implementation of the Liability Management Exercise or result in all or part of the Liability Management Exercise being declared to be unlawful and invalid retrospectively.

Litigation seeking to challenge the implementation of the Liability Management Exercise

Whilst the exact nature of any disputes and legal proceedings in connection with the Liability Management Exercise, and the likelihood of their occurrence or their outcome, cannot be predicted in advance with any certainty, the Bank is aware that previous liability management exercises by other institutions have demonstrated that, in such situations, there are people who may seek to bring claims or raise arguments in Court. Therefore it is possible that Holders may seek to bring claims or raise arguments in Court with the objective of preventing or delaying the implementation of all or part of the Liability Management Exercise.

In particular, it is possible that Holders may advance arguments seeking to persuade the Court not to: (i) approve the composition of the voting class for the purposes of the Scheme Meeting; and/or (ii) sanction the Scheme. Holders may also bring claims seeking to challenge the lawfulness of the Exchange Offers in respect of the Preference Shares, the 13% Bonds and/or the 5.5555% Bonds, and/or the related Proposals in respect of those securities. The success of any such arguments or claims or delay to the implementation of the Liability Management Exercise arising out of any such arguments or claims (including where any such claims are without merit) could result in the failure of the Liability Management Exercise.

Claims determined after the implementation of the Liability Management Exercise

It is possible that claims challenging the elements of legality of the Liability Management Exercise, or certain aspects of that exercise, may be brought after the Liability Management Exercise has been implemented. Other claims brought before such implementation may not be determined until after such implementation.

However, the success of such claims could result in all or part of the Liability Management Exercise being declared to be unlawful and invalid retrospectively. The consequences of such a finding would largely depend on the scope of the claims and the legal basis of the finding, but it could conceivably result in the Bank no longer meeting the PRA's requirement that the Bank raise an additional £1.5 billion Common Equity Tier 1 Capital. It is not clear, in such circumstances, what steps the PRA would take, but the Bank would take immediate action to try to address the Bank's capital shortfall, including holding urgent discussions with the PRA. See also the risk factor titled "*Consequences of a failure of the Liability Management Exercise*".

Other potential consequences of proceedings

The Bank may incur significant expense in connection with any such proceedings (whether seeking to challenge the implementation of the Liability Management Exercise or determined after the implementation of the Liability Management Exercise), even if such proceedings are ultimately concluded in favour of the Bank. Any one or more proceedings could also expose the Bank to substantial monetary damage, other penalties and injunctive relief and/or a negative effect on the Bank's reputation, any of which could have an adverse impact on the Bank's operations, financial condition and prospects. An adverse decision in any one matter could lead to further claims against the Bank.

The failure of the Liability Management Exercise is likely to result in the Bank ceasing to be a going concern.

As a result of the Bank's capital position and its dependency on the success of the Liability Management Exercise, along with other matters and uncertainties set forth in note 2 to the Interim Financial Information, the notes to the Bank's Interim Financial Information indicate that, and the audit report in respect of the Bank's Interim Financial Information contain an "emphasis of matter" statement to the effect that, there is a material uncertainty which may cast significant doubt on the Bank's ability to continue as a going concern.

If the Liability Management Exercise is not successfully completed on or before 31 December 2013, and in the absence of alternative support, the Bank believes that the Bank will be unable to continue as a going concern. Were the Bank to be unable to continue as a going concern, it is likely that the Resolution Authorities would exercise their powers under the Banking Act to resolve the Bank. See the risk factor titled "*The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009. In such circumstances, Holders of Existing Securities could potentially have no recovery at all in respect of their investment in Existing Securities.*"

The Liability Management Exercise will, if successfully implemented, result in all Existing Securities being exchanged or sold pursuant to the Liability Management Exercise, even those held by Holders who do not voluntarily participate

It is a term of the Liability Management Exercise that it will only be implemented if all Existing Securities will be exchanged or sold pursuant to the Liability Management Exercise.

Holders of Dated Notes should be aware that if the Scheme is approved at the Scheme Meeting and sanctioned by the Court, all Dated Notes (including those held by Holders who vote against the Scheme or who take no action in connection with the Scheme) will (if the Liability Management Exercise settles) be mandatorily exchanged for a combination of New Ordinary Shares and Bank T2 Notes in accordance with the terms of the Scheme.

Holders of Preference Shares should be aware that, even if they do not offer to exchange (or sell to Co-operative Group) their Preference Shares in the relevant Exchange Offer, if the resolution proposed at the meeting convened for Holders of the Preference Shares is passed and implemented, the Bank will (if the Liability Management Exercise is settled) mandatorily effect the exchange (or sale to Co-operative Group) of all Preference Shares (including those held by Holders of Preference Shares who vote against the resolution or who take no action in connection with the Liability Management Exercise) for Group Notes on the same economic terms as those on which Preference Shares are exchanged (or sold) in the Exchange Offer. In that regard, Holders should also be aware that any such Holder who offers to exchange (or sell) its Preference Shares in the Exchange Offer will also instruct a proxy to exercise the votes attached to those Preference Shares in favour of the resolution at the meeting.

Holders of 13% Bonds should be aware that, even if they do not offer to exchange (or sell to Co-operative Group) their 13% Bonds in the relevant Exchange Offer, if the resolution proposed at the meeting convened for Holders of the 13% Bonds is passed and implemented, the Bank will (if the Liability Management Exercise settles) mandatorily effect the exchange (or sale to Co-operative Group) of all 13% Bonds (including those held by Holders of 13% Bonds who vote against the resolution or who take no action in connection with the Liability Management Exercise) for Group Notes on the same economic terms as those on which 13% Bonds are exchanged (or sold) in the Exchange Offer. In that regard, Holders of 13% Bonds should also be aware that any such Holder who offers to exchange (or sell) its 13% Bonds in the Exchange Offer will also instruct a proxy to exercise the votes attached to those 13% Bonds in favour of the resolution at the meeting.

Holders of 5.5555% Bonds should be aware that, even if they do not offer to exchange their 5.5555% Bonds in the relevant Exchange Offer, if the resolution proposed at the meeting convened for Holders of the 5.5555% Bonds is passed and implemented, the Bank will (if the Liability Management Exercise settles) mandatorily effect the exchange all 5.5555% Bonds (including those held by Holders of 5.5555% Bonds who vote against the resolution or who take no action in connection with the Liability Management Exercise) for Bank T2 Notes on the same economic terms as those on which 5.5555% Bonds are exchanged in the Exchange Offer. In that regard, Holders of 5.5555% Bonds should also be aware that any such Holder who offers to exchange its 5.5555% Bonds in the Exchange Offer will also instruct a proxy to exercise the votes attached to those 5.5555% Bonds in favour of the resolution at the meeting.

Exchange Instructions are irrevocable except in certain limited circumstances.

It is a term of the Exchange Offers that Exchange Instructions are irrevocable from the time of their submission, except that Holders will be entitled to revoke their Exchange Instructions during a period of two days following the publication of any supplement to this Prospectus and/or the Group Notes Prospectus.

The participation by Holders in the Liability Management Exercise will result in the blocking of their Existing Securities such that they will be unable to transfer those Existing Securities pending settlement or termination of the Liability Management Exercise.

By offering to exchange or sell Existing Securities in the Exchange Offers or voting on the Proposals or entering into certain arrangements with respect to the Scheme, Holders of Existing Securities will be required to take steps to immobilise their Existing Securities (by blocking them in a relevant securities account or surrendering their certificates to the relevant Registrar). Except where, in respect of Holders of Preference Shares, 5.5555% Bonds or 13% Bonds only, the Holder revokes its Exchange Instruction in the limited circumstances in which revocation will be permitted, each Holder will not be able to transfer such Existing Securities until the Liability Management Exercise is successfully completed (in which case those Existing Securities will be transferred to the Bank or Co-operative Group, as applicable or as it directs) or terminated (in which case the Existing Securities will no longer be immobilised and can be transferred by such Holder). Holders should take into account these restrictions on the transfer of their Existing Securities before deciding whether or not to participate in the Liability Management Exercise.

The nominal amount of New Securities to be delivered in exchange for Existing Securities will generally be lower than the nominal amount of the Existing Securities, and there are important differences between the Existing Securities and the New Securities.

The Existing Securities exchanged or sold in the Liability Management Exercise will be exchanged or sold at an effective discount, such that if a Holder's Existing Securities are exchanged or sold for New Securities in the Liability Management Exercise (whether through voluntary participation by such Holder or as a result of the Bank mandatorily exchanging Existing Securities through the Scheme or the Proposals), the nominal amount of the New Securities delivered to such Holder will generally be lower than the nominal amount of its Existing Securities exchanged or sold. Whilst holders of the 13% Bonds and the Preference Shares who elect to receive Instalments Repayment Notes will receive a nominal amount of Instalment Repayment Notes which is initially higher than that of their 13% Bonds or Preference Shares, such Instalments Repayment Notes will not bear interest, and will, in real terms, amount to an effective discount to their 13% Bonds or Preference Shares. In addition, the terms of the New Securities will be different from the Existing Securities in certain material respects. The consequences of the discount and the different terms of the New Securities may include that the Holder's income from its investment will decrease and the tax consequences of the investment may change.

With respect to Preference Shares, 13% Bonds and 5.5555% Bonds, certain differences between those securities and the New Securities for which they may be exchanged or sold are set out in Parts 6, 7 and 8 of Section C of the Offer Memorandum, which is appended to and forms part of this Prospectus.

Holders of Preference Shares, 13% Bonds and 5.5555% Bonds should note, in particular:

- the difference between the annual income payable on their Existing Securities and the amounts which they will receive each year as a result of holding the Group Notes or (in the case of the 5.5555% Bonds) the Bank T2 Notes. For the avoidance of doubt, no interest shall be payable on the Instalment Repayment Notes;
- the difference between the tax treatment of Existing Securities and New Securities (particularly where Preference Shares are exchanged for Final Repayment Notes);
- the differences between the payment obligations of the Bank under the Existing Securities (including the ability of the Bank to defer interest on the 13% Bonds and the 5.5555% Bonds and that the Bank may, in certain circumstances, deliver additional Preference Shares instead of paying a cash dividend in certain circumstances) and the payment obligations of the Bank and Co-operative Group, respectively, on the Bank T2 Notes and Group Notes which will be mandatory);
- that the Bank T2 Notes and Group Notes will not be perpetual, but rather the Bank and Co-operative Group, respectively, will be required to repay those Bank T2 Notes and Group Notes; and
- that the date of such repayment will be ten years after issue in the case of the Bank T2 Notes and twelve years after issue in the case of the Final Repayment Notes whereas the Instalment Repayment

Notes will repay principal in twelve equal instalments over twelve years rather than in one payment at the end of those twelve years.

Holders of the Dated Notes should note that part of the consideration for exchange of their Dated Notes will be delivered in the form of New Ordinary Shares. Holders of New Ordinary Shares will be the first creditors of the Bank to suffer losses (i.e. potentially lose all of their investment) in a winding-up of the Bank. The Bank will not expect to be able to pay dividends on such New Ordinary Shares in the near-term, as more fully described in paragraph 9 titled "*Dividend Policy*" in Section 8 (*Description of the Bank*). The Ordinary Shares will not, as of their date of issue, be listed or admitted to trading on any stock exchange.

These differences described above are not the only differences between the Existing Securities and the New Securities, and Holders should ensure that they carefully review the terms of their Existing Securities and the New Securities which they may receive in the Liability Management Exercise and that they fully understand the differences (including the tax consequencies thereof).

The tax treatment of Existing Securities may be different to the tax treatment of the New Securities. The tax treatment of Holders of Preference Shares or 13% Bonds opting to exchange their Preference Shares or 13% Bonds for Final Repayment Notes will be different to the tax treatment of such Holders opting to sell their Preference Shares or 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment.

Failure to comply with the procedures of the Liability Management Exercise may result in Holders being unable to attend or vote at the Scheme Meeting, exchange or sell their Existing Securities or attend or vote at the meetings convened for the Holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds.

Holders of Existing Securities are responsible for complying with all of the procedures for participating in the Liability Management Exercise, which are set out in the Offer Memorandum appended to this Prospectus as Appendix C (*Consent and Exchange Offer Memorandum*) and, in the case of the Dated Notes, the Explanatory Statement and the other Scheme documents. Failure to do so may result in Holders being unable to receive New Securities in exchange for their Existing Securities or, as the case may be, attend or vote at the meetings convened for the Holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds or, in the case of the Dated Notes, attend or vote at the Scheme Meeting.

The price obtained on a sale of New Securities pursuant to the trust arrangements may be less than their price on issue

If any Holder of Dated Notes fails to comply with certain procedures in connection with the Scheme, the Bank T2 Notes and New Ordinary Shares for which such Holder's Dated Notes will be exchanged if the Scheme is sanctioned and implemented to which such Holder becomes entitled pursuant to the Scheme will be transferred to Lucid Issuer Services Limited as holding period trustee (the **Holding Period Trustee**). Such Bank T2 Notes and New Ordinary Shares will be held on trust by the Holding Period Trustee pending:

(a) confirmation for or on behalf of the relevant Holder that it or its Designated Recipient is eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the Holding Period Trustee will transfer the relevant Bank T2 Notes and New Ordinary Shares to that Holder or its Designated Recipient;

(b) confirmation for or on behalf of the relevant Holder that it is not eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the relevant Bank T2 Notes and New Ordinary Shares will be sold by or on behalf of the Holding Period Trustee and the net proceeds of such sale (after deduction of all applicable fees and expenses) will be distributed to that Holder; or

(c) the date falling 36 months following the Scheme Settlement Date, at which time the Holding Period Trustee will sell or procure the sale of the Bank T2 Notes and New Ordinary Shares not already distributed or sold as described in paragraphs (a) and (b) above and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the Bank.

In the event that the Holding Period Trustee or selling agent (as applicable) sells any New Securities in the market as described above, the price obtained will be less than their current market price after deduction of costs and expenses, may be less than the price at which they were issued and may also be less than the holder's own valuation of such New Securities.

Sales of New Securities pursuant to the trust arrangements may affect the value of other New Securities

Any sales by the Holding Period Trustee or selling agent (as applicable) in the circumstances described in the risk factor "*The price obtained on a sale of New Securities pursuant to the trust arrangements may be less than their price on issue*" set out above may have an adverse effect on the market price of other New Securities issued pursuant to the Liability Management Exercise and which are not sold pursuant to the trust arrangements. In particular, certain holders of Dated Notes may not be permitted to hold unlisted ordinary shares of any company (including the Bank) which may mean a large number of New Ordinary Shares may be sold pursuant to the arrangements described above. Any such sales of any New Securities (particularly if a large number of New Securities are sold by the Holding Period Trustee or selling agent) may adversely affect the value of such other New Securities.

Holders may face penalties or the unwinding of transactions unless they comply with the offer terms and Offer Restrictions.

There are certain offer restrictions (called **Offer Restrictions**) imposed on the Liability Management Exercise and, in addition Holders will be deemed to make a number of acknowledgements, representations, warranties and undertakings on submission of an Exchange Instruction. Failure to comply with such Offer Restrictions or any such acknowledgements, representations, warranties and undertakings could result in, among other things, the unwinding of trades and/or heavy penalties.

RISKS RELATING TO THE BANK AND ITS BUSINESS

A failure to successfully implement or a delay in implementing the Bank's strategy may adversely impact the Bank's business, results of operation, financial position and/or prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements.

The difficult situation currently faced by the Bank is unprecedented for the Bank. The Bank has recently adopted a new four to five year business plan and begun to implement a range of measures aimed at improving its financial and operational performance and capital position. This includes the Recapitalisation Plan, separating its Non-core Business from its Core Business, refocusing the Core Business onto its core relationship retail and SME banking customers, overseeing a controlled run-off and exit of its Non-core Assets over the medium term, as well as embarking on a significant cost reduction programme across the Bank. In connection therewith, the Bank is beginning to implement steps designed to upgrade and enhance many of its operational processes and IT systems for the Core Business. Further information on the Bank's strategy is contained in Section 8 (*Description of the Bank*).

The Bank's newly adopted strategy was developed in a relatively short timeframe, has yet to be implemented and its performance and effectiveness is not yet proven. It is therefore possible that the Bank's strategy may not sufficiently address the Bank's problems or deliver the expected benefits to the Bank. The successful implementation of the Bank's strategy requires the simultaneous execution of a number of complex and overlapping changes (including the finalisation of the separation arrangements between the Bank and Co-operative Group, significant cost reductions, a substantial re-engineering of its IT platform, the reorientation of its distribution network, improving revenue in its business in the medium-term, the streamlining of its product offering, and the managing of its Non-core Assets in a manner intended to achieve optimal economic outcomes, after taking into consideration capital requirements, liquidity provisions, the nature of the assets and the underlying trends of value of such assets) in a manner that does not negatively impact on the Bank's brand, reputation, customer satisfaction or its relationship with, and ability to retain, its employees. The Bank also has a poor historic track record of successfully implementing large-scale changes.

In delivering its strategy, the Bank will be reliant on the collective skill, experience and commitment of its Directors, senior management team, and persons working for the Bank. The board has been strengthened through the appointment of Richard Pym as Chairman of the board and Niall Booker as Chief Executive Officer and the Bank intends further to strengthen the Board. The senior management team has also recently been strengthened through the appointment of Robert Rickert as Chief Operating Officer and Julie Harding as HR Director. The Directors and senior managers therefore have a relatively limited track record of working for the Bank and working together. Notwithstanding these appointments, a number of further appointments are still required. In particular, following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's board. Grahame McGirr is currently both head of Co-operative Asset Management (**CoAM**) and CRO; following completion of the Liability Management Exercise the expectation is that a new CRO will be appointed allowing Grahame McGirr to focus solely on CoAM. In addition, Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank and the Executive Director responsible for the Bank's Core Business has given notice to terminate his contract and is expected to leave the Bank in March 2014. A replacement will need to be found for Rodney Bulmer. The failure to recruit or delay in recruiting suitable members of the senior management team, the loss of one or more executive Directors or members of senior management without finding suitable replacements or any adverse perception resulting from the change to the Bank's ownership structure following the successful completion of the Recapitalisation Plan may delay or impact on the ability of the Bank to successfully implement its strategy.

The delivery of the strategy is also dependent on the commitment and ability of persons working for the Bank to effectively and appropriately implement and support the numerous changes required by the strategy at the same time that cost reductions and redundancies are being implemented. The successful implementation of the strategy will necessitate changes to a more performance-based culture, with clear accountability and with commercially driven decision making whilst retaining the co-operative principles that help differentiate the Bank. At the same time, in areas where the Bank lacks or does not have sufficient number of skilled persons, the Bank is reliant on being able to attract and recruit such persons and to do so within the timescales envisaged by the Bank. A failure by the Bank to change its culture, a failure by persons working for the Bank to advocate or implement the changes required by the strategy, a deterioration in employee engagement, the loss of skilled and experienced employees, or a failure to attract and retain skilled employees or to do so within the timescales envisaged may negatively impact on the Bank's business, operating results, financial position and prospects. The ability of the Bank to recruit skilled and experienced employees is currently negatively impacted by uncertainty as to whether the Liability Management Exercise will be successfully implemented. A failure to successfully implement the Liability Management Exercise will have a significant negative impact on the Bank's ability to attract and recruit such employees. See the risk factor titled "*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, financial position and prospects and its ability to achieve its strategy*" below for further details.

There can be no assurance that the Bank will be able to successfully implement all or part of its strategy or implement it when expected or targeted. The Bank may experience unexpected costs or cost increases, delays and other execution problems in implementing its strategy; in particular, any significant delay in or failure of the Bank to implement the required steps to separate from Co-operative Group as a result of the change in the Bank's shareholding structure, the Liability Management Exercise, or to re-engineer its existing IT platform may result in a significant delay in delivering planned cost savings and may impact on the Bank's ability to achieve its business strategy. Risks may also emerge from the separation of services currently provided by the Co-operative Group. There can also be no assurance that the Bank will be able to achieve its capital, financial or operational targets (including its targets for return on equity, cost-to-income ratio, Non-core Assets profitability and Common Equity Tier 1 Capital) or realise all or part of the benefits that it expects from its current plans or other future initiatives. A failure or delay in implementing the Bank's strategy or a failure by the Bank to achieve its targets may adversely affect the Bank's business, results of operation, financial position and/or prospects, its regulatory capital position and its ability to comply with its regulatory capital requirements.

The implementation of the Bank's strategy has the following specific risks:

- The Bank's strategy includes leveraging the Bank's strong and differentiated brand and leading levels of customer satisfaction. The implementation of significant cost reductions, branch closures, redundancies and the reorientation of the Bank's distribution network may have a negative impact on the Bank's brand and levels of customer satisfaction which may, in turn, result in customer attrition. The Bank may also be unsuccessful in achieving a shift in customer behaviour towards self-service and digital banking.
- The Liability Management Exercise and the arrangements entered into in connection therewith and/or actions taken by the Bank in the implementation of its strategy may inadvertently be, or may be perceived to be, contrary to the principles of the co-operative movement which could negatively impact on the Bank's brand and business, in particular it may result in a loss of customers.
- The Bank's strategy also includes improving revenue in its Core Business through improved pricing of its products, appropriate re-pricing of existing products towards market rates, growing primary account customers in the Bank's key market segments, cross-selling products and growing the volume of higher margin unsecured lending. The Bank's ability to improve revenue in its Core Business is dependent upon a number of factors, including prevailing macroeconomic conditions (including the level of interest rates), the Bank's relative position versus its competitors and the ability of persons working for the Bank to appropriately cross sell products (see the risk factor titled "*The Bank faces competition in all of the core markets in which it operates*" and "*The Bank's business and financial performance have been and may continue to be affected by general economic conditions in the UK, and adverse developments in the UK or global financial markets could cause the Bank's earnings and profitability to decline*").
- There is also a risk that the recent credit rating downgrades, the Bank's capital shortfall and/or the Bank's disappointing financial results for the six months ended 30 June 2013, continuing press reporting and public scrutiny of the same and of the Recapitalisation Plan and/or actions by the Holders of the Bank's Existing Securities may, individually or cumulatively, over the longer term have a negative impact on the Bank's brand and reputation or on the strength of the co-operative movement as a whole.
- The Bank's high cost-to-income ratio continues to impact on its profitability and its capital position, and reducing its cost base remains a priority for the Bank. This cost reduction will be delivered through (i) the simplification of the Bank's product offering, allowing for efficiency gains in the Bank's operations and IT functions; (ii) greater levels of self-service through the reorientation of the Bank's distribution model towards digital and other self-service channels; (iii) business process re-engineering (both IT and non-IT enabled) which will remove middle and back office costs; (iv) delayering of management; and (v) full integration of Britannia within the Bank. There is no guarantee that these actions will achieve the intended cost benefits and will be successful or that they will otherwise be delivered on time or when expected. In particular, the implementation of this cost reduction programme currently has no member of the senior management team who has been appointed to oversee and be accountable for the delivery of this plan. In addition, the reorientation of the Bank's distribution model and its cost reduction programme may negatively impact the Bank's customer service, which may result in customer attrition.
- The Bank needs to significantly improve, and the Bank intends to progressively re-engineer, its existing IT platform. This re-engineering of its IT platform is significant, both in terms of scale and cost, and involves a number of risks (see the risk factor titled "*The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business*"). In addition, the Non-core Business and the Core Business also share the same IT platform. As the IT platform is remediated, digitalised and re-engineered in line with the Core Business' strategy, the systems may over time cease to be suitable for the activities of the Non-core Business and the Non-

core Business may, as a consequence, be negatively impacted and/or required to move to alternative IT systems.

- The inability of the Bank to deleverage its Non-core Assets in a controlled and capital efficient manner may have a negative impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position. In addition, any greater than expected costs or delays in deleveraging the Non-core Assets may divert funding from and adversely impact the longer term development and growth of the Core Business (for further information see the risk factor titled "*The inability of the Bank to deleverage its Non-core Assets in a controlled and capital efficient manner may have a negative impact on the Bank's financial position and operating results and, its regulatory capital position and ability to comply with its regulatory capital requirements. Any greater than expected costs or delays in deleveraging the Non-core Assets may divert funding from and adversely impact the growth of the Core Business*").

The model used to create the Bank's four to five year plan was produced in a relatively short timescale. In addition, the model is reliant on manual inputs and controls, and inputs are from a wide range of sources. Whilst and notwithstanding that the Bank engaged independent advisers to assist it in developing its model and separate independent advisers to perform an external review of the model (consequential to which a number of changes to the model were made) and a number of checks have been carried out to confirm the accuracy of the data inputs, given the relatively short timescale in which the model was created and given the reliance on manual inputs and controls, there is a risk that there are weaknesses in the design of the model and there is a risk that data has been incorrectly input into the model.

The successful development and implementation of the Bank's strategy requires difficult, subjective and complex judgements, including forecasts of economic conditions. Furthermore, the successful implementation of the Bank's strategy is contingent upon a range of factors which are beyond the Bank's control, including market conditions, the general business environment, regulation (including currently unexpected regulatory change), the activities of its competitors and consumers and the legal and political environment.

The inability of the Bank to deleverage its Non-core Assets in a controlled and capital efficient manner may have a negative impact on the Bank's financial position and operating results and its regulatory capital position and ability to comply with its regulatory capital requirements. Any greater than expected costs or delays in deleveraging the Non-core Assets may divert funding from and adversely impact the growth of the Core Business.

The Bank's Non-core Assets consist of asset classes of the Bank which are not consistent with the Bank's Core Business strategy. As at 30 June 2013 the Non-core Business had total segment assets of £14.2 billion constituting 32.1 per cent. of the Bank's total segment assets. The Bank's Non-core Assets therefore constitute a significant part of the Bank's total assets.

A key part of the Bank's overall strategy is a controlled run-off and exit of the Non-core Assets in a manner that the anticipated future losses from such run-off and exit do not materially exceed the capital which is released from the reduction in RWAs, and which the Directors believe minimises adverse impact on the realisation of the Bank's Core Business strategy and the Bank's core customers. As part of this process, the Bank has reviewed its corporate loan book on an asset-by-asset basis, identified Non-core Assets for run-down and exit and changed the work-out approach on a significant number of such assets. The assets are managed taking into consideration their capital requirements, provisioning (both past and future), the nature of any security over the assets, returns, and the ability to improve economic outcomes by proactive management of the assets. Depending on the asset, this may involve the sale or refinancing of the asset or the holding of the asset until maturity. The Bank has also adjusted its credit risk management approach and the data upon which impairment assessments are made. These factors in part resulted in significant impairment charges of £496.0 million for the six month period ended 30 June 2013.

A failure by the Bank to deleverage its Non-core Assets in a controlled manner in accordance with its strategy may (for example, through greater than currently expected losses from the run-off or sale of Non-core Assets) negatively impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position and ability to comply with its regulatory capital requirements. The Bank may, for example, be unable to exit or run down its Non-core Assets as anticipated due to unfavourable market conditions, lack of appetite from buyers, or because sales take longer to execute than assumed. In addition, the Bank may be competing against other financial and other institutions also seeking to exit from their Non-core Assets, in particular given the continuing European-wide deleveraging of similar assets, which may impact on secondary market pricing and demand for its Non-core Assets, and the Bank may be required to compete on price and ease of execution. In addition, given the period over which the Bank will be running off and exiting from its Non-core Assets, the Bank is exposed to market conditions, including declines in commercial property values, and other macro-economic factors during this period. For further information see the risk factor titled see "*Worsening economic and market conditions could result in increased commercial property loan losses beyond what the Bank has already provided for, which could adversely impact the Bank's financial and operational performance*". The Bank may be required or may decide to exit on short notice and at unfavourable prices for liquidity, funding or other needs.

Notwithstanding the significant impairments already made to the Non-core Assets, the Non-core Business also has significant additional impairment risk given the underlying assets, which includes Optimum, a book of predominantly interest-only intermediary and acquired mortgage book assets (as at 30 June 2013, £7.3 billion). Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in the Non-core Assets suffering from more than expected impairments which would adversely impact on the Bank's operating results and financial position (in particular, its net interest margin) and its regulatory capital position and ability to comply with its regulatory capital requirements (for further information see the risk factor titled "*Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*").

The Non-core Business' corporate asset book is relatively concentrated, with the result that a small number of borrowers account for a large proportion of the total loans outstanding. A significant impairment of any of these borrowers would result in a disproportionate impact on the Bank's operating results and financial position (for further information see the risk factor titled "*A number of the Non-core Asset classes have a small number of borrowers accounting for a large proportion of the total loans outstanding*").

The failure of the Non-core Business to deleverage its assets in a controlled manner in accordance with its strategy may hinder or restrict the longer term development and growth of the Core Business' business, and divert management attention from the Core Business. For example, it may restrict the ability of the Core Business to grow its existing loan portfolios or to expand its growth of other products, such as unsecured lending. In addition, the Non-core Business is partially funded by retail deposits from the Core Business. Any greater than expected expenses or operating costs or delays in the exiting and running down of the Non-core Assets may require additional funding from the Core Business (and which cannot reasonably be funded from elsewhere) which may divert funding from the Core Business to the Non-core Business and may adversely impact the development and growth of the Core Business.

The commitment by Banking Group to contribute £333 million of Common Equity Tier 1 Capital during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Group.

An important part of the Recapitalisation Plan is the contribution by Banking Group of £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately prior to the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

As announced on 17 June 2013, Banking Group intends to satisfy the 2014 Commitment and the Undertaking to Pay from the net proceeds of the sale by Banking Group of Co-operative Life Insurance and

Asset Management and the proposed sale of CIS General Insurance (the **Insurance Proceeds**). The Insurance Proceeds are currently anticipated to be sufficient to satisfy the Undertaking to Pay subject to these disposals realising the Insurance Proceeds in the expected timeframe. In the absence of the Insurance Proceeds (and the proceeds of the Intra-group Loan (as described further below)), Banking Group would be unable to satisfy its obligations under the Undertaking to Pay without seeking alternative sources of funding.

The sale of Co-operative Life Insurance and Asset Management to The Royal London Mutual Insurance Society Limited (**Royal London**) completed on 31 July 2013. The total consideration for the sale was £219.0 million, of which £39.0 million has already been paid to Banking Group. Payment of the remaining £180 million (as deferred consideration) is subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RL (CIS) Ltd) into Royal London under Part VII of FSMA. There is no certainty as to timing or outcome of the court process and therefore no certainty as to when the deferred consideration may be received by Banking Group or if it will be received at all. The Bank also understands that Banking Group, together with the Co-operative Group, is currently in discussions with various interested parties to sell CIS General Insurance, but as at the date of this Prospectus, no legally binding agreement to sell CIS General Insurance has been entered into and any such agreement may, when entered into, be subject to various conditions precedent. In addition the trustee of Pace have a guarantee from CIS General Insurance for the liabilities of that scheme, which would need to be released as part of the sale process. It is therefore uncertain how much, if any, proceeds will be generated by Banking Group through a disposal of CIS General Insurance as a result of this requirement.

The PRA have stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

To provide support to Banking Group's obligations under the Undertaking to Pay, the Bank and Banking Group have entered into an intra-group loan with Co-operative Group (the **Intra-group Loan**). The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (and is only subject to a small number of customary conditions precedent – see the paragraph number 20.6 titled "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Given Banking Group's potential reliance on the Intra-group Loan to fund its obligations under the 2014 Commitment Agreement, Banking Group may, as a result, be dependent on the ability of Co-operative Group to satisfy, in turn, its obligations under the Intra-group Loan. Co-operative Group has informed the Bank that it has appropriate arrangements in place to fund any draw down under the Intra-group Loan to enable Banking Group to satisfy the discharge of its obligations under the Intra-group Loan from alternative resources in the event that the Insurance Proceeds are not sufficient to enable Banking Group to satisfy the amount of the 2014 Commitment or are otherwise not received in time to satisfy the PRA's required timing to satisfy the 2014 Commitment. Whilst Co-operative Group has an established track record of executing such transactions, they are by their nature dependent on purchasers and finance providers being willing to enter into such transactions which, in turn, are dependent on market conditions at the time of the transactions. As a result of such dependencies, it is possible that Banking Group may be unable to successfully draw down under the Intra-group Loan in the envisaged manner should this be required should the Co-operative Group have insufficient funds to comply with its funding obligations.

As a result, Banking Group may then, in turn, be in default of its obligations under the 2014 Commitment Agreement and Bank will be able to exercise certain rights under the 2014 Commitment Agreement and/or to take legal action against Banking Group to recover any amounts owed. The Bank may fail to recover some or all of such amounts in such circumstances, which would adversely impact its regulatory capital position as the New Ordinary Shares which have been issued under the 2014 Commitment Agreement do not constitute Common Equity Tier 1 Capital until they Undertaking to Pay in respect of them has been satisfied. Should the Bank fail to raise £1.5 billion of additional Common Equity Tier 1 Capital by the end of 2014 the Bank will likely be in breach of the PRA requirement that the Bank raise an additional £1.5 billion of Common Equity Tier 1 Capital by the end of 2014 and similar consequences to those described in the risk factor entitled "*The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009. In such circumstances, Holders of Existing Securities could potentially have no recovery at all in respect of their investment in the Existing Securities*" above could apply.

See paragraph titled "*The Recapitalisation Plan*" in Section 12 (*Operating and Financial Review*) and paragraph 20.4 titled "*2014 Commitment Agreement*" in Section 20 (*Additional Information*) for more details of the 2014 Commitment.

The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements.

The Bank is required to maintain adequate regulatory capital and capital ratios at all times. The Bank will be required to meet new international capital and liquidity requirements (commonly referred to as **Basel III**) as implemented in the EU through the introduction of the Prudential Requirements Regulation (the **PRR**) and a further iteration of the Capital Requirements Directive (the **PRD**, and together with the PRR, **CRD IV**). The PRR will have direct effect in the UK with effect from 1 January 2014 and the PRA has consulted on the implementation of CRD IV in the UK, which must also be implemented by 1 January 2014; the results of that consultation are not yet public. These new EU capital requirements (and any additional UK requirements in excess of those required by CRD IV) will among other things require increased minimum levels of, and quality standards for, capital, increased risk weighting of assets, introduction of a minimum leverage ratio and additional capital buffers and new liquidity requirements. The Bank monitors its capital position under the forthcoming Basel III requirements and it believes, based on its current understanding of how such regulations will be implemented by the PRA in the UK and subject to implementation of the Recapitalisation Plan, that it will be compliant with the new Basel III capital requirements once they are implemented in the UK.

As the PRA's implementation of CRD IV in the areas in which Member States have discretion is not yet finalised, the impact on the Bank of certain of the new requirements is difficult to quantify. The PRA's rules (in exercising its discretion under CRD IV) and/or the requirements imposed as a result of finalisation of the European Banking Authority's (the **EBA**) technical standards could, therefore, have a negative impact on the Bank's capital and liquidity calculations and funding requirements and consequentially adversely affect its business or profitability beyond what is currently contemplated. It is not currently possible to predict with accuracy the final details of these reforms and the impact on the costs of capital.

The Regulatory Capital Framework

On 16 December 2010 and on 13 January 2011, the Basel Committee issued its final published guidance on a number of fundamental reforms to the regulatory capital framework (such reforms being commonly referred to as Basel III) (revised in June 2011), including new capital requirements, higher capital ratios, more stringent eligibility requirements for capital instruments, a new leverage ratio and liquidity requirements intended to reinforce capital standards and to establish minimum liquidity standards for financial institutions, including the Bank.

The Basel III reform package will be implemented in the European Economic Area (the **EEA**) through the PRR and the associated directive, the PRD, each of which was adopted by the European Parliament and the European Council on 26 June 2013. The PRR establishes a single set of harmonised prudential rules which will apply directly to all credit institutions in the EEA from 1 January 2014 with the PRD containing less prescriptive provisions which will need to be transposed into national law. Full implementation will begin from 1 January 2014, with particular requirements being phased in over a period of time, to be fully effective by 2019.

Key elements of the CRD IV include the following:

- Regulatory capital requirements – higher minimum capital ratios and the introduction of conservation, countercyclical and systemic risk buffers (together, the **Capital Buffers**), which are expected to be phased in over the period January 2016 to January 2019. Once implemented, a bank will be restricted in making discretionary distributions where the Capital Buffer requirements are not met;
- Definition of capital – whilst all of the Bank's Dated Notes, Preference Shares and Perpetual Subordinated Bonds are intended to be retired as part of the Liability Management Exercise (if it is successful) any of the Bank's subordinated debt which is not retired following a failure of the Liability Management Exercise and which does not meet the new recognition criteria will cease to be recognised as capital over the period from 1 January 2014 to 1 January 2022. It is possible that the PRA may seek to decrease this time period. Over the period 2014-2018, changes and additions to capital deductions will also apply;
- Counterparty credit risk – an additional capital charge for representing the volatility of credit valuation adjustments applied to derivative positions will be imposed;
- Securitisation exposures – the new regulation will also lead to certain securitisation exposures being deducted 100 per cent. from Basel III Tier 1 Capital from 2014, as opposed to the current treatment of a 50 per cent. deduction from Core Tier 1 Capital and a 50 per cent. deduction from Tier 2;
- New liquidity metrics – two new liquidity ratios will be introduced. These are a short-term liquidity stress ratio, referred to as the liquidity non-performing loans average ratio, and a longer-term ratio, referred to as the net stable funding ratio. Both ratios are required to be maintained at levels in excess of 100 per cent, when fully implemented; and
- New leverage ratio – a new ratio, calculated by reference to Basel III Common Equity Tier 1 Capital after deductions divided by adjusted balance sheet exposure is required to be maintained at a level of at least 3 per cent. The PRR requires firms to disclose their leverage ratio from 2015. Calculation of the CRD IV leverage ratio remains subject to review by the EBA; following this review the European Commission is expected to develop a further legislative proposal for submission to the European Parliament and the European Council by the end of 2016. On the current timetable the CRD IV leverage ratio is not expected to be finally implemented until 2018. In the UK, the interim Financial Policy Committee (**FPC**) recommended that the regulator encourage UK banks to disclose their leverage ratios publicly; such disclosures began in 2013 in respect of the 2012 financial year end. It is currently expected that the requirement for a specific leverage ratio will be implemented on 1 January 2018. Because the leverage ratio requirement remains subject to EBA review, the impact of it remains unknown. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

EBA technical standards yet to be finalised

The actual impact of CRD IV on the Bank's capital requirements is also dependent on the EBA's technical standards (to be issued by the EBA and other European supervisory authorities), a large number of which are yet to be finalised. Based on its current understanding of how the CRD IV will be implemented in the UK, the Bank believes it will be in compliance with the requirements upon their implementation. However, the risk that the final content of these technical standards may differ materially from current expectations cannot be excluded. In that case, the Bank may become subject to regulatory capital requirements not currently anticipated or provided for.

PRA implementation of CRD IV

The PRR and PRD contain a number of national discretions for the competent authorities of EU Member States which, depending on how those discretions are exercised in the UK by the PRA, could impact upon the Bank; in particular, the Bank's current forecasts of its capital position vis-à-vis its capital requirements may need to be revised.

On 2 August 2013, the PRA published a consultation ("*Strengthening Capital Standards: Implementing CRD IV – CP5/13*") on the changes to the PRA rules to implement the new EU capital requirements. Under the PRA consultation, the PRA proposed that the definition of Common Equity Tier 1 Capital will require capital deductions and amendments to prudential filters to apply fully from 1 January 2014, rather than on a transitional basis as permitted by CRD IV. However, the disclosures on the Bank's capital resources in Section 13 (*Capital Adequacy*) are produced in-line with PRA requirements issued before the consultation on CRD IV and do not include these proposed amendments to the transitional period. The PRA has consulted on the proposals in CP5/13, and the consultation closed on 2 October 2013. The PRA intends to publish its policy statement containing the finalised rules in December 2013. As the PRA's rules are not in final form, it is not possible to assess with absolute certainty the impact of CRD IV on the Bank in areas where Member States have national discretion. If the PRA's final rules differ substantially from the current proposals, the Bank's capital position may differ from its current forecasts; the Bank does not presently expect such substantive changes, but it is a risk which cannot presently be excluded.

The key areas, from the Bank's perspective, in which Member States have discretion as to the details and/or timing of implementation include:

- **Capital Buffers** – the PRA has discretion as to the implementation date of the capital conservation buffer (a buffer comprised of Common Equity Tier 1 Capital and representing a percentage of risk weighted assets at group and solo level, intended to enable banks to absorb losses in stressed periods). The PRA currently proposes to begin phasing this buffer in from 1 January 2016. The quantum of the capital conservation buffer is also subject to the discretion of the home Member State. Member States may also impose additional capital buffers if it is considered that the Capital Buffers prescribed for in the PRD are insufficient to enable firms to meet their capital requirements under stress. Whilst the PRA has indicated its intention to utilise this discretion, it is yet to propose provisions in this respect. If the PRA were to require the Bank to hold a greater quantum of capital against its risk weighted assets than is prescribed for in the PRD (though within the discretions permitted to Member States), this may require the Bank to raise its capital beyond that required by the minimum harmonisation requirements of the PRD. Should it fail to hold the capital buffer required by the PRA, the Bank would be restricted in making discretionary distributions to holders of its securities.
- **Risk weighting for qualifying holdings outside the financial sector** – the PRD gives competent authorities of Member States discretion as to whether to apply a risk weight of 1250 per cent. to "qualifying holdings" outside of the financial sector which exceed certain thresholds (i.e. direct or indirect holdings of 10 per cent. or more of the capital or voting rights of an undertaking). The PRA has indicated its intention to elect not to prohibit firms from having qualifying holdings exceeding the relevant thresholds. As the PRA's rules are not yet finalised in this respect, the PRA's position may change.
- **Capital treatment of securitisations** – the decision as to whether significant risk transfer (**SRT**) has been achieved (and so whether the capital benefits that securitisations offer banks are available to a firm) and the ability of originators to use SRT, is subject to the discretion of the competent authorities of Member States. The SRT requirements seek to ensure that any reduction in capital as a result of a securitisation is matched by a commensurate transfer of risk to third parties. The PRA has indicated its intention to apply a high degree of scrutiny in its assessment of whether SRT has been achieved. Depending on the PRA's application of its discretions as to the capital treatment of securitisations, the Bank may need to revise the calculation of its capital position vis-à-vis its capital requirements (and its statements of current and historic capital position as calculated in accordance with Basel III) to ensure compliance with the PRA's rules.

FPC recommendations for possible additional capital

In March 2013, a meeting of the then interim FPC, a part of the Bank of England responsible for macro-prudential regulation, voted unanimously that the PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies, including the Bank, hold capital resources equivalent to at least 7 per cent. of their risk-weighted assets assessed using the Basel III definition of equity capital but after:

(i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weights. The FPC noted that, relative to that benchmark, major UK banks and building societies in aggregate had a shortfall in capital of around £25 billion. The introduction by the PRA of any higher regulatory capital requirements in excess of the 7 per cent. referred to above on major UK banks could have an adverse impact on the Bank's operations, business, results, financial conditions and prospects. This risk is not currently quantifiable and so has not been accounted for by the Bank.

Consequences of changes to regulatory capital requirements or the Bank's current understanding of such requirements

Effective management of the Bank's capital is critical to its ability to operate and grow its business and to pursue its strategy. Any change that limits the Bank's ability to manage effectively its balance sheet and capital resources could have a material adverse impact on its business, financial condition, results of operations, liquidity and/or prospects.

In the event that the impact of any of the new Basel III regulatory capital and liquidity requirements is greater than is currently anticipated by management and the Bank were as a consequence to suffer a shortage of regulatory capital (assuming and notwithstanding the completion of the Recapitalisation Plan), the Bank would expect to enter into discussions with the PRA and consider what actions to take in light of such circumstances, taking into account the regulatory capital position and requirements of the Bank at that time. Any such discussions with the PRA could take some time before agreement is reached. Any such actions, or any delay in implementing such actions or in agreeing them with the PRA, may have a material adverse effect on the Bank and its business. Possible actions might include accelerating the Non-core Business's asset disposal plan. A regulatory capital shortfall resulting from any of the new Basel III regulatory capital and liquidity requirements may in extreme circumstances result in the Bank being subject to a resolution procedure under the Banking Act. See paragraph 2.6 titled "*Recovery and resolution regime*" in Section 17 (*Supervision and Regulation*) for further details of such resolution procedures.

The Bank is not currently compliant with its Individual Capital Guidance (**ICG**), being the PRA's statement as to the regulatory capital it expects the Bank to hold, although the Bank does meet its Pillar 1Requirements. The Bank has discussed, and agreed, with the PRA the Bank's recently adopted four to five year business plan which contemplates that the Bank will meet its ICG by the end of the plan period. The plan also envisages that the Bank will raise approximately £400 million by way of additional tier 2 capital during the plan period. Whether the Bank is able to meet its ICG during the period of the plan will depend on a number of factors, both within and outside the control of the Bank, including the Bank's ability to meet its newly adopted business plan and economic and market conditions generally in the UK. Whilst the PRA has agreed its plan with its ICG, the PRA has discretion to revisit the Bank's ICG and the Bank's non-compliance with its ICG. It is not possible to predict with any degree of certainty, if and therefore when, the PRA would revisit them and, if so, the nature or extent of any possible changes to the ICG. Should the Bank fail to meet its ICG or its plan to comply with its ICG, it is not possible to predict how the PRA would react. The PRA may, in any such circumstances, at its discretion elect to exercise one or more of its various powers over the Bank, which could include a variation of the Bank's permissions, restricting the Bank's business or, in conjunction with the other Authorities, imposing a resolution procedure on the Bank.

On 1 October 2013, the Bank of England published a discussion paper ("*A framework for stress testing the UK banking system*") setting out proposals for annual, concurrent stress tests of the UK banking system. The discussion paper follows the FPC recommendation in March 2013 that "looking to 2014 and beyond, the Bank of England and the PRA should develop proposals for regular stress testing of the UK banking system". The main purpose of the proposed stress-testing framework is to provide a quantitative, forward looking assessment of the capital adequacy of the UK banking system and individual institutions within it. The discussion paper states that the Bank of England expects that the stress-testing framework will use a suite of models to translate both common and bespoke scenarios into projections of bank profitability and capital ratios. The stress testing for 2014 will cover only the eight major UK banks. These banks (including the Bank) will be required to submit the results of the analysis to the PRA by 30 June 2014. The outcome of the analysis will be considered by the FPC and PRA during the fourth quarter of 2014, and will be used to inform remedial actions either at a system or individual bank level. It is not possible to predict with any certainty what the output of the 2014 stress testing might be. As a result of such stress tests, the Bank may be required to hold more regulatory capital, or to take other steps to mitigate risks identified as part of the stress tests.

Failure by the Bank to maintain adequate regulatory capital could lead to an inability of the Bank to support its business operations and implement its strategy, meet regulatory requirements, implement its investment plans, raise (in the medium term) further capital, make distributions, and could result in further changes to its credit ratings. Such consequences could, in turn, have a material adverse effect on the Bank's business, operating results, financial condition and prospects.

The Bank operates in highly regulated industries and the Bank's business and results may be significantly affected by the laws and regulations applicable to it. In particular, the Bank may face legal and regulatory proceedings.

As a financial services firm, the Bank is subject to extensive and comprehensive regulation under the laws of the jurisdictions in which it does business. These laws and regulations significantly affect the way that the Bank does business, and can restrict the scope of its existing businesses and limit its ability to expand its product offerings, or can make its products and services more expensive for clients and customers. There has also been an increased focus on regulation and procedures for the protection of customers and clients of financial services firms. This has resulted, moreover, in increased willingness on the part of regulators to investigate past practices of financial services firms.

The Bank is exposed to many forms of risk relating to legal and regulatory proceedings, including that: (i) business may not be, or may not have been, conducted in accordance with applicable laws and financial and other penalties may result; (ii) contractual obligations may either not be enforceable as intended or may be enforced in a way adverse to the Bank; (iii) intellectual property may not be adequately protected and the Bank may use intellectual property which infringes, or is alleged to infringe, the rights of third parties; and (iv) liability for damages may be incurred to third parties harmed by the conduct of the Bank's business.

The Bank is currently involved in litigation (for further information see paragraph 21 titled "*Litigation and Arbitration*" in Section 20 (*Additional Information*)) and may in the future become involved in further litigation. The outcome of any legal proceedings is difficult to predict.

Following the publication by the Bank of its annual report and accounts for the financial year ended 31 December 2012 (the **2012 Accounts**), the Bank received enquiries from the FCA relating to the Bank's compliance with the Disclosure and Transparency Rules in respect of disclosures made by the Bank concerning its regulatory capital position. In addition, the Bank has received certain enquiries from the Conduct Committee of the Financial Reporting Council in respect of the 2012 Accounts. These enquiries relate to the disclosure in the 2012 annual report and accounts of the Bank's regulatory capital position. They also relate to the Bank's loan impairment, impairment of its investment in its replacement banking IT platform, and to fair value disclosures.

For example the 2012 Accounts included on page 80 of the statements that: (a) "Adequate capitalisation can be maintained at all times even under the most severe stress scenarios, including the revised FSA 'anchor' stress scenario"; and (b) "A capital buffer above Individual Capital Guidance (ICG) is being maintained to provide the ability to absorb capital shocks and ensure sufficient surplus capital is available at all times to cover the Bank's regulatory minimum requirements". The Board has reviewed the basis for these statements and has concluded that they are inaccurate and, should they be read in isolation, these statements could be misleading, but when taken in the context of the 2012 Accounts as a whole, including the disclosures on pages 18, 29 and 30 of the 2012 Accounts, a more balanced view can be formed. The Directors believe that the 2012 Accounts would not have been required to be reissued solely on the basis of the inaccuracy on page 80 referred to above. KPMG has confirmed agreement with the conclusion reached by the Board on this matter.

Given the preliminary nature of such enquiries the Bank is unable to make any definitive comment in relation to them and the Bank is cooperating with such enquiries. Given that the Bank is currently unable to assess whether or not it is likely that the enquiries may result in more formal investigations or proceedings and whether such or other investigations or proceedings may result in findings adverse to the Bank.

On 12 July 2013 Co-operative Group and the Bank announced the launch of an independent review, to be chaired by Sir Christopher Kelly, into the events that led to the recent announcement of the Recapitalisation Plan to address the Bank's £1.5 billion capital shortfall, the decision to merge the Bank with Britannia in 2009 and the proposed acquisition of the Verde Business (the **Kelly Review**). The Kelly Review will include an analysis of strategic decision-making, management structures, culture, governance and accounting practices and aspects of the role of the Bank's auditors. The intention is to present the findings of the Kelly Review to Co-operative Group's members at its annual general meeting in May 2014. The Bank may face additional enquiries or proceedings arising out of the Kelly Review. In addition, the House of Commons Treasury Committee is also currently conducting hearings in connection with its enquiry into the required divestment of the Verde Business and the collapse of the Bank's bid for the Verde Business.

The outcome of these enquiries or any other future legal, regulatory or other enquiries, investigations or proceedings, including any legal, regulatory or other enquiries, investigations or proceedings arising out of any other allegations made against the Bank, is difficult to predict. However, the Bank may incur significant expense in connection with any legal, regulatory or other enquiries, investigations or proceedings, which could expose the Bank to any of the following: substantial monetary damages and fines; other penalties and injunctive relief; potential for additional civil or private litigation; potential for criminal prosecution in certain circumstances; potential regulatory restrictions on the Bank's business; and/or a negative effect on the Bank's reputation. Any of these risks, should they materialise, could have an adverse impact on the Bank's operations, financial results, condition and prospects, and the confidence of the Bank's customers in the Bank, as well as taking a significant amount of management time and resources away from the implementation of the Bank's strategy.

The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits becomes limited and/or becomes more expensive, and this may have an adverse effect on the Bank's business, profitability and its ability to meet its liabilities as they fall due.

The Bank is subject to liquidity risk as an inherent part of its business. Liquidity risk is the risk that an institution may not have sufficient funds at any time to make full payment in respect of liabilities falling due or can only do so at excessive cost. This may result in an inability to operate in the ordinary course, and/or a failure to meet liquidity or regulatory capital requirements, and/or may adversely impact the Bank's business and/or the implementation of its strategy.

The Bank raises the majority of its funding through accepting retail and corporate deposits. The Bank also maintains a range of funding programmes (including medium-term note, securitisation and covered bond programmes), targeting wholesale investors. The Bank's funding programmes are used for both short and medium-term funding, whilst its covered bond issues serve to satisfy longer-term funding requirements.

Depositors are a significant source of funding for the Bank and the maintenance and growth of the level of the Bank's lending activities depends in large part on the availability of deposit funding on appropriate terms. The Bank's deposits are split between retail and corporate deposits. As at 30 June 2013, the Bank's retail customer deposits totalled £28.1 billion and the Bank's corporate customer deposits totalled £4.7 billion, equal to 82.1 per cent. and 13.6 per cent., respectively, of the Bank's total customer funding as at that date. The Bank offers savings products which, generally, give rise to liabilities to repay depositors either "on demand" or on relatively short notice. The Bank's mortgage products, by contrast, are long-term assets repayable to the Bank over relatively long repayment terms. As a result, and given that the Bank's main source of funds is deposits, the Bank faces the risk of not being able to replace funds when they are withdrawn or, should a significant number of depositors seek to withdraw their funds, of not being able to meet its obligations to fund such withdrawals, repay lenders in accordance with its financing arrangements or fulfil commitments to lend.

The Bank monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed and regularly assesses its funding position. This is supported with detailed contingency funding plans and recovery options which are tested and reviewed on regular basis. The Bank's liquidity management framework is designed in line with the BIPRU regulations and industry guidelines. The Bank calculated its total liquidity resources as at 30 June 2013 as £8,971.9 million compared with £8,657.7 million as at 31 December 2012.

The Bank uses a combination of asset pools to manage its liquidity, with "primary liquidity" (being assets that are eligible under BIPRU 12.7, being operational balances with central banks, gilts and central government and multilateral development bank bonds) which are used predominantly for short term cash flow movements, while "secondary liquidity" (being all other liquid assets (excluding non-buffer assets) is used for creating longer term or contingent liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid.

The overall quantum of the Bank's liquidity has remained stable during the period ended 30 June 2013, supported by a large reduction in the Bank's non-buffer assets over this period. The Bank's secondary liquidity portfolio has been boosted by an increase in assets eligible for discounting at central banks. Overall, there has been a substantial reduction in non-buffer assets of the period (from £1,927.2 million as at 31 December 2012 to £188.2 million as at 30 June 2013). This reflected the change in the Bank's funding profile as a result of the Bank's rating downgrades and the sale of non-buffer assets which has been used to maintain sufficient levels of primary liquidity. The Bank's liquidity position is described in further detail in the paragraph titled "*Capital adequacy and liquidity requirements*" in Section 12 (*Operating and Financial Review*).

However, notwithstanding the steps that the Bank has taken to maintain its levels of total liquidity, given the reliance by the Bank on its customer deposits to provide funding for the Bank, any severe decline in customer confidence in the Bank could increase the amount of deposit withdrawals in a short space of time or over a sustained period. Given the relative size of the Bank's deposit base as compared with its other sources of funding, the Bank is particularly exposed to any serious loss of confidence by its depositors. Should the Bank experience an unusually high level of withdrawals which exceed the Bank's ability to manage through the application of its liquidity controls and contingency planning, this may have an adverse effect on the Bank's day-to-day operations, maintain the Bank's planned lending which may have an adverse effect on the Bank's business, results and financial position and could, in extreme circumstances, prevent the Bank from meeting its financial obligations as they fall due, meeting its regulatory minimum liquidity requirements or fulfilling its commitments to lend. In such circumstances, the Bank may be subject to a resolution procedure under the Banking Act.

The Bank's ability to access retail and wholesale funding sources on satisfactory economic terms or at all is subject to a variety of factors, some of which are outside the control of the Bank. Factors which apply generally include general economic conditions (including interest rates) and market volatility, market dislocation, confidence in the UK banking system and the economy in general and the financial services industry specifically, regulatory requirements, and major disasters. These risks can be exacerbated by enterprise-specific factors, such as over-reliance on a particular source of funding. There is also a risk that the funding structure employed by the Bank may prove to be inefficient, giving rise to a level of funding cost that is not sustainable in the long-term for the Bank to grow its business.

If the Bank's sources of short-term funding become volatile or unavailable, the Bank may be required to utilise other, possibly more expensive, sources to meet its short-term funding needs. The availability of wholesale funding depends on a variety of factors including market conditions, the general availability of credit, the volume of trading activities, the overall availability of credit to the financial services industry, and rating agencies' and funding markets' assessment of the Bank's credit strength.

The Bank is also a participant in the Bank of England's sterling monetary framework and, as such and subject to certain eligibility criteria at the Bank of England's discretion (as detailed in Chapter VIII of the Bank of England's Red Book), the Bank may be granted access to the Bank of England's Discount Window Facility (the **DWF**). The DWF offers liquidity insurance for idiosyncratic as well as system-wide shocks and is a bilateral facility designed to be able to address short-term liquidity shocks without disturbing the Bank of England's incentives for prudent liquidity management. At the Bank of England's discretion, eligible banks may therefore borrow gilts for 30 or 364 days, against a wide range of collateral in return for a fee, which will vary with the collateral used and the size and maturity of the borrowings. In the event that the Bank was not granted access to the DWF and the Bank at such time was dependent on the provision of liquidity from the DWF, the absence of such liquidity may have an adverse effect on the Bank's business, results and financial position, and could, in extreme circumstances, prevent the Bank from meeting its financial obligations as they fall due, from meeting its minimum liquidity requirements or from fulfilling its commitment to lend.

The credit rating downgrade experienced by the Bank has (i) led to sub-investment grade ratings on the Bank's senior debt leading to a significant reduction in the demand for these types of instrument (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding, and (iii) increased the Bank's collateral requirements used in the clearing systems. In addition, the total amount of the Bank's corporate deposits also fell by approximately £1.4 billion in the first half of 2013, which the Bank believes was probably caused by the credit rating downgrade. To a lesser extent, the Bank's regulatory capital shortfall, its disappointing results for the six months ended 30 June 2013, and the continued press attention and speculation to which the Bank is subject have also affected the Bank's funding profile and the cost to the Bank of raising new funding. The Bank's business plan also envisages that the Bank will raise approximately £400 million by way of additional tier 2 capital during the plan period. This continued impact on access to funding and increased cost of funding may, over the longer term, have adverse effects on the Bank's business, financial performance or future prospects and/or adversely affect the Bank's ability to achieve its strategy.

Whilst the retail deposit base has remained broadly stable (in appropriate circumstances, the Bank has managed its retail offering to mitigate against the risk of depositors withdrawing funds), a failure by the Bank to achieve its strategy, a deterioration in the Bank's operating results or financial position, or the continued press attention and speculation to which the Bank is subject may result in a severe decline in customer confidence which could result in the withdrawal of retail funds.

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, financial position and prospects and its ability to achieve its strategy.

The Bank depends on the continued contributions of its Directors, senior management and other key persons with the experience, knowledge and skills in retail banking and asset management for its success. The board has recently been strengthened through the appointment of Richard Pym as Chairman of the board and Niall Booker as Chief Executive Officer and the Bank intends to further strengthen the Board. The senior management team has also recently been strengthened through the appointment of Robert Rickert as Chief Operating Officer and Julie Harding as HR Director. The Directors and senior managers therefore have a limited track record of working for the Bank and working together. Notwithstanding these appointments, a number of further appointments are still required. In particular, following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's board. Grahame McGirr is currently both head of CoAM and Chief Risk Officer; following completion of the Liability Management Exercise the expectation is that a new Chief Risk Officer will be appointed allowing Grahame McGirr to focus solely on CoAM. In addition, Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank (and the Executive Director responsible for the Bank's Core Business) has given notice to terminate his contract and is expected to leave the Bank in March 2014. A replacement will need to be found for Rodney Bulmer. The failure to recruit, or delay in recruiting suitable members of the senior management team, or the loss of one or more Directors or members of senior management without finding suitable replacements, or any adverse perception resulting from the change in the Bank's ownership structure following the successful completion of the Recapitalisation Plan, may delay or impact on the ability of the Bank to implement its strategy and may have an adverse effect on the Bank's business, prospects, results of operations and financial position. In the delivery of its strategy, the Bank is reliant on the skill, commitment and support of appropriately skilled and experienced persons working for the Bank to deliver the required changes. The successful implementation of the strategy will necessitate changes to a more performance-based culture, with clear accountability and with more commercially driven decision making whilst retaining the co-operative principles that help differentiate the Bank. At the same time, in areas where the Bank lacks or does not have sufficient number of skilled persons, the Bank is reliant on being able to attract and recruit such persons and to do so within the timescales envisaged by the Bank. The challenges which the Bank faces in the implementation of its strategy, the impact of any proposed staff redundancies and cost reductions, and the impact of transferring employees to the Bank as part of the Bank's separation process from Co-operative Group (for further information see paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*)), may adversely impact staff morale, retention and the ability to recruit new staff, in particular highly competent specialists. Any significant reduction in staff morale may have a consequential impact on service delivery and customer service and, potentially, the Bank's brand, positioning and its ability to maintain its retail funding. In addition, and more generally, competition for personnel with skills (in particular highly competent specialists, particularly those with financial, banking, IT and other specialist skills) and proven ability is intense among financial institutions. Given the current difficult situation facing the Bank, it is harder for the Bank to retain and to attract and recruit appropriately skilled and experienced individuals.

There is no guarantee that the Bank will be able to retain and to attract and recruit a sufficient number of appropriately skilled and experienced employees to deliver the required changes and a failure to do so may impact on the Bank's ability to achieve the strategy which, in turn, may negatively impact on its business, operating results, financial position and prospects.

As at 30 June 2013, approximately 73 per cent. of the individuals who currently provide the Bank's services, are engaged by CFS Management Services Limited (**CFSMS**) and their services are then provided to the Bank through secondment arrangements agreed with CFSMS under the terms of the CFSMS-Bank 2006 Agreement. The significant majority of these people work full time for the Bank but in some cases, these individuals only spend part of their working time servicing the Bank and the rest is spent servicing other parts of Co-operative Group. Whilst the Bank intends to continue to operate through the use of secondment arrangements in the short-term as described in paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*) the Bank and the Co-operative Group expect to amend these arrangements such that, the Bank expects to agree an arrangement whereby the services of relevant individuals would transfer to the Bank. However, until such agreement can be reached the current arrangements will continue with the consequential risks of significant additional VAT charge for Bank and reliance of CFSMS for staff on terms that are not sufficiently robust (see the risk factor titled "*It may not be possible to agree new arrangements pursuant to which the Co-operative Group and CFSMS will continue to provide services, personnel and assets to Bank. A failure or delay in agreeing the new arrangements will result in a significant VAT charge for the Bank. The new arrangements may be less favourable to Bank than the existing arrangements*").

The Bank's inability to attract, retain and (where relevant) obtain PRA and/or FCA approval for, directors and highly skilled personnel, and to retain, motivate and train its staff effectively could adversely affect its competitive position, which could in turn result in an adverse effect on its business, prospects, results of operations and financial position.

Union representation subjects the Bank's business to the risk of interruptions through strikes or delays resulting from any restructuring of the Bank or in renegotiating labour contracts.

The Bank collectively recognises three trade unions – Britannia Staff Union, Unite and the National Association of Co-operative Officials. As at 30 June 2013, approximately 60 per cent. of the Bank's employees are union members. Whilst the Bank has not experienced any significant business interruption as a result of labour disputes at any of its businesses since August 2005, and the Bank considers its relations with employees to be good, the Bank does have a high proportion of staff, including senior individuals, who are members of a trade union. Union representation subjects the Bank's business to increased risk of interruptions through strikes or delays resulting from any restructuring of the Bank or in renegotiating labour contracts.

The Bank's strategy includes a significant cost-cutting exercise, which includes workforce redundancies. In addition, the terms and conditions for the majority of the staff are negotiated through collective bargaining with the unions. The Bank may be unsuccessful in concluding any such negotiations with unions regarding redundancies and reaching an agreement with the unions. A failure to conclude negotiations and reach agreement, or any protracted negotiations, may result in interruptions to the business through strikes or delays, a diversion of management time from running the Bank's business and implementing the Bank's strategy, a deterioration in employee relationships, an adverse impact on the Bank's reputation, and/or an adverse impact on the Bank's customer relationships. Such interruptions may, in turn, impact on the Bank's business, financial condition and results of operations and its ability to achieve its strategy.

There can be no assurance that such arrangements will always be in place in the future or that the Bank will be able to continue to negotiate wages and salaries and terms and conditions of employment on terms that support its ability to offer its services at competitive prices.

The processes for consolidating the Bank's financial results are manual in nature and involve significant spreadsheet overlays. The processes are reliant on checks and reconciliations to ensure accuracy of the results reported, and are resource intensive.

The Bank's financial reporting process is complex, reflecting reliance on legacy systems which have not been integrated following the merger of the Bank and Britannia. The Bank relies on manual processes to consolidate the Bank's financial results, and there is a significant use of spreadsheets, as opposed to automated consolidation processes. The manual nature of the processes increases the risk of accounting errors.

The Bank's statutory results and management accounts are drawn from five different ledgers on different versions of Oracle Financials. Spreadsheets are used to consolidate information from the five ledgers and to perform consolidation adjustments (e.g. remove intercompany balances and eliminate the cost of investment in subsidiaries). This process is further complicated through fair value adjustments (which arise from the accounting treatment of the Bank's merger with Britannia) and further manual adjustments (usually in relation to key judgements and estimates). Similarly, the production of the monthly management accounts requires the use of spreadsheets and templates to produce the consolidated Bank results.

Given the manual and complex nature of these processes, the Bank has implemented controls and checks to help ensure the accuracy of the financial results. These include reconciliations between ledgers and operating systems and further detailed account reconciliations performed by the financial control team. They also include the production and review of board performance reports, which detail the composition of each balance sheet item in the statutory balance sheet.

Since 2012, a project has been ongoing to improve the consolidation process. As the Bank will continue to use five ledgers for the foreseeable future, it will not have a fully automated consolidation process. The project will, however, result in greater automation and in improved processes and controls in respect of the spreadsheet consolidation. The Bank intends to have completed implementation of these changes by the end of 2014. These changes may take longer or prove to be more expensive than currently anticipated.

Although the Bank will not have implemented all these changes by the time of completion of the Liability Management Exercise, the Bank does not believe that the Bank's financial reporting processes will result in inaccuracies or delays in the financial or other information which the Bank is required to publish as a company with securities admitted to the Official List. Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that the Bank will be unable to comply with its obligations as a company with securities admitted to the Official List.

The Bank is exposed to a number of conduct risks

The Bank is exposed to many forms of legal and regulatory risk, which may arise in a number of ways. In particular:

- certain aspects of its business may be determined by the PRA, the FCA, HM Treasury, the Financial Ombudsman Service or the courts as not being conducted in accordance with applicable laws or regulations, or, in the case of the Financial Ombudsman Service, with what is fair and reasonable in the Ombudsman's opinion. If the Bank fails to comply with any relevant regulations, there is a risk of an adverse impact on its business due to sanctions, fines or other actions imposed by the regulatory authorities;

- the alleged mis-selling of financial products, including as a result of having sales practices and/or reward structures in place that are determined to have been inappropriate, may result in disciplinary action (including significant fines) or requirements to amend sales processes, withdraw products or provide restitution to affected customers, all or any of which could result in the incurrence of significant costs, may require provisions to be recorded in the Bank's financial statements and could adversely impact future revenues from affected products; and

- the Bank may be liable for damages to third parties harmed by the manner in which the Bank has conducted one or more aspects of its business.

Failure to manage these risks adequately could lead to significant liabilities or reputational damage, which could have a material adverse effect on the Bank's business, financial condition, results of operations and relations with customers. The Bank also faces both financial and reputational risk where legal or regulatory proceedings are brought against it or members of its industry generally, or where complaints are made against it or members of its industry generally to the Financial Ombudsman Service or another relevant body.

The Bank's provision for customer redress is reflected in a significant item charge of £163.0 million in the six month period ended 30 June 2013, which includes provisions for potential customer compensation claims relating to past sales of payment protection insurance (**PPI**), alleged failings relating to the introduction of third-party sales of card and identity protection products, arrears charges and the processing of first payments on certain mortgages, the mis-selling of interest rate swaps and an additional provision following identification of a technical breach of the CCA as announced by the Bank on 21 October 2013.

In the past, the Bank sold PPI alongside mortgage and non-mortgage credit products. Although the Bank stopped selling loans PPI in January 2009 and mortgage PPI in March 2012, there can be no assurance that its estimates for potential liability are correct, and its reserves taken to date might prove inadequate. Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain other aspects of the Bank's current or historic business may be determined by the FCA and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion. In particular, there is currently a significant regulatory focus on the sales practices and reward structures that financial institutions have used when selling financial products. The Bank faces the possibility of regulatory investigations and actions against it in regards to the alleged mis-selling of financial products such as interest-only mortgages, packaged accounts, customer first mortgage payments and lending into retirement plans. The nature of any future disputes and legal, regulatory or other investigations or proceedings into such matters cannot be predicted in advance. Furthermore, the outcome of any on-going disputes and legal, regulatory or other investigations or proceedings is difficult to predict. However, it may be that in connection with any such on-going and future matters the Bank will incur significant expense investigating and, where applicable, defending such claims. In addition, such action could lead to substantial monetary damages and/or fines, public reprimands, a negative effect on the Bank's reputation, increased regulatory compliance requirements or other potential regulatory restrictions on the Bank's business. Any of these risks, should they materialise, could have an adverse impact on the Bank's operations, financial results and condition and prospects. There is also a risk that the outcome of such investigations or proceedings may give rise to changes in law or regulation as part of a wider response by relevant law makers and regulators. An adverse decision in any one matter, either against the Bank or another financial institution facing similar claims, could lead to further claims against the Bank.

Potential regulatory investigation could cause reputational damage to the Bank's brand arising from any association, action or inaction which is perceived by stakeholders to be inappropriate or unethical. Failure to appropriately manage conduct and reputation risks may reduce – directly or indirectly – the attractiveness of the Bank to stakeholders, including customers, and may lead to negative publicity, loss of revenue, litigation, higher scrutiny and/or intervention from regulators, regulatory or legislative action, loss of existing or potential client business, reduced workforce morale, and difficulties in recruiting and retaining talent. Sustained damage arising from conduct and reputation risks could have a materially negative impact on the Bank's operations, financial condition and prospects.

The Bank faces competition in all of the core markets in which it operates.

Competition in the UK personal financial services markets may adversely affect the Bank's operations. The Bank competes mainly with other providers of personal financial services, including other banks, building societies and insurance companies, and operates in an increasingly competitive UK personal financial services market. Each of the main personal financial services markets in which the Bank operates is mature and slow-growing, so that growth requires taking market share from competitors. This places elevated focus on price and service as the key differentiators, each of which carries a cost to the provider. The quality of the Bank's products and systems, in particular distribution and IT, in turn impact on price and service. If the Bank is unable to match its competitors in these respects, it risks losing customers to its competitors which may adversely affect its business and prospects.

The UK market for financial services and the mortgage market in particular have been reshaped by the recent financial crises. Lenders have moved increasingly towards a policy of concentrating on the highest quality customers, judged by credit score and loan-to-value criteria, and there is strong competition for these customers.

Notwithstanding the Funding for Lending Scheme, which has seen banks drawing on this rather than pricing up in the retail deposit market, there remains significant competition for retail deposits, which has inevitably impacted lenders' margins. Competition may intensify further in response to consumer demand, technological changes, the impact of consolidation by the Bank's competitors, regulatory actions and other factors. If increased competition were to occur as a result of these or other factors, the Bank's business, financial condition and results of operations could be materially adversely affected. In particular, the implementation of the draft Banking Reform Bill, which requires, among other things, the separation of retail banking activities from the wholesale and investment banking activities carried on by large banking groups operating in the UK between 2015 and 2019 could reduce the distinctiveness of the co-operative model. The Bank's revised strategy is designed to meet the requirements of the Banking Reform Bill by 2016.

In addition, each of the major UK banks has announced that it will focus on improving its customer service. If the Bank's customer service levels were perceived to be negatively impacted by the implementation of its strategy, in particular, as a consequence of the Bank's cost reduction programme and the reorientation of its distribution channel, including branch closures, or were perceived by the market to be only in line with, or materially below, those of competitor UK financial institutions, it could lose existing and potential new business. In contrast to the Bank, a number of the Bank's competitors have recently increased the marketing of their brands and products. Whilst such increased marketing efforts are not specifically directed at the Bank, there is a risk that such efforts are successful in attracting customers of the Bank to transfer their banking relationship or primary account relationships to the Bank's competitors. If the Bank is not successful in retaining and strengthening its core relationship with retail and SME customers, it may lose market share as a result of the targeting of the Bank's customers by its competitors or otherwise, incur losses on some or all of its activities or fail to attract new deposits or retain existing deposits, which could have a material adverse effect on its business, financial condition and results of operations. In September 2013 a new Current Account Switch Service, overseen by the UK Payments Council, was launched. This has given rise to increased competition for the Bank. Whilst it is too early to establish any trends in this activity, based on prior period monthly averages the Bank has experienced, over the short period since the introduction of the Current Account Switch Account Service, a period which has seen significant incremental advertising spend by the Bank's competitors, a material reduction in the number of accounts switching to the Bank. This Current Account Switch Account Service may result in the Bank losing customers to competitors and/or needing to provide an enhanced proposition for retail customers in order to retain and attract customers.

The Bank's business and financial performance have been and may continue to be affected by general economic conditions in the UK, and adverse developments in the UK or global financial markets could cause the Bank's earnings and profitability to decline.

As with its competitors, the Bank is directly and indirectly subject to inherent risks arising from general economic conditions in the UK and other economies and the state of the global financial markets both generally and as they specifically affect financial institutions. Since mid-2008, the global economy and the global financial system, and the Eurozone in particular, have experienced a period of significant turbulence and uncertainty. The severe dislocation of the financial markets around the world that began in August 2007 and significantly worsened in mid-2008 triggered widespread problems at many commercial banks, investment banks and other financial and related institutions in the UK and around the world. The dislocation severely impacted general levels of liquidity, the availability of credit and the terms on which credit is available. This crisis in the financial markets led the Government and other governments to inject liquidity into the financial system and take other forms of action relating to financial institutions, including bank recapitalisations and the provision of government guarantees for certain types of funding, aimed at both supporting the sector and providing confidence to the market. There can be no guarantee of such support in the future, and such support is likely to be on more punitive terms for financial institutions than in the past.

These market dislocations were also accompanied by recessionary conditions and trends in the UK and many economies around the world. The widespread deterioration in these economies adversely affected, among other things, consumer confidence, levels of unemployment, the state of the housing market, the commercial real estate sector, bond markets, equity markets, counterparty risk, inflation, the availability and cost of credit, transaction volumes in wholesale and retail markets, the liquidity of the global financial markets and market interest rates, which in turn had, and continues to have, in a number of respects, a material adverse effect on the Bank's business, operating results, financial condition and prospects.

Although there have been periods where market conditions have generally improved, developments in 2011 and 2012, particularly in the Eurozone, have demonstrated that there continues to be significant uncertainty; see the risk factor titled "*The Bank's business and financial performance would be adversely affected by a break-up of the single European currency*" below.

The sovereign debt crisis in Europe led to an increase in the cost of funding. The initial impact of this increase was felt in the wholesale markets, and there was a consequent increase in the cost of retail funding, with greater competition in a savings market which is growing only slowly by historical standards. A number of policy interventions, including most recently the Bank of England's Funding for Lending Scheme have helped to ease these funding pressures. However, if there were to be further escalations in the European sovereign debt crisis, the cost of funding could increase again.

Prospects for the UK economy continue to be challenging and continued uncertainty surrounding the combined economic prospects of the Eurozone presents a risk of a significant slowdown in economic activity in the UK's principal export markets, which would have a corresponding effect on the broader UK economy. Domestically, both public and household spending are being constrained by austerity measures, an on-going squeeze on household incomes, and declines in real disposable incomes. These pressures on households may, particularly if combined with an increase in interest rates, lead to an increase in arrears in the Bank's residential lending portfolios, in particular Optimum, and an associated increase in retail impairment provisions; see the risk factor titled "*Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*" below. The Bank continues to expect the UK's economic recovery to be slow, with the Bank of England's explicit forward guidance regarding the future conduct of monetary policy presently anticipating base rate rises only when the official measure of unemployment falls to 7 per cent. (subject to certain conditions), currently anticipated to occur in 2016. In the meantime, the low interest rate environment will continue to exert downward pressure on net interest income across the financial sector. The continuation of the low interest rate environment, however, continues to support affordability of the Bank's mortgages by its customers. The Bank has experienced a decline in its net interest margin since the market dislocations commenced in August 2007 from 259 bps for the year ended 31 December 2007 to 104 bps for the six months ended 30 June 2013. The UK housing market, which the Bank is exposed to, has remained muted since late 2009, with transaction levels below historic norms and with house prices essentially flat since mid-2010 although recent indicators suggest that the UK housing market is improving, particularly London and the South East. Whilst forecasts of the UK housing market are difficult to make with any certainty, the Bank expects overall buyer activity across the UK in the short/medium term to continue to be relatively subdued, with the potential to decline should the labour market situation deteriorate markedly, or if strains in the financial system re-emerge and impair the flow of credit to the wider economy. Similarly, the outlook for the commercial property market continues to be uncertain in the light of the uncertain broader macroeconomic conditions. Potential for further weakening in tenant demand and investor appetite means the impairment outlook for the Bank's commercial lending business has become more uncertain; for further information see the risk factor titled "*Worsening economic and market conditions could result in increased commercial loan losses beyond what* *the Bank has already provided for, which would adversely impact the Bank's financial and operational performance*" below.

The continued effect of margin compression and exposure to both retail and commercial loan impairment charges resulting from the impact of general economic conditions means that the Bank's results of operations and financial position may continue to be adversely impacted by such factors, and there remains the possibility of further downward pressure on its results of operation and financial position and growth depending on a number of external influences, such as the consequences of a more austere economic environment.

Rating downgrades and/or negative market sentiment with respect to the Bank, the sector and/or the UK may have an adverse effect on the Bank's performance.

The Bank's ratings have been adversely affected by concerns regarding the Bank's capital position with the result that the Bank's debt is no longer rated with an investment grade rating.

On 20 June 2013, Fitch downgraded the Bank's long-term Issuer default rating by three notches to BB- from BBB- reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a two notch downgrade on 5 April 2013 from BBB+ to BBB- and a one notch downgrade on 19 July 2012 from A- (which was the long-term rating the Bank had held since 2009) to BBB+.

On 18 June 2013, Moody's downgraded the Bank's senior unsecured debt and deposit ratings by four notches to Caa1 from Ba3 reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a six notch downgrade in the Bank's deposit and senior debt ratings on 9 May 2013 from A3 to Ba3 and the placing of the Bank onto watch for a possible downgrade on 30 July 2012. Previously, the Bank had held a credit rating of A3 since October 2011.

The Bank raises the majority of its funding through accepting retail and corporate deposits. The Bank also maintains a range of funding programmes (including medium-term note, securitisation and covered bond programmes), targeting wholesale investors. In addition, the Bank maintains a high quality portfolio of marketable asset pools that it uses for liquidity management within the Treasury operation. Specifically, this includes a core portfolio of liquid assets comprising gilts, cash at the Bank of England and multilateral development bonds. In addition, the Bank also has access to a wider pool of liquid assets which, though not as liquid as its core portfolio, provide further diversification within the Bank's total liquid asset portfolio.

The total amount of the Bank's corporate deposits fell by approximately by £1.4 billion in the first half of 2013, probably caused by the downgrading of the Bank's credit rating by the credit rating agencies. In addition, the credit rating downgrade has: (i) led to sub-investment grade ratings on the Bank's senior debt leading to a significant reduction in the demand for these types of instruments; (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding; and (iii) increased the Bank's collateral requirements used in the clearing systems. The retail deposit base has, however, remained broadly stable. The credit rating downgrades and, to a lesser extent, the announcement of the Bank's regulatory capital shortfall, its results for the six months ended 30 June 2013 and the continued press attention and speculation to which the Bank is subject have affected the Bank's funding profile and the cost to the Bank of raising new funding.

The securitisation and covered bond programmes are in the process of being amended due to the downgrade received by the Bank from the rating agencies in the first half of 2013. These proposed amendments relate to the appointment of back up servicing and back up cash management and bank account triggers to accommodate, amongst other things, the latest structured rating agency methodology and changes to the rules relating to direct debits and payment schemes. The Bank will consider further issuance from these programmes after these modifications are complete and if market conditions permit.

There can be no guarantee that the implementation of the Bank's strategy or other actions taken by the Bank will restore the Bank's investment grade rating. Further negative change in sentiment towards the Bank as a result of market or other conditions could result in the Bank's credit rating being kept at below investment grade and/or reduced further. Any future declines in those aspects of the Bank identified by the rating agencies as significant business or a failure by the Bank to achieve its strategic objectives could also adversely affect the rating agencies' perception of the Bank's credit and cause them to take further negative ratings actions.

The continuation of the Bank's current rating or any further downgrade in the Bank's credit ratings could:

- trigger additional collateral requirements on derivative contracts and other unsecured funding arrangements;
- undermine confidence in the Bank and/or result in an outflow of deposits from the Bank;
- increase its borrowing costs; and/or
- further limit its access to the capital markets or limit the range of counterparties willing to enter into transactions with the Bank, as many institutions require their counterparties to satisfy minimum ratings requirements.

By way of an illustration of the potential financial effect of a downgrade, the Bank is party to contracts which specify collateral requirements based on the Bank's rating. As a result, a downgrade of the Bank's long-term debt rating results in cash outflows to meet the new collateral requirements. However, the contractually required cash outflow would not necessarily match the actual cash outflow as a result of other actions that could be taken by management to reduce the impact of the downgrades.

Furthermore, in February and April 2013, both Moody's and Fitch reduced the 'UK's long-term ratings, from Aaa to Aa1 (in the case of Moody's) and from AAA to AA+ (in the case of Fitch). Although these actions have not impacted the respective agencies' ratings of the Bank, any further downgrade of the UK sovereign credit rating or the perception that such a downgrade may occur could destabilise the markets, impact the Bank's own rating and borrowing costs and have a material adverse effect on the Bank's operating results and financial condition. In addition, on 13 December 2012, S&P affirmed its AAA/A-1+ long- and short-term unsolicited sovereign credit ratings for the UK, but revised the outlook to negative from stable. A further UK sovereign downgrade or the perception that such a downgrade may occur could depress consumer confidence, restrict the availability, and increase the cost, of funding for the Bank and/or its customers, further depress economic activity or inhibit any recovery, increase unemployment and reduce asset prices. These risks are exacerbated by concerns over the levels of the public debt of, the risk of further sovereign downgrades of, and the weakness of the economies in, Greece, Italy, Ireland, Portugal and Spain (the **GIIPS countries**) in particular. Further instability within these countries or others within the Eurozone might lead to contagion.

Future legislative and regulatory changes could impose operational restrictions on the Bank, increase the Bank's expenses and/or otherwise adversely affect its business, results, financial condition or prospects.

Future changes in regulation, fiscal or other policies are unpredictable and beyond the Bank's control and could materially adversely affect its business or operations. Regulators and other bodies in the UK and worldwide have produced a range of proposals for future legislative and regulatory changes which could impose operational restrictions on the Bank, cause the Bank to raise further capital, increase the Bank's expenses and/or otherwise adversely affect its business results, financial condition or prospects. These include, amongst others:

- measures contained in the Financial Services (Banking Reform) Bill (the **Banking Reform Bill**) including: (i) ring-fencing domestic retail banking services of UK banks; (ii) increasing UK banks' and building societies' loss-absorbing capacity (including by way of bail-in bonds); and (iii) increasing the ranking of insured depositors on a winding-up to rank ahead of all other unsecured creditors. On 1 October 2013, HM Treasury published amendments to the Banking Reform Bill under which it is proposed, amongst other things, that the Bank of England be given the power, in a resolution scenario, to cancel, reduce or defer the equity liabilities of a bank (including divesting shareholders of a bank of their shares), convert an instrument issued by a bank from one form or class to another (for example, a debt instrument into equity) and/or transfer some or all of the securities of bank to an appointed bail-in administrator. The Bank's revised strategy is designed to meet the requirements of the Banking Reform Bill by 2016, but as the legislation is still subject to the UK legislative procedure, it is possible that more stringent requirements than currently envisaged will be imposed on the Bank, which would require the Bank to raise additional capital, change its current legal structure and/or revise its strategy;

- at the EU level, structural reform measures that are similar to some of those contained in the Banking Reform Bill are also under consideration, following the report of the Liikanen Group, which was published in October 2012. This report's proposals were heavily influenced by the UK experience but there remains a risk that any subsequent EU legislation implementing the recommendations in the report may impose requirements which are more onerous than those in the Banking Reform Bill or which may not be completely consistent with those in the Banking Reform Bill. The Bank (and therefore holders of its securities) may be negatively affected if the EU reforms impose requirements on the Bank in excess of those currently contemplated in the UK;

- also at the European level, the draft RRD, which requires Member States to ensure that regulatory authorities have, among other things, powers to intervene in failing banks. The draft RRD also provides for Resolution Authorities to have the power to require institutions and groups to make structural changes to ensure legal and operational separation of "critical functions" from other functions where necessary, or to require institutions to limit or cease existing or proposed activities in certain circumstances. The exercise of these powers may require the Bank to change its current structure or operations, having negative consequences for the Bank's strategy and causing the Bank to incur potentially significant costs. It is currently contemplated that the RRD will be implemented in Member States by 31 December 2014 except for certain bail in provisions which are to be implemented by 1 January 2018. The draft RRD is not in final form and changes may be made to it in the course of the legislative process; and

- on 19 June 2013, the Parliamentary Commission on Banking Standards published its final report ("*Changing banking for good*"). This was followed by the publication of the Government's response on 8 July 2013, accepting the overall conclusions of the report and all of its principal recommendations. Among other things, this included proposals for a new banking standards regime governing the conduct of bank staff, the introduction of a criminal offence for reckless misconduct by senior bank staff, and steps to improve competition in the banking sector. Depending on how the Government decides to implement these proposals, they may have a substantial impact on banks in the UK generally, including the Bank, and ensuring future compliance with the requirements is likely to cause the Bank to incur potentially significant costs.

There is also a risk that the recent restructuring of regulatory bodies and, in particular, the creation of multiple regulators in the UK could lead to a lack of co-ordination and the emergence of inconsistencies between policies of the different regulatory bodies. Any such development could adversely impact the Bank's ability to manage its business efficiently and subject it to increased costs through managing as a result of the need to manage an increasingly complex compliance burden.

If implemented in their current form, none of these anticipated or forthcoming changes to the legal and regulatory framework to which the Bank is subject give rise to specific and quantifiable risks for the Bank. However, at this point it is impossible to predict the effect that any of the proposed changes listed above will have on the Bank's operations, business and prospects or how any of the proposals discussed above will be implemented in light of the fundamental changes to the regulatory environment proposed by the Government. Depending on the specific nature of the requirements and how they are enforced, such changes could have a significant impact on the Bank's operations, structure, costs and/or capital requirements. Accordingly, the Bank cannot assure potential investors that the implementation of any of the foregoing matters or any other regulatory or legislative changes that may be proposed will not have a material adverse effect on its operations, business, results, financial condition or prospects.

The Bank has a regulated branch in Guernsey and a regulated branch and subsidiary in the Isle of Man, each of which are subject to local regulatory requirements that may impact on their business or profitability and thus on the business or profitability of the Bank.

The Bank's relevant regulated branch in Guernsey and regulated branch and subsidiary in the Isle of Man are also subject to the local regulatory regime and the potential for regulatory intervention in Guernsey and the Isle of Man respectively.

The principal risk associated with regulated branches is that the local regulators may require the branch to hold liquidity locally; the local regulators also have oversight of the branch's operations and may have powers to require changes to those operations.

Regulated subsidiaries are subject to the full scope of regulation in the jurisdiction in which they are established – including locally imposed capital requirements and liquidity requirements, as well as conduct of business and other operational requirements. The local regulator may impose requirements on the subsidiary which will affect that subsidiary's ability to generate a return for the Bank, including requirements to hold both further capital and liquidity. The consequence of these requirements is that they will impact the Bank's liquidity and consolidated capital requirements. For example, the Bank's Isle of Man subsidiary has been required to hold additional collateral against its existing lending to the Bank following the announcement of the Bank's Recapitalisation Plan. The Bank intends to approach the Isle of Man regulators to request permission to terminate these additional collateral arrangements upon successful completion of the Recapitalisation Plan. There is no guarantee that the Isle of Man regulator will agree to this.

The Bank's earnings and net interest margins have been adversely affected by a number of factors, including a prolonged period of low Bank of England base rates and competition for retail funds, and may continue to be adversely affected for so long as one or more of these factors persist. In addition, the ratings downgrade, regulatory capital shortfall and other recent events impacting the Bank may have an adverse effect on the Bank's net interest margin.

The Bank's net interest margin and, consequentially, earnings are affected by the pricing on the lending products it offers to its customers and the cost of funding. The Bank's net interest margin has been squeezed by a number of factors which have negatively impacted on the pricing of its lending products and the cost of its funds.

The very low level of the Bank of England base rate since March 2009 contributed to a decline in the Bank's net interest margin as funding costs rose relative to base rate, in turn caused by savings rates falling below base rate. The Bank of England base rate has remained at 0.5 per cent. since March 2009, having fallen from 5.75 per cent. in July 2007 through eight consecutive cuts of between 0.25 per cent. and 1.0 per cent. In the 30 years preceding July 2007, the lowest level of the base rate was 3.5 per cent. Following the announcements by the Bank of England's Monetary Policy Committee on 7 June 2013, the Bank currently does not expect any short-term increase in the base rate and, accordingly, is likely to continue to be impacted by the effects which the low base rate has on its net interest margin.

Competition for the highest quality mortgages is intense and is likely to continue, putting downward pressure on returns available for the lowest risk-weighted mortgage assets. The ratings downgrade, regulatory capital shortfall and other recent events impacting the Bank, together with the publicity surrounding those events, has made it more difficult for the Bank to access funding for such mortgages and therefore to compete for such mortgages.

At the same time, price comparison websites have become more popular and widely used, allowing customers more easily to compare products and make buying decisions based on price. Whilst the Bank aims to provide fair pricing to its customers there is a risk that there will always be a number of other providers offering better pricing that will attract customers who may otherwise have joined or stayed with the Bank. In consequence, there is a risk that industry pricing will be forced lower, impacting on the Bank's ability to deliver its strategic income targets and impacting on its financial performance.

For a number of years, the retail savings market has been under pressure from restrictions on households' ability to save, historically low interest rates and competition from banks seeking to lower their loan-to-deposit ratios and to reduce their reliance on wholesale funding. Notwithstanding the Funding for Lending Scheme (which has reduced competition for retail deposits by providing financial institutions with cheap funding), the net result of these pressures has been an increase in the relative price for retail savings, adversely impacting the Bank's ability to manage its net interest margin. The ratings downgrade, regulatory capital downgrade and other recent events impacting the Bank have also increased the costs of funding as the Bank has sought to manage its deposits offering to mitigate against the risk of customers leaving the Bank.

Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance.

The performance of the Bank's core retail lending portfolios (which excluded Optimum, a closed book of intermediary and acquired mortgage book assets) has been stable over the past three financial years, with levels of arrears that are below industry averages published by the Council of Mortgage Lenders (the **CML**). The number of the Bank's customers greater than 2.5 per cent. in arrears is 0.3 per cent. (excluding Platform and Optimum) at 30 June 2013 (CML average was 1.40 per cent. as of 30 June 2013). However, despite some deleveraging, the personal sector in the UK remains heavily indebted and vulnerable to increases in unemployment, rising interest rates and/or falling house prices.

Increased unemployment could lead to borrowers who lose their jobs being unable to service the loan payments in a timely fashion which would result in higher levels of arrears in both the Bank's secured residential mortgage loan and unsecured consumer loan portfolios which, in turn, would lead to an increase in the Bank's impairment charges in respect of these portfolios. Increased unemployment could also result in less demand for the Bank's products.

Rising interest rates would put pressure on existing and new borrowers whose loans are linked to the base rate or the Bank's variable rates and who may have become accustomed to the current low interest rate environment. A significant portion of the Bank's outstanding residential mortgage loan products are potentially subject to changes in interest rates. In particular, the Optimum portfolio, being a portfolio of predominantly interest-only intermediary and mortgage book assets (as at 30 June 2013, £7.3 billion) is particularly sensitive to changes in interest rates. By way of example, and to illustrate the sensitivity of this portfolio to a rise in interest rates, if interest rates were to rise by 2.5 per cent. management estimate the impact on credit losses of Optimum resulting from such a rise in interest rates would be approximately £200 million (on a purely single stress basis). In addition, borrowers with a mortgage loan that is subject to a variable rate of interest or where the interest rate adjusts following an initial fixed rate or low introductory rate are exposed to increased monthly payments as and when their mortgage interest rate adjusts upward (or, in the case of a mortgage loan with an initial fixed rate or low introductory rate, at the end of the relevant fixed or introductory period). In an increasing interest rate environment, borrowers seeking to avoid these increased monthly payments by refinancing their mortgage loans may no longer be able to find available replacement loans at comparably low interest rates and this could lead to an increase in arrears in the Bank's retail lending portfolios as well as an increase in the Bank's retail loan impairment charges. In addition, a significant portion of the Bank's outstanding unsecured loan portfolio is also subject to changes in interest rates.

A number of loans are also linked to LIBOR and such loans would be impacted by an increase in LIBOR, whether or not there is an increase in underlying interest rates. The Bank has approximately 21,000 customers with aggregate balances of £2.2 billion on a LIBOR-linked mortgage (out of a total of approximately 245,000 customers). Virtually all these customers hold a mortgage originated on the Optimum platform.

According to the seasonally adjusted Halifax House Price Index, average house prices in the UK peaked in Q3 2007 at almost £200,000 before falling steadily until Q1 2009 to £158,000. Average house prices have then remained delicately balanced and in the three quarters to Q2 2013 have recovered to £167,000. If UK house prices were to fall generally or in particular regions to which the Bank has significant exposure in response to renewed economic pressures and/or the actions of lenders seeking to realise the values of impaired assets, this would be likely to result in an increase in the Bank's retail loan impairment charges as the value of the security underlying its mortgage loans was eroded. In addition, a key assumption in the judgement of estimated future credit losses is the Bank's estimate of future house price index movements. Optimum, which had an average loan-to-value of 79.2 per cent. as at 30 June 2013, is particulary exposed to movements in house prices. If Optimum's future house price index movements were to differ from management's expectations with a deterioration of 5 per cent., the impact on credit losses would be £22.1 million.

As a result of recent government initiatives, there has been an increased interest in buy-to-let loans, with buy-to-let lenders advancing 40,000 buy-to-let loans in Q2 2013 resulting in £5.1 billion of mortgages according to data published by the CML. Both the number of buy-to-let loans and the value of lending were the highest since Q3 2008, a trend which the Bank expects will continue in the near term. Whilst the Bank intends to constrain volumes of new buy-to-let mortgages as a proportion of total new lending, as at 30 June 2013, the Bank had £1.1 billion buy-to-let loans in its Core Business and £2.1 billion in its Non-core Business. As at 30 June 2013, 90.6 per cent. of the Bank's buy-to-let loans were interest-only. These borrowers have been supported through the financial crisis by a combination of low interest rates, stable house prices and rising rents as first-time buyers have struggled to raise the required deposit to allow them to purchase their own homes. Whilst, as at 30 June 2013, the percentage of buy-to-let loans with greater than 2.5 per cent. in arrears was low, if interest rates were to rise and/or the economy were to weaken and place pressure on employment, incomes and/or house prices, the credit performance of the Bank's buy-to-let mortgage book (together with the Bank's retail mortgage book), may deteriorate, which in turn could adversely impact the Bank's financial and operational performance. In addition, the buy-to-let market has not been through a period of significant decline in house prices and therefore it is difficult to predict how buy-to-let investors will react.

Worsening economic and market conditions could result in increased commercial property loan losses beyond what the Bank has already provided for, which would adversely impact the Bank's financial and operational performance.

The Bank's portfolio of loans secured on commercial property amounted to £3.5 billion at 30 June 2013. The underlying credit quality of these loans has been negatively impacted by continued poor economic conditions. The Bank has segregated much of the Bank's commercial property loans into its non-core division, CoAM. These commercial loans had already suffered a significant degree of impairment prior to being placed into run-off.

However, the conditions which continue to adversely impact the commercial property market include:

- falling commercial property valuations, in part as a result of a general focus by banks across Europe on reducing their exposures to higher risk assets through portfolio sales and individual asset disposals;
- lower availability of debt and equity finance to support restructurings;
- uncertainties about the capital treatment of commercial real estate lending, with a trend towards higher regulatory capital requirements for commercial real estate lending;
- several high-profile tenant failures in recent years; and
- a continuation in the market trend for shorter lease life and of tenants exercising breaks.

All these factors reduce the certainty of cash flows and exacerbate shifts in collateral values and difficulties in refinancing. Reflecting these factors, it is possible that there may be further declines in collateral values in the next few years, particularly in secondary office and retail properties, with some recovery thereafter with the result that further impairments in connection with the Bank's remaining commercial loan property portfolio may occur.

A number of the Non-core Asset classes have a small number of borrowers accounting for a large proportion of the total loans outstanding.

As at 30 June 2013 the Bank's Non-core Business gross loans and advances to customers, totalled £14.9 billion of exposure of which 47.9 per cent. represented the Optimum mortgage book, 23.5 per cent. represented commercial real estate (**CRE**) borrowers, 11.4 per cent. represented general corporate borrowers, 7.2 per cent. represented private finance initiative (**PFI**) borrowers, 6.2 per cent. represented registered housing associations, 3.6 per cent. represented energy and 0.2 per cent. represented local authorities. The top ten exposures in each asset class represented 24 per cent. of CRE, 21 per cent. of general corporate borrowers, 29 per cent. of PFI, 58 per cent. of registered housing associations, 47 per cent. of energy and 41 per cent. of leveraged finance exposure.

The nature of such assets and the complexity of the issues potentially involved requires detailed and careful management. The Bank may, in appropriate circumstances, decide to increase lending to a borrower in order to better facilitate a more successful exit. The complexity of the risks involved also increase the possibility of not being able to successfully exit or run down such assets given their complexity. The concentration within certain asset classes also increases the risk that a failure to achieve a timely exit or to achieve an exit in a capital neutral or accretive manner in respect of one or more of such assets will have a greater negative impact on the Bank's results of operation and financial position.

The Bank will continue to rely on Co-operative Group and the Co-operative brand. Co-operative Group will also continue to exert substantial influence over the Bank.

Immediately following completion of the Liability Management Exercise, Co-operative Group will own 30 per cent. of the issued ordinary share capital of the Bank.

While it remains a significant shareholder of the Bank, Co-operative Group will continue to have the power, among other things, to affect or influence the Bank's legal and capital structure and certain changes to its operations. The interests of Co-operative Group could conflict with those of the Bank or other shareholders, and this concentration of ownership may also have the effect of delaying, deferring or preventing the Bank's ability to effect certain types of transactions that require approval by Co-operative Group, including by special resolution. In addition, the separation between the Bank and Co-operative Group will provide a challenge to the Bank's operating model.

In order to manage these risks, the Bank has entered into a Relationship Agreement with Co-operative Group which, as from and conditional upon completion of the Liability Management Exercise, will regulate (in part) the relationship between and the degree of control that Co-operative Group and its subsidiaries may exercise over the Bank. In addition, as referred to in the Relationship Agreement, the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, grant Co-operative Group the right to appoint up to two members to the Board depending on the size of its holding of Ordinary Shares (see paragraph 20.3 titled "*Relationship Agreement*" in Section 20 (*Additional Information*) of this Prospectus for further details of the Relationship Agreement).

The Bank is also dependent on the strength of the Co-operative Bank brand, the wider Co-operative brand and its reputation with customers and potential customers of the Bank. Whilst the Bank seeks to manage material risks to the Co-operative brand through careful monitoring, ultimately the Bank is exposed to the risk that Co-operative Group acts in a way such as to bring the Bank brand into disrepute. For example, litigation, employee misconduct or the misconduct of anyone associated with the Co-operative brand, operational failures, accidents, the outcome of regulatory investigations, press speculation and negative publicity, disclosure of confidential customer information, inadequate products and services, amongst others, could negatively impact the Co-operative brand or Co-operative Group's reputation. Should, as a result, the Bank's brand, levels of customer satisfaction or the co-operative movement more generally be damaged, this would have a negative effect on the Bank's business, financial position and prospects and negatively impact the ability of the Bank to achieve its stated strategy.

In addition, the Bank will, following completion of the Liability Management Exercise, continue to be dependent on Co-operative Group for the provision of certain services, in particular IT (see "*The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business*" and "*The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT*", below). There can be no guarantee that these arrangements between Co-operative Group and the Bank will be sufficient for the Bank's future needs or that such provision of services will not be interrupted or cease altogether. If the contractual arrangements with Co-operative Group are terminated, the Bank may not find an alternative outsource provider or supplier for the services, on a timely basis, on equivalent terms without significant expense, or at all. The additional costs and expenses incurred in doing so may have a material adverse effect on the Bank's cost base. This could have a material adverse effect on the Bank's business and the results of its operations. In relation to certain other administrative services provided by Co-operative Group to the Bank (such as finance, marketing and human resources) the Bank expects to agree with Co-operative Group to bring such services back into the Bank and that (depending on the separation method pursued) staff may transfer to it from CFSMS as a result, but the Bank does not have certainty that, in that scenario, it will get the right number or skill set of staff to maintain the necessary service level (see paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*)).

Furthermore, the Secretary of State for Business, Innovation and Skills may, under section 76(1) of the Companies Act 2006, direct the Bank to change its registered name if, in his opnion, it gives so misleading an indication of the nature of its activities as to be likely to cause harm to the public. The FCA has the power to prevent the use of the "co-operative" name, or to take other action regarding the Bank's branding, if the FCA considers this desirable to protect consumers, to promote competition in the interests of consumers or to protect the integrity of the UK financial system (note 2.55L(2)(c) and (3), s.55N and the FCA's objectives in s.1C, 1D and 1E of FSMA).

The Bank's strategy is based in part on leveraging the Bank's reputation as being fairer, more responsible and more trusted than its competitors. This is a key competitive advantage for the Bank and there is a risk that, as a result of the Recapitalisation Plan and the Bank's new ownership structure, the Bank's reputation as being fairer, more responsible and more trusted than its competitors may be undermined.

The Bank has been wholly owned by Co-operative Group, which is a mutual organisation owned by and run for the benefit of, its members. As a result, the Bank has sought to manage its business so as to target a higher quality of service and a superior product offering to its customers, sometimes including more customer attractive interest rates, rather than focusing specifically on profit maximisation.

Upon the successful completion of the Recapitalisation Plan, 70 per cent. of the equity of the Bank will be owned by its former lower tier 2 bondholders (i.e. the holders of the Dated Notes). As a result of the Bank's new ownership structure or as a result of implementing its newly adopted strategy, the Bank may find itself in conflict between its obligations to its new Ordinary Shareholders and its mutual ethos and heritage, in particular around profit maximisation and the steps required to implement certain elements of the Bank's strategy. There is a risk therefore that the Bank decides to follow a course of action which is inconsistent with the Bank's mutual ethos and heritage. This may, unless the consequential reputational damage is mitigated, make customers, depositors and investors unwilling to do business with the Bank which may, in turn, result in customer attrition. Furthermore, such conflict may lead to the Bank reconsidering all or certain aspects of its strategy, such as building on the Bank's co-operative brand strength and high levels of customer satisfaction (see paragraph 3 titled "*Strategy*" in Section 8 (*Description of the Bank*)).

The group of Holders of Dated Notes who were involved in the negotiation of the terms of the revised Recapitalisation Plan with the Bank and Co-operative Group (the **LT2 Group**) have acknowledged that the Bank is unique for its ethics, mission and heritage which are essential components of the Bank's differentiated approach and it is important to them that the Bank maintains its unique characteristics and ethos. Further, to ensure that the Bank continues to have a clear ethical focus, cooperative values and ethics shall be, for the first time, with the agreement of the Co-operative Group and the LT2 Group, been embedded in the constitution of the Bank and the Bank will set up a values and ethics committee, with an independent director as chair.

However, shareholders of the Bank may decide to remove those provisions of its constitution that entrench Co-operative values and ethics. The Bank has agreed principles of co-existence with Co-operative Group pursuant to which the use of trade-marks as between Co-operative Group and Bank is governed. Under this agreement, Bank's removal of those provisions without Co-operative Group's consent, would result in the Bank being obliged to cease exploitation of Co-operative Group's trademarks and ceasing to offer membership rights in Co-operative Group or any other benefits associated with being a co-operative. This would, in turn, under the Bank's current strategy, conflict with those aspects of its strategy focused on building on the co-operative brand strength and leveraging off the Bank's relationship with Co-operative Group and the Co-operative Group membership. It is therefore likely that the removal of these entrenched values and ethics would result in the Bank changing its strategy which could adversely effect the Bank's business and financial condition and results of operations and could damage its relationships with its regulators.

The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business.

The Bank relies heavily on its operational processes and on IT and communication systems to conduct its business, including the pricing and sale of its products, payment processing, data collection, assessing acceptable levels of risk exposure, setting required levels of provisions and capital, and maintaining customer service and accurate records and security.

These processes and systems may not operate as expected, may not fulfil their intended purpose or may be damaged or interrupted by increases in usage, human error, unauthorised access, implementation/change activities, natural hazards or disasters or similarly disruptive events. Any failure of the Bank's IT and communications systems and/or third-party infrastructure on which the Bank relies, including that of Co-operative Group or other suppliers, could lead to significant costs and disruptions that could adversely affect the overall operational or financial performance of the business as well as harm the Bank's reputation, cause the Bank to breach its obligations as a regulated entity and/or attract increased regulatory scrutiny.

Notwithstanding anything in this risk factor, this risk factor should not be taken as implying that the Bank will be unable to comply with its obligations as a company with securities admitted to the Official List (as the case may be).

The Bank has recently undertaken a review of the IT resilience risks associated with the Bank's IT platform and infrastructure. The review has identified risks that fall broadly into the categories of "disaster recovery" "design of IT systems", "single points of failure", "end of life technology" and "third party suppliers". The output from this risk review has been shared with the PRA as part of their thematic review of IT resilience risks across the UK banking industry. The Bank has initiated a three-year IT resilience remediation programme which will remediate the critical risks identified by the review, and has committed significant additional investment to this programme. The resilience review also identified risks in the Bank's data centre facilities and the committed investment covers the required remediation activities. The Bank will continue to be subject to these risks until such time as it has completed its planned remediation activities, scheduled for the end of 2016 (and the intention is to prioritise remediation of high priority risks by the end of 2014 wherever possible). Any failure in systems as a result of not remediating the IT risks, or in the period to such remediation being completed, could adversely affect the Bank's ability to conduct its business and lead to the PRA imposing additional requirements on the Bank or subject the Bank to additional regulatory scrutiny.

There are also access control issues across the Bank that have been highlighted within past internal and external audit reports and internal assessments highlighting associated risk exposures. These issues include the overall governance of logical access and how access to data is managed within IT and the wider business. In response, there is targeted activity to address key areas of control weaknesses such as the Logical Access Management project. The need for further remediation is being assessed and will be reported to the Bank's Risk Committee.

The Bank had previously intended to replace key IT systems (including the existing core banking platform, and the applications that support the branch, internet and call centre channels) with a new core software platform which it had been developing or, had the planned acquisition of Lloyds TSB branches (the **Verde Business**) gone ahead, with the IT systems used by the Verde Business. The Bank has since undertaken a strategic review of its overall IT requirements against the backdrop of the strategy of the Core Business, and has agreed a new IT strategy. This strategy involves incremental re-engineering of the existing platform to create a target platform that supports the Core Business, including: introduction of new digital channel applications with improved capabilities as the Bank's digital channel offerings lag significantly behind its competitors; enhancements to the core mainframe platform to allow for simpler product development and management; improved reporting and analytics; and improved process and workflow automation. This re-engineering will be combined with simplification of IT systems in order to reduce running costs (as the IT running costs are currently above the Bank's industry peers) e.g. rationalisation of existing savings and mortgage platform. Cost reductions from improvements in IT operating efficiency will also be targeted although this will require management of the risk that these reductions reduce service below acceptable levels.

These IT initiatives are significant, both in terms of scale, complexity and cost and the Bank also has a poor historic track record of successfully implementing large-scale changes and therefore these initiatives involve delivery risk, although this is partially mitigated by the modular and iterative delivery approach that is being adopted. Any significant delay in or failure of the Bank to deliver these IT re-engineering initiatives may result in significant additional investment costs and also significantly impact on the Bank's ability to achieve its business strategy, and may adversely affect the future operational and financial performance of the business. Whilst the investment costs continue to be assessed by the Bank, if investment costs materially exceed the level of cost that the Bank determines through the current assessment process, then the Bank would consider alternative IT strategies to implement the business strategy. The Bank recognises that there are aspects of the delivery of this re-engineering programme and the implementation of the IT strategy which will require the Bank to engage third parties to complement its intended delivery capability, in particular in respect of the digitalisation aspects of the programme (although others may be identified in due course).

As part of the Bank's wider strategy, the Bank is still in a process of transition from the merger with Britannia and is continuing to integrate heritage systems and processes. As a result, there are risks associated with the on-going integration of two organisations of the size of the Bank and Britannia. Particular areas of risk include: difficulties or unexpected costs relating to the integration of technology platforms, financial and accounting systems and difficulties or unexpected costs in realising synergies from the remaining consolidation of head office and back office functions. If the implementation of any such projects is not delivered on time, and/or the costs of implementation rise significantly and the Bank fails to exploit such projects once implemented, there is a risk that there could both be a delay to the future benefits, and an increased cost for the transformation process which may have an adverse effect on the Bank's business, financial position and results of operations.

The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT.

The IT services provided by Co-operative Group include core infrastructure services, colleague technology services, network services, service management services (including change management services), architecture direction, architecture design, supplier management, IT programme management and management operations. For further information see paragraph 7 titled "*Technology/IP/IT*" in Section 8 (*Description of the Bank*).

It is intended that one of the IT functions which is currently provided to the Bank by Co-operative Group under the Existing IT Service Agreement will return to the Bank under a New IT Services Agreement (as defined in paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*)), the terms of which are to be finalised. The returned function is IT service continuity and disaster recovery. Under the New IT Services Agreement the Bank would manage the Bank's receipt of Co-operative Group's provision of these services. For further information please see paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*). Following completion of the Liability Management Exercise, a significant majority of the IT functions provided to the Bank by Co-operative Group are expected to return, over time, to the Bank.

In addition, the Bank relies on Co-operative Group to provide certain services in respect of finance (including procurement), marketing, human resources, risk, corporate affairs, secretariat (governance), secretariat (legal), estates and investment property management functions. Some of these services are critical to maintaining the level of support for the on-going needs of the business and customers. Please see paragraph 20.1 titled "*Project Unity*" in Section 20 (*Additional Information*) for further details of these services.

The Bank intends that certain services which are currently provided to the Bank by Co-operative Group under the Existing MSA will return to the Bank on completion of the Liability Management Exercise under a New MSA (as defined in paragraph 20.1(b) titled "*MSA*" in Section 20 (*Additional Information*), the terms of which are under negotiation. These include secretariat services and corporate affairs. Under the New MSA the Bank would control and direct Co-operative Group's provision of these and other services. Please see paragraph 20.1(b) titled "*MSA*" in Section 20 (*Additional Information*) for further details. As described in paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*), the Bank and Co-operative Group shall be considering further changes to the arrangements under the current MSA such that, following completion of the Liability Management Exercise, all services that would otherwise have been provided by Co-operative Group to the Bank under the MSA will return to the Bank.

The concentration of responsibility for providing a wide range of services with Co-operative Group, as a single supplier, increases the risk that any event or series of events impacting the ability of Co-operative Group to provide the services or perform its other obligations (such as an event of *force majeure* or an insolvency event) would have an impact on the Bank's ability to conduct its business.

Under the New IT Services Agreement and New MSA, to the extent implemented in their current form, the Co-operative Group would be required to provide the services in accordance with Co-operative Group policies, except where Co-operative Group and the Bank agreed that a Co-operative Bank policy should apply in substitution for a Co-operative Group policy. The Bank would be able to require that a Co-operative Bank policy is followed where required by applicable law or a regulator. As a result, Co-operative Group would seek to provide these services in a way that enables it to comply with its policies (e.g. its ethical policies which may be detrimental to the business of the Bank).

If Co-operative Group fails to provide or procure the services envisaged or provide them in a timely manner or to agreed levels under either of the Existing IT Services Agreement or Existing MSA, such failure could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank is dependent on third party providers of services, IT, software, data and other assets.

There is a risk that third-party providers will fail to supply services, IT, software, data or other assets. If third party providers fail to provide or procure the services envisaged or to provide them in a timely manner or to agreed levels, or the arrangements with those providers are terminated by the third party, such failure could have a material adverse effect on the Bank's business, prospects, results of operations and financial position. The Bank may be unable to source an alternative provider for the services, IT, software, data or other assets on a timely basis, on equivalent terms or without significant expense, or at all. The additional costs and expenses incurred in doing so may have a material adverse effect on the Bank's cost base. This could have a material adverse effect on the Bank's business and the results of its operations.

Any reduction in third party product quality or any failure by a third party to comply with the Bank's licensing or regulatory requirements, including requirements with respect to the handling of customer data, could cause a material disruption to or adverse financial and/or reputational impact on the Bank's business. Any of these events could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank is dependent on CFSMS to provide certain personnel and assets, and to on-supply certain services, data and assets supplied by third party providers.

A significant proportion of third party services and assets are procured by CFSMS for the benefit of the Bank and other members of Banking Group.

CFSMS was established as a wholly-owned subsidiary of Banking Group to facilitate economies of scale through the sharing of employees and the sourcing of third party services across Banking Group, including the Bank. It employs the majority of personnel within Banking Group. Banking Group utilises employees across its different businesses. As such, the Bank procures certain assets and third party services (including services provided by Steria Limited and SAS Software Limited) through CFSMS. The Bank receives third party services and assets with the support of procurement service provided by Co-operative Group, but the agreements under which those assets or third party services are provided are entered into by CFSMS.

As a result, the Bank is reliant on CFSMS to on-supply services, staff and assets to Bank. As part of the proposed separation (see paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*)) the Bank intends to transfer from CFSMS the employees, assets and contracts it uses pursuant to the CFSMS-Bank 2006 Agreement, so that it is significantly less reliant on CFSMS to provide personnel and services to conduct its day-to-day activities. To the extent that these transfers or alternative arrangements cannot be implemented before completion of the Liability Management Exercise, the Bank's current proposal that the Bank and CFSMS will enter into a new agreement to replace the CFSMS-Bank 2006 Agreement, for the purpose of (amongst other reasons) ensuring the Bank has robust contractual recourse should CFSMS fail to deliver assets or secondees or fail to enforce the terms of any third party agreement under which those supplies are obtained or otherwise is in breach. A summary of the draft terms of the amended CFSMS-Bank Framework Agreement is set out in paragraph 20.2 titled "*CFSMS – Bank Framework Agreement*" in Section

20 (*Additional Information*). However, until such agreement can be reached, the current arrangements will continue with the consequential risk of significant additional VAT charge for the Bank and reliance on CFSMS staff on terms that are not sufficiently robust.

It may not be possible to agree new arrangements pursuant to which Co-operative Group and CFSMS will continue to provide services, personnel and assets to Bank. A failure or delay in agreeing the new arrangements will result in, amongst other things, a significant VAT charge for the Bank. The new arrangements may be less favourable to Bank than the existing arrangements.

The Bank is dependent on Co-operative Group for the provision of a number of services and is dependent on CFSMS for the provision of certain personnel, assets and the on-supply of certain third party services (see "*The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT*" and "*The Bank is dependent on CFSMS to provide certain personnel and assets, and to on-supply certain services, data and assets supplied by third party providers*" above). There are a number of agreements in place to govern these arrangements (the "**Existing Service Agreements**").

In light of the fact that, on completion of the Liability Management Exercise, the Bank will cease to be part of the same group as Co-operative Group and CFSMS, the Bank, Group and CFSMS are currently renegotiating the terms of the Existing Service Agreements with a view to ensuring that the replacement arrangements are appropriate to reflect this fact.

As the terms of the replacement arrangements are still the subject of negotiation, there is a risk that the scope of or terms upon which the services are agreed to be provided to Bank may not be as favourable to Bank as the terms of the current arrangements or that Bank may not receive all the personnel, use of assets or services which it requires. In such circumstances, the Bank will be dependent on sourcing such personnel, assets or services from elsewhere and there is no guarantee that the Bank will be able to source such personnel, assets or services, to do so within a reasonable period of time, or to do so on favourable terms.

If, and for so long as, the terms of the new agreements cannot be agreed, the Existing Service Agreements will continue to apply with the result that the Bank would incur a significant VAT cost from completion of the Liability Management Exercise as a result of VAT becoming payable in respect of the services, as the Bank and Co-operative Group will no longer be in the same VAT group. In relation to staff, continuation of the Existing Service Agreements will result in the Bank continuing to have to rely on CFSMS for the provision of the majority of the staff in its business. In addition, if, and for so long as, the terms of the Existing Service Agreements continue to apply, Co-operative Group and CFSMS will continue to be able to terminate those agreements on relatively short notice with the consequence that, should they do so, the services provided under the Existing Service Agreements may cease before appropriate replacement arrangements have been found. Consequently, failure to reach agreement on the replacement arrangements could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank's requirement for standalone insurance arrangements.

The Bank has historically participated in Co-operative Group's insurance programme. On completion of the Liability Management Exercise, the Bank will need to arrange its own insurance on a standalone basis. As at the date of this Prospectus, there is no guarantee that the cover which the Bank will be able to obtain on a standalone basis will be equivalent to that available to it under Co-operative Group's programme, whether in respect of the level, pricing and terms (including continuity) of cover.

The contributions that the Bank is required to make to its pension schemes may change over time. The Bank may be obliged to make large one-off payments to the pension schemes if certain events occur.

Co-operative Group operates several pension schemes. The main Co-operative Group pension scheme is Pace, which provides defined contribution and defined benefit pensions for current employees and former employees. The Bank participates in Pace. In addition, Co-operative Group operates several other pension schemes, including the Britannia Pension Scheme (the **Britannia Scheme**). The Bank is a guarantor in respect of the Britannia Scheme.

The assets of the pension schemes are held and managed by trustees separate from the Bank's assets. At present there is an actuarial deficit in Pace, with the most recent actuarial report indicating that there was a funding deficit of £715 million as at 5 April 2013. The employers participating in Pace make aggregate contributions towards the deficit as agreed between Co-operative Group and the trustee of Pace following the advice of the independent scheme actuary. These contributions are reviewed by the trustee and Co-operative Group following each triennial actuarial valuation. The time by which the trustees and Co-operative Group are required, under pensions legislation to agree contributions is 15 months after the effective date of the valuation, although this deadline can often be extended. This may lead to an increase in the rate of contributions the participating employers are required to make to the scheme. Co-operative Group conducts negotiations with the trustee of Pace on behalf of all the employers in Pace and then allocates the agreed aggregate employer contributions among the participating employers. Although Co-operative Group seeks input from the Bank in connection with the valuation process, ultimately the Bank's contributions can be determined by Co-operative Group without the Bank's agreement. However Co-operative Group has undertaken to agree with the Bank its proportion of the employer contributions to Pace (if not agreed, the matter will be referred to an independent third party).

CFSMS is the employer in relation to the Britannia Scheme and charges the Bank for any payments due to the scheme in respect of members employed by CFSMS and working for the Bank. This means that the Bank is charged for contributions to the Britannia Scheme which have historically been determined without any input from the Bank. However, Co-operative Group has undertaken to procure that if CFSMS is not controlled by the Bank, CFSMS will not take or omit to take any action without the Bank's prior agreement if the result would be to increase the Bank's liabilities or contributions in respect of the Britannia Scheme. In addition the Bank has also provided guarantees in respect of the Britannia Scheme under which the Bank may become liable to contribute towards that scheme. The most recent actuarial report indicated that the funding deficit in the Britannia Scheme as at 5 April 2013 was £61 million.

Risk arises from the schemes because the value of their asset portfolios and returns from them may be less than expected and because there may be greater than expected increases in the estimated value of the schemes' liabilities (for example, due to rates of investment return, pensioner mortality, changes in interest rates, changes in pension regulations, changes in expenses (including the Pension Protection Fund levy) and changes in the trustees' view of the strength of the employer). In these circumstances, the Bank could be obliged, or may choose, to make additional contributions to the pension schemes.

Liabilities may also arise for the Bank as an employer participating in a defined benefit pension scheme (or as the guarantor of such employers) in certain circumstances set out in legislation, for example on ceasing to participate in the pension scheme or becoming insolvent. The liability will be the value of the employer's share of the deficit at the time, calculated by reference to the cost of buying out the scheme's liabilities in the insurance market (which commonly produces a greater deficit than the ongoing funding deficit – in some cases a substantially greater deficit). No formal calculations have been undertaken in respect of what the Bank's share of such deficit would be, and if calculated it could be very large. Co-operative Group has the power under the rules of Pace to require the Bank (or any other participating employer) to cease to participate in Pace; exercise of that power would result in a liability for the Bank of this type. However Co-operative Group has undertaken not to exercise its powers without the Bank's prior written approval except (i) where the Bank is in breach of the rules of Pace, (ii) where required by law or (iii) where all other employers cease participation at the same time so that a liability of this type does not arise. Further, if the Bank sought to address its risks as a participating employer in Pace by terminating its participation, a liability of this nature would result.

It is possible to agree arrangements that would reduce the Bank's liability on termination of participation in Pace. Any such arrangement would require the consent of the trustees of Pace and in some cases of Co-operative Group and the Pensions Regulator. No arrangements have been agreed and there is a risk that none can be agreed.

If CFSMS terminated its participation in the Britannia Scheme (for example as part of separating the Bank's pension arrangements from Co-operative Group's), CFSMS would incur a liability as described above which would have to be met by the Bank. Any arrangement to reduce CFSMS's liability would require the consent of the trustees of the Britannia Scheme and in some cases of the continuing sponsoring employer after CFSMS's exit. No arrangements have been agreed and there is a risk that none will be agreed.

Pace is a non-segregated, hybrid pension scheme in which several Co-operative Group companies participate, including the Bank. On an on-going basis, each employer is responsible for funding a proportion of the Pace liabilities, as determined by Co-operative Group, subject to Co-operative Group's undertaking to agree the Bank's proportion with the Bank. In addition, there are circumstances in which funding from an employer may be required for liabilities relating to members' service with another employer. In particular, where other employers in Co-operative Group have ceased to participate in the pension scheme without satisfying their liabilities (for example due to insolvency) the Bank's share of the deficit could include liabilities relating to those other employers, up to the level of the entire deficit in the scheme (calculated on the insurance buy-out basis mentioned above).

The Pensions Regulator also has the power to require an employer of a defined benefit scheme or a person connected or associated with it to make a contribution to or provide financial support for that scheme in certain circumstances. There are eight defined benefit pension schemes within the Co-operative Group in addition to Pace and the Britannia Scheme and there is a risk that the Pensions Regulator could impose liability in respect of any of these Co-operative Group pension schemes on the Bank. Such liability could have a material adverse affect on the Bank.

Co-operative Group has engaged in discussions with the trustees of the pension schemes and the Pensions Regulator. These discussions have centred on the effect on the pension schemes of the turnaround plan, in particular on the future funding of the pension schemes and the position of the trustees as creditors compared with that of other creditors. These discussions have not yet concluded and Co-operative Group continues to seek to satisfy the trustees and the Pensions Regulator on the matters they have raised.

The burden on the Bank of the Financial Services Compensation Scheme, which imposes significant levies on the Bank, may increase in future periods.

FSMA established the FSCS, which pays compensation to eligible customers of authorised financial services firms which are unable, or are likely to be unable, to pay claims against them. An institution's FSCS levy is linked to its share of the UK deposit market, and therefore its FSCS levy may have a material impact on its profits. As at the date of this Prospectus, a number of claims against the FSCS have been triggered. Claims on the FSCS are funded by loans from HM Treasury, and until such loans are repaid, increased levies on UK deposit-taking institutions fund interest payments on such loans. As a result of the various claims under the FSCS, the Bank, in common with all regulated UK deposit takers, has recently been subject to significantly increased FSCS levies. In certain circumstances, regulated UK deposit takers may further be required to fund, by way of a further increase in the FSCS levy, the capital repayment to HM Treasury of such loans. There can also be no assurance that there will be no actions taken under the Banking Act that may lead to future claims against the FSCS, and concomitant increased FSCS levies payable by the Bank (and other regulated UK deposit takers), which may have a material adverse effect on its results of operations.

Based on its share of protected deposits, the Bank pays levies to the FSCS to enable the scheme to meet claims against it. The amount provided for in the Bank's accounts to meet its obligations to the FSCS was £38.4 million as at 30 June 2013. While it is anticipated that the substantial majority of claims will be repaid wholly from recoveries from the institutions concerned, there is the risk of a shortfall, such that the FSCS may place additional levies on all FSCS participants, which levies may be in significant amounts that may have a material impact on the Bank's profits. For example, in March 2012 the FSCS and HM Treasury agreed the refinancing of £20.4 billion in loans made to the FSCS by HM Treasury to fund the compensation payments made by the FSCS to customers whose savings were put at risk by bank failures in 2008 and 2009. As a result, the FSCS was required to pay a significantly increased amount of interest which it will recover through additional levies on the financial services industry. Following recoveries since March 2012, the FSCS currently has outstanding loans of approximately £17.3 billion.

As noted above, in common with other financial institutions which are subject to the FSCS, the Bank also has a potential exposure to future FSCS levies resulting from the failure of other financial institutions and consequential claims which arise against the FSCS as a result of such failure. The quantification and timing of such losses are, accordingly, yet to be determined and, therefore, although the Bank's share could be significant (reflecting the fact that the share is calculated by reference to the level of each institution's protected deposits and, for the scheme year 2012/2013, the Bank's share of such deposits was 3 per cent.), the Bank has not made any provision in respect of such levies yet.

Historically, compensation scheme levies similar to the FSCS have tended to increase over time (especially during and in the aftermath of periods of economic crisis), and there can also be no assurance that there will not be any further claims against the FSCS and concomitant increased FSCS levies payable by the Bank. Any such increases in the Bank's costs and liabilities related to the levy may have a material adverse effect on the results of operations of the Bank. In July 2012, the FCA published a consultation paper as part of its FSCS Funding Model Review (**FFMR**). The FFMR will concentrate on issues such as the composition of the nine funding classes, the levy thresholds applicable to each and their tariff bases. However, the methodology for determining levies per institution will be driven primarily by revisions to the EU Deposit Guarantee Scheme Directive (**DGSD**). The European Commission published a legislative proposal in July 2010. The main changes proposed included a tighter definition of deposits, a requirement that the Deposit Guarantee Scheme pay customers within a week and that banks must be able to provide information on the aggregated deposits of a depositor, known as the single customer view, at any time. On 12 June 2013 the European Council announced that the negotiations on revisions to the DGSD were on hold, pending further development on the RRD.

As a result of the structural reorganisation and reform of the UK financial regulatory authorities, the FSCS is now the responsibility of the FCA. It is possible that future policy of the FSCS and future levies on the Bank may differ from those at present, and such reforms could result in the Bank incurring additional costs and liabilities, which may adversely affect its business, financial condition and/or results of operations.

During 2012, the FSCS indicated that it expected to raise a capital levy to cover the estimated shortfall in the amounts recovered from the failed banks to repay HM Treasury loans made to the FSCS. The Bank has provided £11.6 million (30 June 2012: £nil) in respect of its share of this levy.

Reputational risk could cause harm to the Bank and its business prospects.

The Bank's reputation is one of its most important assets and its ability to attract and retain customers and conduct business with its counterparties could be adversely affected to the extent that its reputation or the reputation of its brand is damaged. Failure to address, or appearing to fail to address, various issues that could give rise to reputational risk could cause harm to the Bank and its business prospects. Reputational issues include, but are not limited to:

- the reputational damage arising from the downgrades to the Bank's credit ratings and the implementation of the Recapitalisation Plan;
- litigation or objections from creditors in connection with the Liability Management Exercise or the Recapitalisation Plan as a whole and associated media coverage;
- being required to raise further capital in the future, which could affect, or be perceived to affect, confidence in the Bank;
- failure to implement the Bank's strategy;
- a reduction in the Bank's' customer service levels resulting from cost-cutting to the Bank's Core Business and/or the reorientation of the Bank's distribution channels;
- the Bank no longer being owned by Co-operative Group with the result that the mutual and ethical reputation of Co-operative Group could conflict with the profit maximisation objective of other holders of Ordinary Shares and the Board's duties to such shareholders;
- an impact to the Bank's reputation as a result of an action of Co-operative Group which adversely impacts the Bank brand, including as a result of adverse findings following from any legal or regulatory investigation into the Bank's conduct, in particular criticism arising from the independent Kelly Review into the events which led to the announcement of the Bank's Recapitalisation Plan, which is due to report to Co-operative Group's members' annual general meeting in May 2014;

- failing to appropriately address potential conflicts of interest;
- breaching or facing allegations of having breached legal and regulatory requirements (including money laundering and anti-terrorism financing requirements and conduct risk events such as past business reviews);
- acting or facing allegations of having acted unethically (including having adopted inappropriate sales and trading practices);
- failing or facing allegations of having failed to maintain appropriate standards of customer privacy, customer service and record-keeping;
- technology failures that impact upon customer services and accounts;
- internal fraud, such as market manipulation;
- failing to properly identify legal, reputational, credit, liquidity and market risks inherent in products offered; and
- generally poor company performance.

A failure to address these or any other relevant issues appropriately could make customers, depositors and investors unwilling to do business with the Bank, which could adversely affect its business, financial condition and results of operations and could damage its relationships with its regulators. The Bank cannot ensure that it will be successful in avoiding damage to its business from reputational risk.

In past years the Government has provided significant support to UK financial institutions, including most recently the Funding for Lending Scheme which commenced on 1 August 2012 and to which an extension was announced on 24 April 2013. Any significant reduction or withdrawal of the Funding for Lending Scheme could increase competition for other sources of funding which could adversely impact the Bank.

In past years the Government has provided significant support to UK financial institutions, including through the Special Liquidity Scheme, which is the liquidity scheme introduced by the Bank of England on 21 April 2008 for certain financial institutions, which was introduced in April 2008 to improve the liquidity position of the banking system by allowing banks and building societies to swap their high-quality mortgage-backed and other securities for UK Treasury Bills for up to three years, and the Credit Guarantee Scheme, which was introduced in October 2008 and under which the Government guaranteed eligible bank and building society debt securities for a limited period.

On 1 August 2012, the Funding for Lending Scheme became operational. The aim is to boost the incentive for banks and building societies to lend to UK households and non-financial companies. The Funding for Lending Scheme is designed to reduce funding costs for participating institutions so that they can make loans cheaper and more easily available. Access to the Funding for Lending Scheme is directly linked to how much each institution lends to the real economy. Those that increase lending are able to borrow more and at a lower cost than those that scale back their loans. Under the Funding for Lending Scheme, participating financial institutions are, for a period of 18 months to the end of January 2014, able to borrow funds with a maturity of up to four years. On 24 April 2013, the scheme was extended for a further 12 months, with drawings now permitted until the end of January 2015 and the funding under the scheme now running until January 2019. The Bank accessed the Funding for Lending Scheme in the first half of 2013, drawing £900 million of Treasury Bills. The Treasury Bills remain available to the Bank until March 2017. The fee payable under the scheme is linked to net lending growth and therefore may increase.

The availability of Government support for UK financial institutions, to the extent that it provides access to cheaper and more attractive funding than other sources, reduces the need for those institutions to fund themselves in the retail or wholesale markets. Any significant reduction or withdrawal of Government support will increase funding costs for those institutions which have previously utilised that support. In addition, other financial institutions that have relied significantly on Government support to meet their funding needs will also need to find alternative sources of funding when that support is reduced or withdrawn and, in such a scenario, the Bank expects to face increased competition for funding, particularly retail funding on which it is reliant, in the future. This competition could further increase its funding costs and thereby adversely impact its results of operations and financial position.

The extension to the Funding for Lending Scheme announced in April 2013 has skewed the incentive towards lending to SMEs, by weighting net lending to that sector by a factor of 10 in 2013 and 5 in 2014. This will benefit eligible institutions which are seeking to reduce the residential mortgage element of their balance sheets but which are still providing loans to SMEs. As the Bank is seeking to reduce its exposure to commercial real estate lending but does conduct some lending with SMEs, there is a risk that its competitive position will be damaged through other institutions having greater access to new Funding for Lending Scheme funds that the Bank does not enjoy, with the result that the Bank might not be able economically to match the pricing of those competitors in the mortgage market.

The Bank's guidelines and policies for risk management may prove inadequate for the risks faced by its business and any failure to properly manage the risks which it faces could cause harm to the Bank and its business prospects. Certain controls have not in the past operated effectively

The management of financial, operational and legal risks requires, among other things, robust guidelines and policies for the accurate identification and control of a large number of transactions and events. In addition, the Bank's board is responsible for setting the overall Bank risk strategy, identifying the key business risks facing the Bank and planning the Bank's risk strategy and the acceptable level of risk appetite. The Bank's risk management guidelines and policies may not always prove to be adequate in practice. The operation of controls over credit risk have, in the past, not operated effectively and not adequately brought issues to the attention of senior management quickly enough. In recognition of this, credit risk controls were recently reviewed by senior management and external advisers, and such controls have been tightened.

Until September 2013, Banking Group maintained a common governance, organisational and risk management structure. From September 2013, and as a result of the separation of the Bank from Co-operative Group, the Bank has put in place its own revised, updated and independent risk management framework. The revised and updated risk management framework and policies have been adopted by the Bank, however these policies will take time to be embedded within individual business units, in particular in relation to awareness of responsibilities. In addition, whilst the revised overall risk management framework (and supporting documented risk policies) adheres to a clear three lines of defence model, there are still occasions where the first and second lines are blurred and improvements are still required to be made to the third line of defence, in particular improving the capability of the internal audit team. Prior to implementing changes to the internal audit team, the Bank is utilising outsourced resources from Deloitte to support its internal audit function. For further information of the Bank's risk management framework, see Section 14 (*Risk Management*).

The Bank faces a wide range of risks in its business activities, including, in particular:

- credit risk is the risk that a borrower or a counterparty fails to pay interest or to repay the principal on a loan or other financial instrument;
- liquidity risk, see the risk factor titled "*The Bank's business is subject to inherent risks concerning liquidity, particularly if the availability of traditional sources of funding such as retail deposits becomes limited and/or becomes more expensive, and this may have an adverse effect on the Bank's business, profitability and its ability to meet its liabilities as they fall due*" above;
- 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 within the retail and corporate businesses and certain characteristics embedded within these products and basis risk. The Bank's Treasury function also creates market risk through its various portfolio management and trading activities along with currency risk;
- interest rate risk (a type of market risk) is the risk arising out of changes in interest rate levels, yield curves and spreads, which may affect the Bank's interest rate margin realised between lending and

borrowing costs. Changes in currency rates, particularly in the sterling-dollar and sterling-euro exchange rates, affect the value of assets and liabilities denominated in foreign currencies and may affect income from assets and liabilities denominated in foreign currency. The performance of financial markets may also cause changes in the value of the Bank's investment and liquidity portfolios. The Bank seeks to minimise the volatility of future earnings from interest rate changes and all fixed interest rate risk exposure is removed from the Core Business and the Non-core Business and consolidated at the centre where it is managed from the core balance sheet within agreed limits. The Bank's Treasury function is responsible for interest rate risk management for the Bank;

- model risk is the risk that an adverse outcome occurs as a direct result of weaknesses or failures in the design or use of a model. Models are mathematical representations of business systems designed to help describe, predict, experiment with or optimise decisions and scenarios and are used throughout the Bank's business;
- operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. The operational risk control framework is in the process of being strengthened to ensure that it meets regulatory requirements; and
- pension risk is the risk arising from 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.

In the past, there have been failings by the Bank's business units to adhere to the Bank's credit risk policies, including in respect of the origination and documentation of corporate loans. Weaknesses in the credit challenge and control process resulted in such failings not being brought to the attention of senior management quickly enough. These historic failings contributed to the impairment charges on the Bank's corporate loans, which were recognised in the financial year ended 31 December 2012 and the six month period ended 30 June 2013. As a consequence, and in March 2013, the Bank launched an internal review of its credit controls, in order to establish more robust control standards and to improve the ability of the Bank to identify and anticipate credit risk issues. In addition, a number of independent reviews, in particular in relation to corporate credit risk, have been undertaken by independent advisers. Consequential to such internal and external reviews, the Bank has documented and approved new credit control standards, and a number of changes have been made to limit the amount of credit control and discretion which can be exercised within the business units themselves, and more detailed checks are now being performed by the credit risk function. These reviews did not result in any amendments to the impairment provisions recorded in prior financial years. There can be no guarantee that the Bank's new control standards will be sufficient to minimise further credit losses in the future.

The Bank has a range of tools designed to measure and manage the various risks which it faces. These methods may prove to be inadequate for predicting risk exposure, which may prove to be significantly greater than is predicted. Methods for risk management are based on evaluation of information regarding markets, customers or other information that is publicly known or otherwise available to the Bank. Such information may not always be correct, updated or correctly evaluated. In addition, even though the Bank constantly measures and monitors its exposures, there can be no assurance that its risk management methods will be effective, particularly in unusual or extreme market conditions. It is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on the Bank's financial performance and business operations.

The Bank's business and financial performance would be adversely affected by a break-up of the single European currency.

In recent years, there has been significant volatility in financial markets around the world. The financial turbulence in 2008 and its after-effects on the wider economy have led to generally more difficult earnings conditions for the financial sector and, at the time, resulted in the failures of a number of financial institutions in the United States, the UK and elsewhere in Europe and unprecedented action by governmental authorities, regulators and central banks around the world. A number of countries in Europe, such as the GIIPS countries, together with Cyprus, have been particularly affected by the difficult financial and economic conditions since 2008 and are struggling with large sovereign debts and/or public budget deficits. These factors, together with weak economies and disruption in the capital markets, necessitated a range of international rescue packages and other assistance, including for Greece and Ireland in 2010, Portugal in 2011, Greece and Spain in 2012 and, most recently, Cyprus in March 2013. The perceived risk of default on the sovereign debt of certain of the GIIPS countries intensified in the latter part of 2011 and into 2012, particularly in relation to Greece. This raised concern about the contagion effect such a default would have on other EU economies as well as the on-going viability of the euro currency and the Economic and Monetary Union (**EMU**).

Reflecting these and other concerns, in January 2012 one of the major international credit rating agencies lowered its long-term ratings in respect of nine European sovereigns, further increasing market uncertainty. Furthermore, the effectiveness of the actions aimed at stabilising European economies and reducing debt burdens is not assured and the possibility remains that the euro could be abandoned as a currency by countries that have already adopted its use or, in an extreme scenario, abandonment of the euro could result in the dissolution of the EMU. This would lead to the re-introduction of individual currencies in one or more EMU Member States. The effects on the European and global economies of the potential dissolution of the EMU, exit of one or more EU Member States from the EMU and the redenomination of financial instruments from euro to a different currency, are impossible to predict fully.

However, if any such events were to occur they would likely:

- result in significant market dislocation;
- heighten counterparty risk; and
- affect adversely the management of market risk and, in particular, asset and liability management due, in part, to redenomination of financial assets and liabilities.

If any such events were to occur, the Bank would be immediately exposed to certain potential losses on its portfolio of treasury assets and to redenomination risks as one or more individual countries introduced new currencies. However, as the Bank is a UK-focused retail and commercial operation it has no sovereign exposure to the GIIPS countries but does have sovereign exposures to other Eurozone governments. As at 30 June 2013, the Bank had a £306.6 million gross exposure to the Government of Finland, and £226.5 million to the Federal Republic of Germany, as well as, by way of exposure to non-Eurozone countries, £91.2 million to the Swedish Export Credit Corporation, repayable in over one year. It held no other material non-UK sovereign debt.

The Bank anticipates that the occurrence of any of the events described above would be likely to adversely impact the cost and availability of wholesale funding, thereby increasing competition for retail funds and adversely impacting the Bank's net interest margin.

The Bank could be negatively affected by a deterioration or a perceived deterioration in the soundness of other financial institutions and counterparties.

Given the high level of interdependence between financial institutions, the Bank is and will continue to be subject to the risk of deterioration of the commercial and financial soundness, or perceived soundness, of other financial services institutions. Within the financial services industry, the default of any one institution could lead to defaults by other institutions. Concerns about, or a default by, one institution could lead to significant liquidity problems, losses or defaults by other institutions, as was the case after the bankruptcy of Lehman Brothers in 2008, because the commercial and financial soundness of many financial institutions may be closely related as a result of their credit, trading, clearing or other relationships. Even the perceived lack of creditworthiness of, or questions about, a counterparty may lead to market-wide liquidity problems and losses or defaults by the Bank or by other institutions. This risk is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges with whom the Bank interacts on a daily basis. Systemic risk could have a material adverse effect on the Bank's ability to raise new funding and on its business, financial condition, results of operations, liquidity and/or prospects.

The Bank routinely executes a large number of transactions with counterparties in the financial services industry, resulting in large daily settlement amounts and significant credit exposure. As a result, the Bank faces concentration risk with respect to specific counterparties and customers. A default by, or even concerns about the creditworthiness of, one or more financial services institutions could therefore lead to further significant systemic liquidity problems, or losses or defaults by other financial institutions.

Changes in the Bank's accounting policies or in accounting standards could materially affect how it reports its financial condition and results of operations.

From time to time, the International Accounting Standards Board (the **IASB**) and/or the EU change the international financial reporting standards issued by the IASB, as adopted by the European Commission for use in the EU (**IFRS**) that govern the preparation of the Bank's financial statements. These changes can be difficult to predict and could materially impact how the Bank records and reports its financial condition and results of operations. In some cases, the Bank could be required to apply a new or revised standard retroactively, resulting in restating prior period financial statements.

For example, amendments to International Accounting Standard 19 (**IAS 19**) are effective for accounting periods beginning on or after 1 January 2013. The amendments update the recognition, presentation and disclosures of retirement benefit plans. The most significant change in the treatment of defined benefit plans is the replacement of the expected return on plan assets and interest cost with a single measure of net interest income (or expense) based on the net retirement benefit asset (or obligation). The Bank is a participating employer in Pace. Pace is a non-segregated hybrid scheme providing defined contribution and defined benefit pensions for current employees and former employees. The Bank accounts under IAS 19 for its payments to Pace on a defined contribution basis, which are recognised as an expense on the income statement as incurred and based on a fixed percentage as agreed with the trustees. The Bank expects to adopt amended IAS 19 in its financial statements for its financial year ending 31 December 2013, however this amendment will not lead to a change in the pension costs disclosed by the Bank on the defined contribution basis.

In addition, changes to International Financial Reporting Standard 9 (Financial Instruments: Recognition and Measurement) (**IFRS 9**), which are due to become effective in relation to accounting periods beginning on or after 1 January 2015, address phase 1 of the IASB's project to replace International Accounting Standard 39, Financial Instruments: Recognition and Measurement. The changes will require the Bank to classify its financial assets either at amortised cost or at fair value and the available for sale category for financial assets currently used by the Bank will cease to be available. In addition, where the Bank opts to fair value its financial liabilities under IFRS 9, the movement in fair value due to own credit risk will be directly recognised in other comprehensive income unless this results in an accounting mismatch. Currently, other than derivatives which are required, to be carried at fair value, the Bank only fair values its liabilities on 'Customer accounts – capital bonds. The capital bonds are fixed term customer accounts with returns based on movements in an index, such as FTSE-100, over the life of the bonds. The Bank uses swaps to create economic hedges against all of its capital bonds and so has elected to carry them at fair value through income and expense in order to prevent an accounting mismatch. The IASB is currently proposing amendments to the classification and measurement requirements of Phase 1 of IFRS 9. The Bank expects that IFRS 9 will significantly impact its financial statements, the full extent of which is currently being considered.

The IASB may make other changes to financial accounting and reporting standards that govern the preparation of the Bank's financial statements, which the Bank may adopt, or which the Bank may adopt prior to the date on which such changes become mandatory if determined to be appropriate by the Bank, or which the Bank may be required to adopt. Any such change in the Bank's accounting policies or accounting standards could materially affect its reported financial condition and results of operations.

The Bank's accounting policies and methods are critical to how it reports its financial condition and results of operations. They require the Bank to make estimates about matters that are uncertain.

Accounting policies and methods are fundamental to how the Bank records and reports its financial condition and results of operations. The Bank must exercise judgement in selecting and applying many of these accounting policies and methods so that they comply with IFRS.

In the Bank's financial statements, the basis of preparation and accounting policies disclosures have identified certain accounting policies in respect of which significant judgement is required in determining appropriate assumptions and estimates when valuing assets, liabilities, commitments and contingencies.

These critical judgements and estimates relate to the assumptions used in the determination of loan impairment provisions, intangible and tangible assets impairments and deferred tax.

A variety of factors could affect the ultimate value that is obtained either when earning income, recognising an expense, recovering an asset or reducing a liability. The Bank has established detailed policies and control procedures that are intended to ensure that these judgements (and the associated assumptions and estimates) are well controlled and applied consistently. In addition, the policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding the Bank's judgements and the estimates pertaining to these matters, the Bank cannot guarantee that it will not be required to make changes in accounting estimates or restate prior period financial statements in the future and any such changes or restatements could be material in nature.

Failure to maintain adequately and protect customer and employee information could have a material adverse effect on the Bank.

The Bank collects and processes personal data (including name, address, age, bank and credit card details and other personal data) from its customers, third party claimants, business contacts and employees as part of the operation of its business, and therefore it must comply with data protection and privacy laws and industry standards in the UK and the EU. Those laws and standards impose certain requirements on the Bank in respect of the collection, use, processing and storage of such personal information. For example, under UK and EU data protection laws and regulations, when collecting personal data, certain information must be provided to the individual whose data is being collected. This information includes the identity of the data controller, the purpose for which the data is being collected and any other relevant information relating to the processing. There is a risk that data collected by the Bank and its appointed third parties is not processed in accordance with notifications made to, or obligations imposed by, data subjects, regulators, or other counterparties or applicable law. Failure to operate effective data collection controls could potentially lead to regulatory censure, fines, reputational and financial costs as well as result in potentially inaccurate rating of risks or overpayment of claims.

The Bank is also subject to certain data protection industry standards, and may be contractually required to comply with those standards. For example, as a major processor of payments from payment cards, the Bank is required to comply with the Payment Card Industry Data Security Standard as part of its contractual obligations to merchant acquirers. For example, there is a risk that certain types of data security breaches could subject the Bank to liability and/or damage to the Bank's brands and reputation.

In addition, the Bank is exposed to the risk that the personal data it controls could be wrongfully accessed and/or used, whether by employees or other third parties, or otherwise lost or disclosed or processed in breach of data protection regulations. If the Bank or any of the third-party service providers on which it relies (including Co-operative Group under the Bank's separation arrangements) fail to process, store or protect such personal data in a secure manner or if any such theft or loss of personal data were otherwise to occur, the Bank could face liability under data protection laws. This could also result in damage to the Bank's brands and reputation as well as the loss of new or repeat business, any of which could have a material adverse effect on the Bank's business, prospects, results of operations and financial position.

The Bank has significant holdings of investment securities and negative changes in the fair value of these securities could have a material adverse effect on the Bank's comprehensive income, financial condition and prospects.

As at 30 June 2013, the Bank's portfolio of available for sale investment securities had a fair value of £3.4 billion. The Bank's investment securities are, where appropriate, fair valued on each balance sheet date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. As a wide range of valuation techniques are available, it may be inappropriate to compare the Bank's fair value information to that of independent market or other financial institutions. Changes to assumptions and different methodologies can have significant impacts, particularly on fair values which are based on unobservable inputs.

In addition, on the merger of the Bank with Britannia in 2009, Britannia's net assets were restated to fair value. The majority of these fair value adjustment unwinds are expected to be through the income statement over the lives of the associated assets and liabilities. Although over time the impact is broadly neutral, the impact in any one year depends on the assumptions made about expected future arrears, interest rates, redemption rates and maturities. The timing of fair value adjustment unwinds may have a material adverse effect on the Bank's operating results, financial condition and prospects.

Any changes in fair value of available for sale investment securities during the relevant period are recorded in other comprehensive income, except for impairment losses and foreign exchange gains or losses which are recognised in the income statement. Gains and losses arising on the sale of available for sale investment securities are also recognised in the income statement, including any cumulative fair value gain or loss previously recognised in other comprehensive income which is reclassified to the income statement. Any changes in fair value of investment securities designated at fair value through income or expense during the relevant period are recognised in the income statement. In each of the three financial years ended 31 December 2012, 2011 and 2010 and the six-month period ended 30 June 2013, the Bank recorded other comprehensive income from available for sale investments (net of amounts reclassified to the income statement) of £10.5 million, £32.6 million, £(15.6) million and £(24.1) million, respectively. In each of the three financial years ended 31 December 2012, 2011 and 2010 and the six-month period ended 30 June 2013, the Bank also recognised net impairment gains on available for sale investment securities of £2.7 million, £nil million, £nil million and £nil million, respectively. The impairment gains related to a structured investment vehicle held by the Bank.

In each of the three financial years ended 31 December 2012, 2011 and 2010 and the six-month period ended 30 June 2013, the Bank recorded fair value movements through the income statement from investment securities designated at fair value through income or expense of £6.5 million, £(1.0) million, £nil and £(16.3) million, respectively.

Although the Bank has recorded other comprehensive income in respect of its available for sale investment portfolio in recent years, it has in previous years experienced significant fair valuation losses on securities included in the portfolio. Accordingly, there can be no assurance that fair valuations of its investment securities in future periods will not result in other comprehensive losses or impairments which could be material. In addition, the value that the Bank ultimately realises for its investment securities may be lower than their current fair value, resulting in losses being recorded in its income statement, which losses could be material. Any of these factors could have a material adverse effect on the Bank's operating results, financial condition or prospects.

The Bank is exposed to the risk of changes in tax legislation and its interpretation and to increases in the rate of corporate and other taxes.

The Bank's activities are principally conducted in the UK and it is therefore subject to a range of UK taxes at various rates. Future actions by the Government to increase tax rates or to impose additional taxes would reduce the Bank's profitability. Revisions to tax legislation or to its interpretation might also affect the Bank's financial condition in the future. In addition, the Bank is subject to periodic tax audits which could result in additional tax assessments relating to past periods of up to six years being made. Any such assessments could be material, which might also affect the Bank's financial condition in the future.

RISKS RELATED TO THE FEATURES OF THE NOTES

Key factors which are material for the purpose of assessing the risks associated with the Notes

The conditions of the Notes will include certain features which are specific to the Notes and which may have a material adverse effect on the amount of principal and interest which the Bank will pay to investors and the timing of such payments. There may be circumstances or events as a result of which investors will not receive any principal and/or interest. The risks associated with the particular features of the Notes include the following risks. Holders of Existing Securities should bear in mind that a number of these risks will also apply to their Existing Securities, and they should consider the following risks in that context.

The Notes are not protected by the Financial Services Compensation Scheme

The Notes will not be protected deposits for the purposes of the FSCS, which is the fund of last resort for customers of authorised financial services firms. In this regard, investors should note that the Bank is currently facing considerable financial difficulties. As a result, if the Bank does go out of business or becomes insolvent, or if the Authorities take action under the Banking Act (or similar future legislation) to preserve or restore the viability of the Bank or part or all of its business, the FSCS will not pay compensation to an investor. Accordingly, in such circumstances, an investor in the Notes may lose some, or the entire amount, of its investment in the Notes.

The Notes are subordinated obligations of the Bank. On a winding-up or dissolution of the Bank, investors in the Notes may lose their entire investment in the Notes

The Notes will constitute unsecured and subordinated obligations of the Bank. On a winding-up or dissolution of the Bank, claims in respect of the Notes would rank behind the claims of all depositors and other unsubordinated creditors of the Bank, and rank equally with all claims of holders of all other dated subordinated obligations (and, potentially, certain undated subordinated obligations) of the Issuer.

Accordingly, in a winding-up, the assets of the Bank would be applied first in satisfying all senior-ranking claims in full, and payments would be made to holders of the Notes, proportionately with payments made to holders of any other instruments which rank equally with the Notes (if any), only if and to the extent that there are any assets remaining after satisfaction in full of all such senior ranking claims. If, in the winding-up of the Bank, the Bank's assets are not sufficient to repay all depositors and other senior creditors in full, investors in the Notes will not be eligible to receive any amounts in the winding-up process and will lose their entire investment in the Notes. If the Bank's assets are sufficient to repay all depositors and other senior creditors in full, but are insufficient to fully repay the Noteholders and other creditors who rank alongside the Noteholders, then the Noteholders will lose some of their investment in the Notes.

There is no restriction on the amount of securities or other instruments which the Bank may issue or incur and which rank senior to, or rank equally with, the Notes. The issue of any such securities or instruments may reduce the amount (if any) recoverable by holders of Notes on a winding-up, liquidation or dissolution of the Bank.

The Bank is currently facing considerable financial difficulties. If the Bank's Recapitalisation Plan is unsuccessful or if its financial condition deteriorates such that there is an increased risk that the Bank may be wound-up, such circumstances can be expected to have a material adverse effect on the market price of the Notes. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such event, investors may lose some or substantially all of their investment in the Notes, whether or not the Bank is wound up.

The Notes may become subject to provisions requiring capital instruments to be written-down or converted to Common Equity Tier 1 Capital (as defined in Basel III) instruments under current proposals

On 16 December 2010 and on 13 January 2011, with a minor revision on 1 June 2011, the Basel Committee (which seeks to set global standards for making the banking system safer) issued final guidance on a number of fundamental reforms to its global regulatory capital framework (such reforms being commonly referred to as **Basel III**). The reforms included a proposal that (amongst other instruments) all tier 2 (as defined in Basel III) capital instruments issued by banks (which would include the Notes) should be capable of being written-down or converted into ordinary shares (or other common equity tier 1 instruments) at the option of the relevant national authorities if such action was considered by those authorities to be necessary to preserve or restore the financial viability of the bank. This mechanism is commonly referred to as 'loss absorption at the point of non-viability', and would be intended to be used before the bank becomes insolvent.

The Basel III proposals are not directly binding in any country, but are expected to be implemented by local law. In the EU (including the United Kingdom), the Basel III proposals are, broadly, being implemented on the basis of two sets of European legislation. The majority of the Basel III proposals will be implemented through CRD IV, which will take effect in the United Kingdom from 1 January 2014.

However, the mechanism enabling the Authorities to require the write-down (which means that the Authorities can reduce (to zero if necessary), the principal amount of the instrument) or conversion to ordinary shares of (amongst other instruments) tier 2 (as defined in Basel III) capital instruments at the point of non-viability is currently expected to be implemented from 1 January 2015 through an EU Directive commonly referred to as the RRD. A first draft of RRD was published on 6 June 2012, and further drafts have since been made available. Whilst the text of RRD has not yet been finalised, and thus there remains significant uncertainty as to the effect and timing of this legislation, it is expected that, if and when the RRD is enacted and implemented in the United Kingdom, the United Kingdom Resolution Authorities will have the power to write-down or write-off the Notes at the point at which they consider such action to be necessary in order to preserve or restore the viability of the Bank.

In addition, it is possible that the Authorities will be afforded similar express powers (to the extent not already available), under current proposals to amend the Banking Act before RRD is finalised. On 1 October 2013, HM Treasury published amendments to the Banking Reform Bill under which it is proposed, amongst other things, that the Bank of England be given the power, in a resolution scenario, to cancel, reduce or defer the equity liabilities of a bank (including divesting shareholders of a bank of their shares), convert an instrument issued by a bank from one form or class to another (for example, a debt instrument (such as the Notes) into equity) and/or transfer some or all of the securities of bank to an appointed bail-in administrator.

The Resolution Authorities will have considerable discretion in determining the timing and circumstances in which they take any action under the Banking Act, but in any event such action would be expected before any injection of public funds by the Government. As such, investors of the Notes would expect to lose all or substantially all of their investment before any 'bail-out' of the Bank by the Government. The inherent unpredictability as to if and when the Resolution Authorities would exercise their powers could also lead to significant volatility in the market prices for the Notes.

If the Notes are written-down or written-off due to the exercise by the Authorities of powers under the Banking Act, Noteholders may receive no compensation or may in certain circumstances receive ordinary shares in the Bank (although, given the circumstances in which such powers would be exercised by the Authorities, the value of such shares is likely to be negligible). Accordingly, any such action taken by Resolution Authorities under the Banking Act would result in Noteholders losing some, or potentially all, of their investment in the Notes, notwithstanding that the Bank does not become insolvent.

In addition, the coming into force of RRD or the other proposed changes to the Banking Act or any similar legislation may have a material adverse effect on the market price of the Notes, and the market price of the Notes may be more volatile than the market prices of other securities or instruments that are not subject to similar write-down or write-off provisions, and may be more sensitive generally to adverse changes in the Bank's financial condition. Further, any anticipated write-down, write-off or conversion of the Notes can be expected to have a material adverse effect on the market price of the Notes, and such effects can be expected to become increasingly pronounced if the Bank's financial condition deteriorates such that it becomes more likely that the relevant non-viability powers will be exercised. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such event, investors may lose some or substantially all of their investment in the Notes, whether or not any write-down, write-off or conversion of the Notes ultimately occurs.

The Bank is currently facing considerable financial difficulties. If the Bank's Recapitalisation Plan is unsuccessful or if its financial condition deteriorates, there is a real risk that the Authorities may elect to use their powers under the Banking Act, which could result in investors in the Notes losing some, or potentially all, of their investment in the Notes.

Noteholders could lose some or all of their investment if the United Kingdom authorities implement other resolution procedures under the Banking Act 2009

In addition to the potential risks under the proposed RRD and the proposed amendments to introduce bail-in powers under the Banking Act, the United Kingdom authorities already have broad powers to effect the resolution of the Bank under the Banking Act. The Banking Act currently empowers the United Kingdom authorities, where a bank is failing (or likely to fail) the threshold conditions for its authorisation to conduct banking business (which includes, amongst other things, the conducting of its business in a prudent manner, which is assessed by reference to its financial and non-financial resources), to impose the SRR on relevant entities. The SRR consists of three stabilisation options, a bank insolvency procedure and a bank administration procedure, which may be commenced by the authorities. For more detail on the Banking Act and the SRR, see the risk factor titled "*Resolution procedure under the Banking Act 2009*".

If the United Kingdom authorities were to take action under the Banking Act to resolve the Bank, an investor in the Notes may lose all or substantially all of its investment, including if the Bank's payment obligations on the Notes are modified, reduced or eliminated, or if the Notes are transferred to, or (in circumstances where the assets of the Bank are transferred to a new entity) left behind in, an entity with no, or non-performing, assets.

Further, if the market anticipates that the Bank may become subject to any such action, this can be expected to have a material adverse effect on the market price of the Notes, and the market price of the Notes may become more volatile, and may be more sensitive generally to adverse changes in the Bank's financial condition. Such effects can be expected to become increasingly pronounced if the Bank's financial condition deteriorates such that it becomes more likely that the relevant powers will be exercised. Investors in the Notes may find it difficult to sell their Notes in such circumstances, or may only be able to sell their Notes at a price which may be significantly lower than the price at which they purchased their Notes. In such event, investors may lose some or substantially all of their investment in the Notes, whether or not the United Kingdom authorities ultimately exercise their powers under the Banking Act.

The Bank is currently facing considerable financial difficulties. If the Bank's Recapitalisation Plan is unsuccessful or if its financial condition deteriorates, there is a real risk that the Authorities may elect to use their powers under the Banking Act, which could result in investors in the Notes losing some, or potentially all, of their investment in the Notes.

Whilst the Notes may pay a higher rate of interest than comparable notes in the market, investors should be aware that this reflects the greater risk which an investment in the Notes may involve when compared to those other notes.

The Notes will bear interest at a rate of 11 per cent. per annum. Whilst this rate of interest may initially appear to be favourable when compared to interest rates payable on some other products and notes in the market, investors should be aware that a higher rate of return tends to indicate a higher degree of risk in the investment. An investment in the Notes will involve considerable risks, given both the current financial condition of the Bank and the challenges it faces in the future and the specific features of the Notes (as described in the present section). Although the Notes may pay a higher rate of interest than other products or notes in the market, there is a real risk that an investor in the Notes will lose all or some of its investment should the Bank become insolvent or if the Authorities take action to resolve the Bank before it becomes insolvent.

An investor must determine for itself, together (if applicable) with its financial and other advisers, whether or not the Notes are a suitable investment for it, given the risks inherent in such an investment. Professional investors tend to invest in higher-risk investments only as part of a balanced and diversified investment portfolio. Investors should consider carefully the impact on their financial circumstances if they were to lose all or substantially all of their investment in the Notes.

There are circumstances in which the Bank (subject to certain conditions) may redeem all outstanding Notes, and an investor may not be able to reinvest the redemption proceeds at as effective a rate of return as that in respect of the Notes

The Bank may (subject to certain conditions) redeem all outstanding Notes at any time at an amount equal to 101 per cent. of their principal amount together with any accrued but unpaid interest if:

(a) as a result of a change in applicable law or regulation, payments in respect of the Notes (i) cease to be partly or fully deductible for United Kingdom corporation tax purposes or (ii) become subject to United Kingdom withholding tax and the Issuer is required to gross-up any such payments; and

(b) as a result of a change in applicable prudential and capital adequacy laws or regulations, the Notes outstanding are (or will, within 90 days, be) fully excluded from tier 2 capital of the Bank.

During any period when the Bank may elect to redeem the Notes, the market value of the Notes generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

An investor may not be able to reinvest the redemption proceeds at an effective rate of return as high as that in respect of the Notes and may only be able to do so at a significantly lower rate of return. Potential investors should consider reinvestment risk in light of other investments which may be available at that time.

Rights of enforcement in respect of the Notes are limited

No remedy against the Issuer, other than the institution of proceedings by the Trustee for the winding-up of the Issuer and/or proving in the winding-up of the Issuer, shall be available to the Trustee or the Noteholders for the recovery of amounts owing in respect of the Notes.

Further, no holder of Notes shall be entitled to take any enforcement action against the Bank in respect of its Notes unless the Trustee, having become bound to take action in accordance with the Conditions, fails to do so within a reasonable period and such failure shall be continuing.

Accordingly, if the Bank were to breach the terms of the Notes, the ability of the holders to require the Bank to resolve the breach, or to seek recompense, is very restricted. In the event of a significant breach of the terms of the Notes by the Bank (for example, if the Bank were to fail to make an interest payment when due), the main right of enforcement available to the Noteholders (through the Trustee) would be to take steps to initiate the winding-up of the Bank. If the Bank were to be wound up, the Noteholders' claim will rank behind the claims of depositors and other unsubordinated creditors of the Bank. In such circumstances, depositors and senior creditors would be repaid in full before the Noteholders receive any amounts, and accordingly investors in the Notes may lose some or all of their investment in the Notes.

The conditions of the Notes will contain provisions which may permit their modification without the consent of all investors and confer significant discretions on the Trustee which may be exercised without the consent of the Noteholders and without regard to the individual interests of particular Noteholders

The conditions of the Notes will contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally, as more fully described in the Trust Deed. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority. The powers afforded to majorities to bind minorities are significant, and could result in material changes to the terms of the Notes, including (without limitation) potentially reducing the amounts of interest and/or principal payable by the Bank, changes to the maturity of the Notes (including extending the time to maturity of the Notes) the timing of those payments of interest and/or principal, mandatory substitution of the Notes with other securities and, in the extreme, the complete abrogation (i.e. annulment) of all rights of the holders under the Notes. Accordingly, a Noteholder's rights under the Notes could be materially adversely affected – or removed altogether – without its consent, where the requisite majority of holders of the Notes exercise those powers.

The conditions of the Notes also provide that the Trustee may, without the consent of Noteholders and without regard to the interests of particular Noteholders, (i) agree to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of the provisions of the Notes or (ii) determine without the consent of the Noteholders that any potential event of default shall not be treated as such or (iii) agree to the substitution of another company as principal debtor under any Notes in place of the Bank. Whilst the Trustee, in exercising those powers and discretions, can be expected to act in a manner in which it considers is not materially prejudicial to the interests of the Noteholders, the Trustee will be entitled to have regard to the Noteholders as a class and to disregard the particular interest or circumstances of individual Noteholders. Accordingly, there can be no assurance that the exercise of those powers and discretions will not result in adverse consequences for any given Noteholder.

Potential denomination should the United Kingdom join the European Monetary Union

If the UK joins the European Monetary Union prior to the maturity of the Notes, there is no assurance that this would not adversely affect investors in the Notes. It is possible that prior to the maturity of the Notes the UK may become a participating Member State (as such term is defined in Section 19 (*Taxation*)) and that the euro may become the lawful currency of the UK. In that event (i) all amounts payable in respect of any Notes denominated in Sterling may become payable in euro, (ii) the law may allow or require such Notes to be redenominated into euro and additional measures to be taken in respect of such Notes, and (iii) there may no longer be available published or displayed rates for deposits in Sterling used to determine the rates of interest on such Notes or changes in the way those rates are calculated, quoted and published or displayed. The introduction of the euro could also be accompanied by a volatile interest rate environment, which could adversely affect investors in the Notes.

RISKS RELATED TO APPLICABLE TAX AND OTHER LEGISLATION

The Notes may be subject to withholding taxes in circumstances where the Bank is not obliged to make gross-up payments and this would result in holders receiving less interest than expected and could significantly adversely affect their return on the Notes

EU Savings Directive

Under EC Council Directive 2003/48/EC on the taxation of savings income (the **EU Savings Directive**), Member States are required to provide to the tax authorities of another Member State details of payments of interest (or other similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or certain limited types of entity established in that other Member State. However, for a transitional period, Austria and Luxembourg are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in Switzerland). In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1 January 2015, in favour of automatic information exchange under the EU Savings Directive.

The European Commission has proposed certain amendments to the EU Savings Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

Foreign Account Tax Compliance Act Withholding

Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986 (**FATCA**) impose a new reporting regime and, potentially, a 30 per cent. withholding tax with respect to (i) certain payments from sources within the United States, (ii) "foreign passthru payments" made to certain non-U.S. financial institutions that do not comply with this new reporting regime, and (iii) payments to certain investors that do not provide identification information with respect to interests issued by a participating non-U.S. financial institution.

In respect of any Notes which are held within the clearing systems, in all but the most remote circumstances, it is not expected that the FATCA will affect the amount of any payment received by the clearing systems. However, FATCA may affect payments made to custodians or intermediaries in the subsequent payment chain leading to the ultimate investor if any such custodian or intermediary generally is unable to receive payments free of FATCA withholding. It also may affect payment to any ultimate investor that is a financial institution that is not entitled to receive payments free of withholding under FATCA, or an ultimate investor that fails to provide its broker (or other custodian or intermediary from which it receives payment) with any information, forms, other documentation or consents that may be necessary for the payments to be made free of FATCA withholding. Investors should choose the custodians or intermediaries with care (to ensure each is compliant with FATCA or other laws or agreements related to FATCA) and provide each custodian or intermediary with any information, forms, other documentation or consents that may be necessary for such custodian or intermediary to make a payment free of FATCA withholding. The Bank's obligations under the Notes are discharged once it has paid the common depositary for the clearing systems (as registered holder of the Notes) and the Bank has therefore no responsibility for any amount thereafter transmitted through the hands of the clearing systems and custodians or intermediaries.

The value of the Notes could be adversely affected by a change in English law or administrative practice

The conditions of the Notes will be based on English law in effect as at the date of this Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Prospectus and any such change could materially adversely impact the value of any Notes affected by it.

RISKS RELATED TO THE MARKET GENERALLY

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

Secondary market

The Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Illiquidity may have a severely adverse effect on the market value of the Notes. If the Notes are traded after their initial issuance, they may trade at a discount to their issue price, depending upon prevailing market rates of return, the market for similar securities, general economic conditions and investors' general perception of the credit risk of the Bank. The market prices may also be volatile, meaning that prices may go up and/or down sharply. In addition, any deterioration in the financial condition of the Bank can be expected to have a material adverse effect on the market price of the Notes, including if the Bank's financial condition deteriorates to an extent where the market anticipates that action may be taken in respect of the Bank or the Notes under the Banking Act or (if and when implemented in the United Kingdom) the RRD or otherwise if the Bank may become insolvent.

Therefore, investors may not be able to sell the Notes easily, or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. Investors in the Notes will lose some of their investment if they sell their Notes at a price that is lower than the price at which they purchased such Notes.

Interest rate and inflation risks

The Notes bear interest at a fixed rate. Investors should note that (i) if market interest rates start to rise then the income to be paid on the Notes might become less attractive and the price the investors get if they sell such Notes could fall (however, the market price of the Notes has no effect on the interest amounts due on the Notes or what investors will be due to be repaid on the Maturity Date if the Notes are held by the investors until they expire); and (ii) inflation will reduce the real value of the Notes over time which may affect what investors can buy with their investments in the future and which may make the fixed interest rate on the Notes less attractive in the future.

Exchange rate risks and exchange controls

The Bank will pay principal and interest on the Notes in Sterling. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than Sterling. These include the risk that exchange rates may significantly change (including changes due to devaluation of Sterling or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to Sterling would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

RISKS RELATING TO THE HOLDING STRUCTURE OF THE NOTES

Risks relating to holding Notes in uncertificated form

CREST, Euroclear and Clearstream, Luxembourg are clearing systems which provide for instruments such as the Notes to be traded electronically, rather than in physical form.

The Bank will discharge its payment obligations under the Notes held in uncertificated form by making the relevant interest and principal payments to, or to the order of, the registered holder of the Notes. Investors in such Notes must rely on the procedures of CREST, any applicable nominee and, if applicable Euroclear or Clearstream, Luxembourg for their share of the relevant payments. Investors must also rely on the procedures of CREST, and, if applicable Euroclear or Clearstream, Luxembourg for trading their Notes and for certain communications with the Bank (including receipt of notices given by the Bank in accordance with the terms of the Notes).

3
INFORMATION ABOUT THE NOTES

The following is an overview of the key terms of the Notes.

The full Conditions of the Notes are contained in Appendix B (*Conditions of the Notes*) to this Prospectus. It is important that Holders read the entirety of this Prospectus, including the Conditions of the Notes, before deciding whether or not to exchange their Existing Securities (in whole or in part) for Notes. If a Holder has any questions, it should seek advice from its financial adviser or other professional adviser before deciding whether or not to invest.

INFORMATION ABOUT THE NOTES

What are the Notes?

The 11 per cent. Subordinated Notes due 2023 (the **Notes**) will be bonds issued by The Co-operative Bank p.l.c. (the **Bank**).

What is a bond?

A bond is a form of borrowing by a company seeking to raise funds from investors. The company that issues a bond usually promises to pay to the holder of such bond a rate of interest periodically until the date when the relevant bond becomes repayable (usually on the relevant maturity date, although a bond may also become repayable early in certain circumstances) when the company also promises to repay the amount borrowed.

An investor does not have to keep a bond until the date when the bond matures. A bond is a tradable instrument (which is one respect in which bonds can be differentiated from traditional bank loans or deposits in a bank account). The market price of a bond will fluctuate between the start of the bond's life and when it matures depending upon a number of factors, including (amongst other things) the financial condition of the company issuing the bond, the relative coupon of the bond and the relative appeal of other investments available in the market from time to time.

Who can buy the Notes?

The Notes are being offered exclusively in connection with a liability management exercise being conducted by the Bank and the Co-operative Group Limited (**Co-operative Group**) in respect of certain existing capital securities of the Bank (the **Liability Management Exercise** or **LME**) as originally announced by the Bank on 17 June 2013 and as more fully described in Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) and Appendix C (*Consent and Exchange Offer Memorandum*).

Part of the Liability Management Exercise involves invitations to Eligible Holders of the Bank's 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) to offer to exchange their 5.5555% Bonds for a portion of the Notes.

A further part of the Liability Management Exercise involves invitations to holders of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (the **2016 Notes**), the 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**), the 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**), the Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**), the 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**), the 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) (the **2024 Notes**), the 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (the **2033 Notes**) (together the **Dated Notes**) to vote on proposals under a scheme of arrangement under Part 26 of the Companies Act 2006 to authorise the Bank to exchange all outstanding Dated Notes (including those held by holders who do not vote in favour of the proposals) for a combination of (i) New Ordinary Shares to be issued by the Bank and (ii) a portion of the Notes.

Accordingly, only investors who hold Dated Notes or 5.5555% Bonds will be able to obtain the Notes upon their initial issue. Instead of paying for the Notes in cash, those investors will deliver their Dated Notes and 5.5555% Bonds to the Bank (or as the Bank directs) in exchange for the Notes.

What is the total amount of Notes to be issued?

The Notes will be issued only upon successful completion of the Liability Management Exercise, and no Notes will be issued if the Liability Management Exercise does not successfully complete.

If the Liability Management Exercise is successful and settles on 18 December 2013, the maximum principal amount of Notes which may be issued is expected to be £206,000,000.

The final principal amount of Notes to be issued (if any) will be announced by the Bank via the Regulatory News Service operated by the London Stock Exchange, which announcement is currently expected to be made on or around 12 December 2013 or, in the event that any meeting pursuant to the Proposals is adjourned, is currently expected to be made on or around 30 December 2013.

What is the issue price of the Notes?

The Notes will be issued at the issue price (which is 100 per cent. of the principal amount of the Notes).

When will the Notes be issued?

The issue date of the Notes will depend upon the progress of the Liability Management Exercise, including whether there are any delays in implementing the Liability Management Exercise. Delays may occur if, for example, the Bank is required to adjourn certain bondholder meetings which are being convened in connection with the Proposals, or if the Bank elects to extend the period during which the Offers remain open.

If there are no delays, the Bank expects to issue the Notes on 18 December 2013. If there are delays, the latest date on which the Bank currently expects to issue the Notes would be 31 December 2013.

The Bank will from time to time make announcements in connection with the Liability Management Exercise via the Regulatory News Service operated by the London Stock Exchange. Persons who participate in the Liability Management Exercise are recommended to check that service regularly in order to obtain any updates on the progress of the Liability Management Exercise, including the final issue date of the Notes assuming successful completion of the Liability Management Exercise.

What are the main features of the Notes?

The full terms and conditions of the Notes are set out in Appendix B (*Conditions of the Notes*) to this Prospectus. Key features of the Notes (some of which are further described below) include that:

(a) the Notes will have a denomination of £10 per Note;

(b) the Notes will pay a fixed rate of interest of 11 per cent. per year;

(c) interest will be paid quarterly at the end of each three-month accrual period;

(d) the Bank will be required to redeem the Notes in full at maturity on the tenth anniversary of the issue date (redemption means that the Bank will repay the principal amount of the Notes, upon which the Notes will be cancelled);

(e) subject to the consent of the Prudential Regulation Authority, the Bank may, in certain circumstances, elect to repay the Notes before maturity at an amount equal to 101 per cent. of their principal amount;

(f) the Notes will not be secured by or over any assets of the Bank;

(g) the Notes will be subordinated obligations of the Bank; and

(h) the Notes are intended to be admitted to trading on the London Stock Exchange.

In what form will the Notes be issued?

The Notes will be issued in registered form in denominations of £10 each. The Notes are intended to be held electronically either (i) in certificated form outside of CREST, Euroclear and Clearstream, Luxembourg, (ii) in uncertificated form in CREST, or (iii) in uncertificated form with Euroclear or Clearstream, Luxembourg through CREST.

Notes held in uncertificated form will be held in accordance with the Uncertificated Securities Regulations 2001, including any modification or re-enactment thereof for the time being in force (the **Uncertificated Securities Regulations**). Notes held in uncertificated form will be participating securities for the purposes of the Uncertificated Securities Regulations. Title to Notes held in uncertificated form will be recorded on the relevant Operator register of corporate securities (as defined in the Uncertificated Securities Regulations) and the relevant "Operator" (as such term is used in the Uncertificated Securities Regulations) is Euroclear UK & Ireland Limited or any additional or alternative operator from time to time approved by the Issuer and the Registrar and in accordance with the Uncertificated Securities Regulations.

What is the interest rate on the Notes?

The Notes will bear interest at a fixed rate of 11 per cent. per year.

When will interest be paid?

Interest will accrue from (and including) the date of issue of the Notes and will be paid quarterly on each three-month anniversary of the issue date until the Notes are redeemed.

As noted above, the issue date of the Notes will depend upon the progress of the Liability Management Exercise. However, by way of example:

If the Notes were to be issued on 18 December 2013, then interest would be paid on 18 March, 18 June, 18 September and 18 December in each year, with the first payment being due on 18 March 2014 and the last payment being due on 18 December 2023.

If the Notes were to be issued on 31 December 2013, then interest would be paid on 31 March, 30 June, 30 September and 31 December in each year, with the first payment being due on 31 March 2014 and the last payment being due on 31 December 2023.

When will the Notes be repaid?

The Bank will be required to repay the Notes at their principal amount on the tenth anniversary of the issue date (the **Maturity Date**). By way of example:

If the Notes were to be issued on 18 December 2013, then the Bank would be required to repay the Notes on 18 December 2023.

If the Notes were to be issued on 31 December 2013, then the Bank would be required to repay the Notes on 31 December 2023.

Are there any circumstances in which the Notes may be repaid early?

The Bank will have the right (subject to the consent of the Prudential Regulation Authority), the United Kingdom banking regulator) to repay the Notes at an amount equal to 101 per cent. of their principal amount before the Maturity Date if either:

(i) there is a change in the tax laws of the United Kingdom resulting in the Bank having to pay additional amounts under the Notes or interest payments on the Notes ceasing to be partly or fully deductible for UK corporation tax purposes; or

(ii) there is a change in English law or applicable banking regulations (or their official application or interpretation) and as a result the Notes are fully excluded from the tier 2 capital of the Bank.

See "*What happens if the Bank fails to make a payment of principal or interest on the Notes*" below for information on what happens in that circumstance.

Can Noteholders require the Bank to repay their Notes before the Maturity Date?

No. The Noteholders do not have any right to require the Bank to repay or purchase their Notes prior to the Maturity Date.

Will the Bank be able to buy Notes in the market?

The Bank, or any of its subsidiaries, may at any time purchase Notes in any manner and at any price, subject to applicable law and regulatory consent of the Prudential Regulatory Authority.

Will the Notes be secured over the assets of the Bank?

No, the Notes will be unsecured.

The Notes are expressed to be 'subordinated'. What does that mean?

The Notes will be subordinated obligations of the Bank. This means that, on a winding-up of the Bank, the claims of holders in respect of the Notes would rank behind the claims of depositors and senior creditors of the Bank such as holders of senior notes issued by the Bank. Accordingly, the assets of the Bank would be used to pay all depositors and senior creditors in full before any payment is made to holders of the Notes. This feature makes the Notes a riskier investment than other investments in the Bank which are not subordinated.

If, in the winding-up of the Bank, the Bank's assets are not sufficient to repay all depositors and other senior creditors in full, investors in the Notes will not be eligible to receive any amounts in the winding-up process and will lose their entire investment in the Notes. If the Bank's assets are sufficient to repay all depositors and other senior creditors in full, but are insufficient to fully repay the Noteholders and other creditors whose claims rank alongside the Noteholders' claims, then the Noteholders will lose some of their investment in the Notes.

Will there be withholding on any payments in respect of the Notes?

Under current United Kingdom tax law, the Bank will not need to withhold or deduct any amounts for or on account of United Kingdom taxation. If in the future withholding or deduction is required under United Kingdom tax law, the Bank will pay an additional amount to ensure that Noteholders will receive the same amount as they would have received without the withholding or deduction, subject to certain customary exceptions.

Who represents the Noteholders?

Law Debenture Trustees Limited (the **Trustee)** will act as trustee for the holders of the Notes under the terms of a trust deed to be entered into between the Bank and the Trustee on the issue date of the Notes (the **Trust Deed**).

What happens if the Bank fails to make a payment of principal or interest on the Notes?

If the Bank fails to make a payment of any principal or interest when due on the Notes and such payment default continues in the case of principal for a period of 7 days and in the case of interest for a period of 15 days, the Trustee may, subject as provided in the Conditions, at its discretion (or, in certain circumstances, if directed by the Noteholders), institute proceedings for the winding-up of the Bank and prove in the winding-up, but may take no other action in respect of such payment default.

If, otherwise than for the purposes of a reconstruction or amalgamation on terms previously approved in writing by the Trustee, an order is made or an effective resolution is passed for winding-up the Bank, the Trustee may, and, if so requested in writing by the holders of at least one-fifth in nominal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the holders of the Notes shall subject as provided in the Conditions, give notice to the Bank that the Notes are, and they shall thereby become, immediately due and repayable at their principal amount, together with accrued interest. This means that the holders of the Notes will have a claim in the winding-up of the Bank, and such claim will be equal to the principal amount of their Notes together with accrued and unpaid interest. That claim will, however, be subordinated as described above under the paragraph titled "*The Notes are expressed to be 'subordinated'. What does that mean?*".

How will notices be given to Noteholders?

The terms of the Notes provide for the Bank to give Noteholders notices in certain circumstances. Notices to the Noteholders are to be mailed to them at their respective addresses in the register of Noteholders maintained by the Registrar and may also be published on the Regulatory News Service operated by the London Stock Exchange.

Can the Conditions of the Notes be amended?

The terms of the Notes and the Trust Deed contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities of the Noteholders attending the relevant meeting to pass resolutions which will bind all Noteholders, including Noteholders who did not attend the meeting as well as Noteholders who voted against the resolution. The powers afforded to majorities to bind minorities are significant, and could result in material changes to the terms of the Notes, including (without limitation) potentially reducing the amounts of interest and/or principal payable by the Bank, the timing of those payments of interest and/or principal, mandatory substitution of the Notes with other securities and, in the extreme, the complete abrogation (i.e. annulment) of all rights of the holders under the Notes.

All Noteholders will have the right to receive notice of such meetings and to vote on any resolution proposed at such meetings. For the avoidance of doubt, Noteholders are not, by virtue of their holding of Notes, entitled to attend or vote at any meeting of the shareholders of the Bank.

The Trustee may also agree to minor or technical amendments to the terms of the Notes or amendments which, in the opinion of the Trustee, are not materially prejudicial to the interests of Noteholders.

Does an investment in the Notes involve any risks?

Yes. As with any investment, an investment in the Notes involves certain risks. Given, in particular, the current financial difficulties which the Bank is facing and also the specific features of the Notes, the risk of an investment in the Notes is considerably higher as of the date of this Prospectus than many other investments (although many of those risks will also apply to the Dated Notes and 5.5555% Bonds which may be exchanged for Notes). Holders of the Dated Notes and 5.5555% Bonds are urged to read carefully the risk factors set out in Section 2 (*Risk Factors*) of this Prospectus.

Will any expenses and taxes be charged to the Noteholders?

The Bank and the Dealer Managers will not charge any expenses or taxes.

4
LETTER FROM THE CHAIRMAN OF THE BANK, BACKGROUND TO AND REASONS FOR THE RECAPITALISATION PLAN AND POTENTIAL CONSEQUENCES OF HOLDERS FAILING TO SUPPORT THE LIABILITY MANAGEMENT EXERCISE

The following section contains a brief explanation of the background to and reasons for the Recapitalisation Plan and potential consequences of holders failing to support the Liability Management Exercise.

LETTER FROM THE CHAIRMAN OF THE BANK, BACKGROUND TO AND REASONS FOR THE RECAPITALISATION PLAN AND POTENTIAL CONSEQUENCES OF HOLDERS FAILING TO SUPPORT THE LIABILITY MANAGEMENT EXERCISE

PART A – LETTER FROM THE CHAIRMAN OF THE BANK

The co-operative bank

(*incorporated in England and Wales under the 1948 Companies Act, as amended and restated, with registered number 990937*)

Registered office:
1 Balloon Street
Manchester
M60 4EP

4 November 2013

Dear Holders

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the Prudential Regulation Authority (the **PRA**), the Bank and Co-operative Group announced that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion (the **June Announcement**). In the June Announcement, the Bank and Co-operative Group also announced the initial details of the Recapitalisation Plan, which was intended to address this capital requirement. At least £1 billion is expected to be contributed pursuant to the Liability Management Exercise by the end of 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is expected to be contributed by Banking Group during 2014.

The publication today of the various documents launching the Liability Management Exercise in relation to the Bank's Existing Securities and describing the Recapitalisation Plan in the form that has developed since June represents a significant milestone in the Bank's plan to address this shortfall.

I said in June that the announcement of the Recapitalisation Plan was an important turning point for the Bank and the Bank Board continues to believe that the completion of that plan will provide the foundations to support the long-term success of the Bank in offering a real alternative to customers. If the initial details of the Recapitalisation Plan had not been announced in June, the Bank believes it is likely that it would have been resolved almost immediately by the Bank of England or HM Treasury. The Recapitalisation Plan which is being announced today is different from the initial plan announced in June but we believe it is much better for all stakeholders than the plan previously announced. The Liability Management Exercise launched today is the cornerstone of the Recapitalisation Plan. The support of Holders is critically important to the success of the Liability Management Exercise and the viability of the Bank. It is only with Holders' support that the Bank will be able to move forward.

The Bank believes that there are only two realistic outcomes for the Bank following the launch of the Liability Management Exercise, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank being subject to a resolution procedure under the Banking Act 2009 (**Banking Act**). The Bank believes that its recapitalisation through the Liability Management Exercise would be substantially more beneficial to Holders of any class of its Existing Securities than resolution of the Bank.

Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) sets out a description of the hypothetical position that Holders would be likely to face if the Bank were to be resolved. The purpose of the resolution analysis contained in Part C of this Section 4 is to assist Holders in determining whether or not to accept the Liability Management Exercise and the offer and proposals set out in this Prospectus (including the Offer Memorandum) and the other documentation we have published today.

In summary, the Bank believes that, if the Bank were to be resolved and go into an insolvency proceeding as a result of that resolution, Holders would not receive any recovery in respect of their Existing Securities in any such insolvency proceeding and would not be entitled to any compensation under the resolution regime arising from their holding of Existing Securities. Further, the Bank considers that there are fundamental uncertainties as to whether the Bank could be successfully resolved such that the Bank itself remained a going concern without the active participation of Co-operative Group and a substantial amount of additional capital.

Over the last few months, we have worked hard to bring the Bank to this stage of announcing the Recapitalisation Plan. In developing the details of the Recapitalisation Plan we know we cannot please everyone but we have sought to balance the interests of a large number of stakeholders and we believe that the Recapitalisation Plan provides an outcome which is in the long-term interests for all stakeholders given the current circumstances of the Bank.

The Bank has listened carefully to the often competing demands of its various stakeholder groups as it has put together the revised Recapitalisation Plan. As a result, the Recapitalisation Plan which is being announced today is different from the initial plan announced in June, but we believe that the revised Recapitalisation Plan is much better for all stakeholders.

Following discussions we have held with certain Holders of Dated Notes and their representatives, these Holders (who represent approximately 49 per cent. of the nominal value of the Dated Notes) have agreed to lock-up their holdings and vote in favour of the Recapitalisation Plan (the **LT2 Group**). This is a significant vote of confidence by these Holders in the revised Recapitalisation Plan.

Upon the successful completion of the Recapitalisation Plan, 70 per cent. of the equity of the Bank will be owned by the LT2 Group. The LT2 Group has acknowledged that the Bank is unique for its ethics, mission and heritage, which are essential components of the Bank's differentiated approach and it is important to them that the Bank maintains its unique characteristics and ethos. Holders of the Dated Notes will also receive the Notes as part of the Recapitalisation Plan.

On completion of the Recapitalisation Plan, Co-operative Group, which will hold the remaining 30 per cent. of the equity in the Bank, will be the Bank's largest single shareholder by far, which will enable it to maintain significant influence over how the Bank operates. Further, to ensure that the Bank continues to have a clear ethical focus, co-operative values and ethics shall be, for the first time, with the agreement of Co-operative Group and the LT2 Group whom we have held discussions with, been embedded in the constitution of the Bank and the Bank will set up a values and ethics committee, with an independent director as its chair. The Bank's values and ethics committee will be entrusted with ensuring that the Bank conducts itself in a manner informed by the established values of the co-operative movement.

In the initial details of the Recapitalisation Plan published in June it was indicated that Holders of the Bank's more junior ranking subordinated securities were likely to be offered a substantially greater proportion of New Ordinary Shares in the Bank as opposed to debt instruments as part of the proposed recapitalisation. Many of the Holders of these junior ranking securities are retail investors and a strong preference has been expressed by, or on behalf of, many of those investors to receive income producing debt instruments rather than Ordinary Shares. Accordingly, the Recapitalisation Plan provides for the issue to such holders of income producing debt instruments rather than Ordinary Shares.

The Recapitalisation Plan also provides for a contribution of £462 million from Co-operative Group, which has been consented to by bank creditors of Co-operative Group on terms which Co-operative Group believes not to be materially detrimental to the development of its other businesses.

As a result, I would urge you to read the rest of the documentation that has been published and which is applicable to the Existing Securities you hold and consider the actions to be taken by Holders set out in Section 6 (*Details of the Liability Management Exercise*) and the Offer Memorandum. I would particularly draw your attention to the description of the risks relating to the Liability Management Exercise, the Bank and its business and the rights related to the features of the Notes, set out in Section 2 (*Risk factors*).

In conclusion therefore, I present to you our Recapitalisation Plan, which has the benefit of the strong backing of both Co-operative Group and the LT2 Group, including strong support for the preservation of the unique co-operative principles and ethics of the Bank, whilst also being able to cater for the demands of the Bank's retail investors. So, whilst the journey has been most unusual, what we are still trying to achieve is a more sustainable bank better placed to serve its customers in the future. I remain convinced that this is a worthwhile enterprise and that, with your support, we can rebuild our Bank.

Your decision as to whether to accept the invitation to exchange or sell your Existing Securities for New Securities to be issued by the Bank, and in certain cases, Co-operative Group, will depend on your individual circumstances. If you are in any doubt as to the action you should take, you are recommended to seek your own personal financial advice from an independent financial adviser authorised under the Financial Services and Markets Act 2000 (as amended) if you are in the UK or, if you are outside the UK, from an appropriately authorised independent financial adviser, without delay.

Yours faithfully

Richard Pym
Chairman

PART B: BACKGROUND TO AND REASONS FOR THE RECAPITALISATION PLAN

1. Introduction

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, the Bank and Co-operative Group announced that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion. The Bank and Co-operative Group also announced the initial details of the Recapitalisation Plan, which was intended to address this capital requirement. The Recapitalisation Plan consists of the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities surrendered in the Liability Management Exercise. The Liability Management Exercise is expected to generate at least £1 billion of Common Equity Tier 1 Capital in 2013 and, conditional upon successful completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is expected to be contributed by Banking Group during 2014, under the 2014 Commitment, of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid by 31 January 2014) and the remaining £163 million by 31 December 2014.

The purpose of this Part B is to set out the background to, and the reasons for, the Recapitalisation Plan and the potential consequences of Holders failing to support the Liability Management Exercise.

The key objective of the Recapitalisation Plan is to strengthen significantly the Bank's Common Equity Tier 1 Capital base and this can only be achieved with the support and participation of Holders of Existing Securities in the Liability Management Exercise. The Board, having explored extensively (both before the June Announcement and since that time) various potential means of strengthening the Bank's capital position, remains of the view that the Recapitalisation Plan (notwithstanding the revisions to the Recapitalisation Plan announced today), and the Liability Management Exercise that forms the cornerstone of that plan, is the only viable means of recapitalising the Bank in a manner outside of a resolution procedure under the Banking Act. If the initial details of the Recapitalisation Plan had not been announced in June, the Bank believes it is likely that it would have been resolved almost immediately by the Bank of England or HM Treasury. The Recapitalisation Plan which is being announced today is different from the initial plan announced in June but the Bank believes that the revised Recapitalisation Plan is much better for all stakeholders than the plan previously announced.

Further details of the background to and components of the Recapitalisation Plan are set out in paragraphs 2, 3 and 6 of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*), Section 6 (*Details of the Liability Management Exercise*), Section 2 (*Risk Factors*) and in the Offer Memorandum.

The decision originally taken in June by Co-operative Group to support the Recapitalisation Plan was taken in the belief that the Recapitalisation Plan was in the long-term interest of all Co-operative Group's and the Bank's respective stakeholders and of the Bank itself. As explained in more detail in section 5 below and Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*), absent the willingness of sufficient Holders to participate in and, where requested, to support the proposals being made in the Liability Management Exercise, the Board believes that the Bank would be subject to a resolution procedure under the Banking Act. For a description of the resolution procedure under the Banking Act see paragraph 2.6 "*Recovery and resolution Regime*" in Section 17 (*Supervision and Regulation*).

In the event that the Bank enters an insolvency procedure following action taken by the Resolution Authorities under the Banking Act, and as further described in Part C of this Section 4, the Board believes it likely that Holders would not receive any recovery in any such insolvency proceedings and would not be entitled to any compensation as a result of a bank insolvency procedure or administration of the Bank. The Bank also believes that there are fundamental uncertainties as to whether it is capable of being resolved as a going concern. The Board therefore believes that the Recapitalisation Plan represents the only realistic opportunity for Holders to recover any value in return for their investment in the Bank.

The details of the Recapitalisation Plan have been discussed with the PRA, which announced on 29 August 2013 (and as reconfirmed to the Bank on 21 October 2013) that its assessment remains that the Bank has a capital shortfall of £1.5 billion relative to the requirement for 7 per cent. Common Equity Tier 1 Capital after adjustments.

The announcement of the Recapitalisation Plan in the June Announcement marked an important turning point for the Bank and the Board continues to believe that the completion of this plan, as amended, will provide the foundations to support the long-term success of the Bank in offering a real alternative to customers. The Bank's strategy to achieve this goal is described in further detail in paragraphs 2 "*Key Strengths*" and 3 "*Strategy*" in Section 8 (*Description of the Bank)*. Only following the implementation of the Liability Management Exercise and the other elements of the Recapitalisation Plan, will the Bank be in a position to pursue this four to five year turnaround plan and seek to achieve the key targets described in paragraph 3 "*Strategy*" in Section 8 (*Description of the Bank*).

However, the support of Holders is critically important to the viability of the Bank and it is only with Holders' support that the Bank will be able to move forward.

Further information on the Recapitalisation Plan (including a summary of the Liability Management Exercise) is set out in the remainder of this Prospectus. You should read the whole of this Prospectus, (including the Offer Memorandum) and the documents (or parts thereof) incorporated therein by reference before taking any decision in connection with the Liability Management Exercise.

Co-operative Group is also today publishing a prospectus (the *Group Notes Prospectus*) in respect of the Group Notes which it intends to issue in connection with the Liability Management Exercise. In addition, certain elements of the Liability Management Exercise are being implemented by way of the Scheme, which is summarised in the Offer Memorandum, the Explanatory Statement and the other Scheme documents (which will be published following the court hearing to convene the Scheme Meeting). Holders should also read all other documents which relate to their holding of Existing Securities, as described in the section of the Offer Memorandum titled "*What documents do I need to read?*" in the part titled "*Introduction to this document*", before taking any decision in connection with the Liability Management Exercise.

A list of defined terms and certain technical terms used in this Part B is included in Appendix A (*Defined Terms*).

2. Background to and reasons for the Recapitalisation Plan

The Bank's capital shortfall

Common Equity Tier 1 Capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses in times of financial distress. As a direct result of the recent global financial crisis, the PRA, in line with banking regulators around the world, is requiring UK banks to bolster their capital resources so that the banks, and the UK banking system generally, are better able to withstand future asset write-downs and financial shocks.

In March 2013, a meeting of the then interim Financial Policy Committee (**FPC**), a part of the Bank of England responsible for macro-prudential regulation, voted unanimously that the PRA should take steps to ensure that, by the end of 2013, major UK banks and building societies, including the Bank, hold capital resources equivalent to at least 7 per cent. of their risk-weighted assets assessed using the Basel III definition of equity capital but after: (i) making deductions from currently-stated capital to reflect an assessment of expected future losses and a realistic assessment of future costs of conduct redress; and (ii) adjusting for a more prudent calculation of risk weightings. The FPC noted that, relative to that benchmark, major UK banks and building societies in aggregate had a shortfall in capital of around £25 billion. The PRA's calculation of capital adequacy was based on CRD IV definitions, applying them on a fully loaded basis with certain PRA adjustments (such adjustments to reflect the FPC's assessment of expected losses and future costs of conduct redress, and adjusting for a more prudent calculation of risk weights, amounting to £1.7 billion for the Bank at that point in time).

Continuing losses in the first half of 2013 have reduced the Bank's capital to a point where, if the Liability Management Exercise is not successfully completed, the Bank will not remain a going concern. Following these losses, as at 30 June 2013 the Bank's Core Tier 1 Capital ratio stands at 4.9 per cent. (2012: 8.8 per cent.) (ie which is the applicable test under Basel II) and at 3.0 per cent. on a Common Equity Tier 1 Capital basis (i.e. which is the applicable test under CRD IV). As a result, the Bank has a significant capital shortfall against the PRA's target of a Common Equity Tier 1 Capital Ratio based on the Basel III/CRD IV definition of at least 7 per cent., and after any required adjustments. See Section 13 (*Capital Adequacy*) for further details of the Bank's capital position.

The Bank remains dependent on the successful completion of the Recapitalisation Plan to return to compliance with its regulatory capital requirements.

For further details of CRD IV and its expected impact on the Bank, please see Section 17 (*Supervision and Regulation*) and Section 2 (*Risk Factors*).

The launch of the Recapitalisation Plan

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment (of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014), and the remaining £163 million by 31 December 2014).

On 17 June 2013, the PRA made the following statement:

"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5 billion in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative Group to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion of Common Equity Tier 1 Capital following the announcement of the Bank's interim results for the six month period ended 30 June 2013. The PRA also reconfirmed that this requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress. The Liability Management Exercise is intended to generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 Capital by the end of 2013. Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged or sold pursuant to the Liability Management Exercise.

The contributions that a successful Liability Management Exercise would provide by the end of 2013 would increase the Bank's Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496.0 million incurred for the six month period ended 30 June 2013 and potential impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

3. The Recapitalisation Plan

The key objective of the Recapitalisation Plan is to strengthen significantly the Bank's Common Equity Tier 1 Capital base and to refocus the Bank's strategy around its strength in core relationship retail banking providing current accounts, residential mortgages and savings products to retail customers and SMEs. The Liability Management Exercise forms a critical element of the Recapitalisation Plan. The Liability Management Exercise is intended to generate at least £1 billion of the £1.5 billion of Common Equity Tier

1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital for the Bank; and
- second, to the extent that Existing Securities are exchanged or sold for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), the amount of that discount will also be recognisable as Common Equity Tier 1 Capital (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**) and certain proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the **Proposals**). The offer in respect of the Dated Notes is being conducted by way of the Scheme. The Liability Management Exercise will only be successfully completed if the entire principal amounts of the Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

The Scheme will also provide that 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million on the terms of the Scheme as described in the Explanatory Statement (the **Additional New Ordinary Shares Offer**).

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this Prospectus as the Liability Management Exercise. In addition, as part of the Liability Management Exercise Holders of certain of the Existing Securities (being Preference Shares and 13% Bonds) will have the option to either exchange their Existing Securities for Final Repayment Notes or sell their Existing Securities to Co-operative Group for cash consideration payable in instalments (represented by Instalment Repayment Notes). Each such Holder will have the opportunity to choose whether it would prefer to receive Final Repayment Notes or Instalment Repayment Notes (if the Liability Management Exercise is successfully completed) each to be issued by Co-operative Group pursuant to the Group Notes.

In addition, the Bank expects that capital created through interest savings on the Existing Securities surrendered in the Liability Management Exercise net of any coupon payments on the New Securities should contribute an additional amount of Common Equity Tier 1 Capital towards the Recapitalisation Plan, beyond that created as a result of the Liability Management Exercise. The Bank currently estimates that net interest savings should result in allowable Common Equity Tier 1 Capital in the region of £40 million during the course of 2014.

2014 Commitment

Under the Recapitalisation Plan, Banking Group has agreed to contribute £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately prior to the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

As announced on 17 June 2013, Banking Group is expecting to satisfy the 2014 Commitment from the net proceeds of the sale by Banking Group of Royal London (CIS) Limited (formerly known as Co-operative Insurance Society Limited) and Royal London Asset Management (CIS) Limited (formerly known as The Co-operative Asset Management Limited) (**Co-operative Life Insurance and Asset Management**) and the net proceeds of the proposed sale of CIS General Insurance Limited (CIS General Insurance) (together the **Insurance Proceeds**). The sale of Co-operative Life Insurance and Asset Management to The Royal London

Mutual Insurance Society Limited (**Royal London**) completed on 31 July 2013. The total consideration for the sale is £219.0 million, of which £39.0 million has already been paid to Banking Group in respect of the disposal of Royal London (CIS) Limited. Payment of the remaining £180 million (as deferred consideration) is subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RL (CIS) Ltd) into Royal London under Part VII of FSMA. There is no certainty as to timing or outcome of the court process and therefore no certainty as to when the deferred consideration may be received by Banking Group or if it will be received at all. In respect of the disposal of CIS General Insurance, the Bank has been told that, whilst Co-operative Group is currently in discussions with various interested parties to sell CIS General Insurance, as at the date of this Prospectus, no legally binding agreement to sell CIS General Insurance has been entered into and any such agreement may, when entered into, be subject to various conditions precedent.

To provide support to Banking Group's obligations under the Undertaking to Pay should the Insurance Proceeds not materialise or be insufficient to satisfy the Undertaking to Pay, Banking Group has entered into an intra-group loan with Co-operative Group and the Bank (the **Intra-group Loan**). The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (see the paragraph number 20.6 "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details of the small number of customary conditions precedent)). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan from alternative resources in the event that the Insurance Proceeds are not sufficient to satisfy the amount of the 2014 Commitment or otherwise not received in time to satisfy the PRA's required timing to satisfy the 2014 Commitment. For further details, see the risk factor titled "*The commitment by Banking Group to contribute £333 million of Common Equity Tier 1 Capital during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Group*" in Section 2 (*Risk Factors*).

The Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities are together referred to in this Prospectus as the **Recapitalisation Plan**.

Structure of the 2014 Commitment

The 2014 Commitment has been structured as follows:

(a) The 54,058,442 New Ordinary Shares to be issued to Banking Group against the Undertaking to Pay will be issued immediately following the implementation of the Scheme in accordance with its terms (including the subscription of Additional New Ordinary Shares to Holders of Dated Notes in accordance with the Scheme). The New Ordinary Shares issued in consideration for the Undertaking to Pay will be fully paid up for the purposes of the Companies Act and will be freely transferable (subject to the lock-up restrictions imposed under the 2014 Commitment Agreement, which are to be superseded by the lock-up restrictions imposed in the Relationship Agreement between Banking Group, Co-operative Group and the Bank once this comes into force (as described in paragraph 20.3 "*Relationship Agreement*" in Section 20 (*Additional Information*)) and fungible with all other Ordinary Shares. The New Ordinary Shares issued against the Undertaking to Pay, which will be issued in the same exchange ratio as the New Ordinary Shares to be issued to Holders of the Dated Notes pursuant to the Liability Management Exercise, will represent 21.6 per cent. of the Ordinary Shares in issue at completion of the Liability Management Exercise.

(b) The Undertaking to Pay does not generate Common Equity Tier 1 Capital of the Bank until such time as the cash proceeds of the undertaking are received by the Bank.

(c) The 2014 Commitment requires Banking Group to deliver the cash proceeds to discharge the relevant proportion of the Undertaking to Pay by such dates as to satisfy the PRA's timing requirements. The PRA has stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

    See paragraph 20.4 "*2014 Commitment Agreement*" in Section 20 (*Additional Information*) for more details of the 2014 Commitment.

(d) The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (and is only subject to a small number of customary conditions precedent – see the paragraph number 20.6 "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

4. Impact of the successful implementation of the Liability Management Exercise

The Liability Management Exercise, if successful, will generate at least £1 billion of Common Equity Tier 1 Capital for the Bank being comprised of the Common Equity Tier 1 Capital generated pursuant to the Exchange Offers, the Proposals and the Scheme, together with £125 million in respect of the Additional New Ordinary Shares Offer under the Scheme. The completion of the Liability Management Exercise will, in turn, mean that the Undertaking to Pay will become unconditional and, when taking into account the allowable capital benefits from interest savings on Existing Securities surrendered as a result of the Liability Management Exercise, means the Bank will be in a position to satisfy the requirement that the Bank raise an additional £1.5 billion of Common Equity Tier 1 Capital by the end of 2014.

Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in risk weighted assets, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

5. Consequences of a failure of the Liability Management Exercise

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

As stated in the June Announcement, Co-operative Group and the Bank continue to believe that the Recapitalisation Plan (including in its revised form), of which the Liability Management Exercise forms an integral part, is in the long-term interests of their respective stakeholders and of the Bank itself.

Absent the support of sufficient Holders to participate in and, where requested, approve the proposals being made in the Liability Management Exercise, it will fail.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Bank's ability to continue as a going concern. The Bank's Interim Financial Information, therefore, included an emphasis of matter statement as to the Bank's ability to continue as a going concern (see note 2 to the Interim Financial Information for further details of the going concern position of the Bank contained in Part A in Section 16 (*Financial Information*)).

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for Holders, if the Liability Management Exercise is not successfully implemented during 2013. However, the Bank has no other source available to it to raise the required additional capital. As stated in the Bank's Interim Financial Information, if the Liability Management Exercise is not successfully completed, the Bank will cease to be a going concern and the Bank considers that it is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA). In such circumstances, the relevant Resolution Authority may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied that the Bank, in particular, has appropriate financial and non-financial resources, including that the Bank has made appropriate provisions for its liabilities. In addition, the Resolution Authorities may also exercise their powers to resolve the Bank even if it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen; and the Bank believes that it is likely that it would be subject to a resolution procedure under the Banking Act. The Bank therefore believes that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank becoming subject to a resolution procedure under the Banking Act.

For further details of the risks of the Liability Management Exercise, see the section entitled "*Risks relating to the Liability Management Exercise*" in Section 2 (*Risk Factors*) of this Prospectus. For further information on the consequences of a failure of the Liability Management Exercise, see Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*).

6. Details of the Liability Management Exercise

The Liability Management Exercise being conducted by the Bank and Co-operative Group involves inviting the Holders of the Existing Securities to exchange or sell their Existing Securities for New Securities to be issued by the Bank and, in certain cases, Co-operative Group.

Details of the Liability Management Exercise can be found in Section 6 (*Details of the Liability Management Exercise*) and in the Offer Memorandum, which is appended to and forms part of this Prospectus.

PART C: POTENTIAL CONSEQUENCES OF HOLDERS FAILING TO SUPPORT THE LIABILITY MANAGEMENT EXERCISE

RESOLUTION ANALYSIS

1. Purpose of this resolution analysis

The purpose of the resolution analysis contained in this Part C is to assist Holders of Existing Securities in determining whether or not to vote in favour of the proposals set out in this Prospectus, and in particular the Offer Memorandum, and the Explanatory Statement. The resolution analysis compares the position which Holders of Existing Securities would be likely to face if the Bank were resolved on 31 December 2013 and the position for Holders of Existing Securities if the Liability Management Exercise is successfully implemented, to assist Holders of Existing Securities in deciding whether or not to vote in favour of the Scheme or, as the case may be, the resolutions to approve the Proposals or otherwise to participate in the Liability Management Exercise.

The Bank of England and HM Treasury (the **Resolution Authorities**) have wide discretionary powers as to how to effect a resolution of the Bank. Analysing the position of Holders of Existing Securities following resolution of the Bank is therefore subject to a number of uncertainties and Holders of Existing Securities should take careful note of the significant limitations and uncertainties set out in section 5 below.

2. Why participate in the Liability Management Exercise?

The Bank believes that if the Liability Management Exercise were to fail this would result in the Bank being subject to a resolution procedure under the Banking Act. If, following resolution, the Bank goes into an insolvency proceeding, the Bank believes, on the basis of the hypothetical analysis described in section 5 below, that Holders of Existing Securities would receive no dividend at all in that insolvency proceeding and no compensation, whether directly or indirectly, as a result of the resolution. The Bank also believes that there is fundamental uncertainty whether the Bank could be resolved a going concern without the active support of Co-operative Group and a substantial amount of additional capital, as described in section 8 below.

If the Liability Management Exercise is successfully completed Holders of the Dated Notes will be entitled to receive Notes and New Ordinary Shares in the Bank (together with the opportunity to participate in the Additional New Ordinary Shares Offer), Holders of the 5.5555% Bonds will receive Notes (together with a cash amount equal to the accrued and unpaid interest on the 5.5555% Bonds) and Holders of the 13% Bonds and Preference Shares would receive the choice to receive either Final Repayment Notes or cash consideration payable in instalments (represented by Instalment Repayment Notes (together with a cash amount equal to the accrued and unpaid dividends on the Preference Shares or interest on the 13% Bonds (as the case may be)) (in each case subject to compliance with the relevant procedures described in the Offer Memorandum and, in the case of the Holders of the Dated Notes, the Explanatory Statement and depending on the extent of their participation in the Liability Management Exercise) (the **Restructuring Consideration**).

3. What happens if the Liability Management Exercise is successfully completed?

If the Liability Management Exercise is successfully completed each Holder of Existing Securities will be entitled to receive, for each £100,000 nominal of Existing Securities which it holds, the amount of Restructuring Consideration described in paragraph 2 "*Summary Offering Tables*" in Section 6 (*Details of the Liability Management Exercise*).

New debt securities

For details of the terms of the Group Notes and the Notes see the Offer Memorandum and for a summary of the associated risk factors relating to these securities see Section 2 (*Risk Factors*) and the prospectuses published in connection with the Group Notes and the Bank T2 Notes (as further described in the Offer Memorandum).

The value of the Group Notes and the Notes are shown in the tables above at nominal (face) value for illustrative purposes and should not be taken as a guide to the market value of these securities following implementation of the Liability Management Exercises.

New Ordinary Shares in the Bank

There is currently no public trading market for the New Ordinary Shares and there can be no certainty as to the development or liquidity of any market for the New Ordinary Shares. Holders of Existing Securities should therefore determine for themselves, based on the information set out in the Prospectus, the value to be ascribed by them to the New Ordinary Shares.

4. What is the likely outcome for Holders of Existing Securities if the Liability Management Exercise is not successfully completed?

Stabilisation powers of Bank of England and HM Treasury

As a preliminary point, regulatory policy (see, for example, Bank of England and FSA joint paper entitled "*A review of requirements for firms entering into or expanding in the banking sector*", March 2013 at pages 5, 9 and 13) is that if a bank is no longer able to survive as a going concern, the bank should be allowed to fail. That is to say, while both the payments system and insured depositors will be protected, there should be no bail out of a bank. In other words, public funds will not be made available in order to resolve a bank.

The stabilisation powers in relation to the Bank available to the Bank of England and HM Treasury, once the relevant conditions are satisfied are as follows:

1. to sell all or part of the business of the Bank to a commercial purchaser;
2. to transfer all or part of the business of the Bank to a company which is wholly owned by the Bank of England; or
3. to take the Bank into temporary public ownership.

HM Treasury may only exercise the Temporary Public Ownership power if the exercise for that power is necessary:

(i) to resolve or reduce a serious threat to the stability of the financial systems of the United Kingdom; or

(ii) to protect the public interest, where HM Treasury have provided financial assistance in respect of the Bank for the purpose of resolving or reducing a serious threat to the stability of the financial systems of the United Kingdom. HM Treasury have not provided any such financial assistance so this would not be applicable.

If the Resolution Authorities exercise a stabilisation power, HM Treasury must make an order which establishes a regime for compensation in respect of the resolution although there is nothing to prevent the application of the valuation principles in such an order establishing a scheme for compensation from resulting in no compensation being payable.[1] A compensation scheme order will provide for a transferor to be paid compensation or provide for a scheme to determine whether a transferor should be paid compensation and will establish a scheme for paying any such compensation. A compensation scheme order may provide for the amount of any compensation payable to be determined by an independent valuer appointed in accordance with the order and may specify principles to be applied in determining the amount of compensation.

[1] Valuation principles under a compensation scheme order may require or permit an independent valuer to make assumptions such as, for example, that the Bank has had its regulatory permissions varied or cancelled, is unable to continue as a going concern, is in administration or is being wound up.

A resolution fund order is an order establishing a scheme under which transferors become entitled to the proceeds of the disposal of things transferred in specified circumstances and to a specified extent.

A third party compensation order provides for compensation to be paid to persons other than transferors. A third party compensation order must provide that the independent valuer must assess the treatment (the **Insolvency Treatment**) which pre-transfer creditors would have received had the Bank entered into insolvency immediately prior to the time at which it was resolved. The independent valuer must assess the treatment (the **Actual Treatment**) which pre-transfer creditors have received, are receiving or are likely to receive if no compensation is paid. If the independent valuer considers that, in relation to any pre-transfer creditor, the Actual Treatment is less favourable than the Insolvency Treatment, the independent valuer must determine that compensation is paid to that pre-transfer creditor. The amount of compensation must be determined by reference to the difference in treatment and on the basis of the fair and equitable value of that difference in treatment.

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

As stated in the June Announcement, Co-operative Group and the Bank believe that the Recapitalisation Plan, of which the Liability Management Exercise forms an integral part, is in the long-term interests of their respective stakeholders and of the Bank itself.

Absent the support of sufficient Holders to participate in and, where requested, approve the proposals being made in the Liability Management Exercise will fail.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Bank's ability to continue as a going concern. The Bank's Interim Financial Information, therefore, included an emphasis of matter as to the Bank's ability to continue as a going concern (see note 2 to the Interim Financial Information for further details of the going concern position of the Bank contained in Part B in Section 16 (*Financial Information*).

Given the discretionary nature of the powers available to the Resolution Authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for Holders if the Liability Management Exercise is not successfully implemented during 2013. However, the Bank has no other source available to it to raise the required additional capital. As stated in the Bank's Interim Financial Information, if the Liability Management Exercise is not successfully implemented, the Bank will cease to be a going concern and, as a result, the Bank is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of FSMA) and the relevant Resolution Authority may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied that the Bank, in particular, has appropriate financial and non-financial resources, including that the Bank has made appropriate provision for its liabilities. In addition, the Resolution Authorities may also exercise their powers to resolve the Bank even if it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the Resolution Authorities to exercise stabilisation powers under the Banking Act had arisen; and the Bank believes it would be subject to a resolution procedure under the Banking Act. The Bank therefore believes that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank ceasing to be a going concern and, as such, the Bank considers it likely that the Bank would be subject to a resolution procedure under the Banking Act.

For further details of the risks of the Liability Management Exercise, see the paragraph titled "*Risks relating to the Liability Management Exercise*" in Section 2 (*Risk Factors*). For further information on the consequences of a failure of the Liability Management Exercise, see Part C of this Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*).

5. The insolvency analysis

In order to form a view as to whether it is likely, if the Bank went into a hypothetical insolvency process following its resolution, that there would be any return to Holders of Existing Securities as a result of that process, the Bank has prepared an insolvency analysis.

The insolvency analysis represents an illustrative estimate of insolvency values and recovery percentages based upon hypothetical insolvency proceedings for the Bank commenced on 31 December 2013. The insolvency analysis is based on the balance sheet contained in the Interim Financial Information.

Insofar as insolvency might be an event that occurs in the future, the ultimate returns to Holders of Existing Securities will be determined by a series of complex circumstances relevant at the time of the insolvency. There may be unforeseen events, changes in economic conditions and many other potential variables that could impact on and change the actual outcome of an insolvency process.

The Bank has prepared the insolvency analysis on the basis of assumptions which the Directors believe are reasonable in the circumstances. However, the assumptions are subject to significant uncertainties which are beyond anyone's control, and unanticipated events and circumstances might materially affect the anticipated results.

Neither the assumptions nor the numbers generated in the insolvency analysis have been audited. While the insolvency values are presented with some specificity (albeit within a range), the actual results achieved would in all likelihood vary, and could vary in ways that may be material. Accordingly, there can be no assurance that the assumptions employed in determining the insolvency value of the assets will result in accurate estimations of such insolvency values.

None of the Bank, its directors or advisers makes any representation or warranty that the actual results for Holders upon an insolvency of the Bank would or would not approximate to the financial outcomes described below.

Nothing in this Part C constitutes a valuation. Where present values for different scenarios are shown they are provided for illustrative purposes only and are subject to assumptions set out in this Part C.

Estimated outcomes

Subject to the caveats and assumptions set out in this Part C, the Bank believes that the return to the Bank's senior unsecured creditors from a bank insolvency procedure or administration of the Bank would be in the range of 91.5 per cent. and that Holders of Existing Securities would receive no recovery at all in such an administration or bank insolvency procedure because their claims are subordinated to the claims of the senior unsecured creditors of the Bank.

The insolvency analysis indicates that there would be approximately £32.4 billion of estimated net recoveries (after secured creditor claims and costs) and approximately £37.3 billion of total senior unsecured creditors. Realisations in the insolvency procedure would therefore need to increase by over £3.1 billion in order for senior unsecured creditors to recover the full principal amount of their claims.

Key insolvency analysis assumptions

A. Insolvency procedures available for the Bank include a bank insolvency procedure, a bank administration procedure (both provided for under the Banking Act), a liquidation or an administration (both provided for under the Insolvency Act 1986). Under an administration pursuant to the Insolvency Act 1986, an administrator has powers to make distributions to creditors (a distributing administration). For the purposes of the insolvency analysis the Bank has assumed that the relevant insolvency procedure is either a bank insolvency procedure or a distributing administration. The Bank considers that the likely strategy of the insolvency office holder and the likely outcome for creditors would be similar under either procedure.

B. Any surplus realisations remaining after payment of the debts proved by senior unsecured creditors would be applied in the insolvency procedure in payment of the debts proved by subordinated creditors in respect of the Dated Notes before being applied in payment of interest, whether on the debts proved by the senior unsecured creditors or on the debts proved by the holders of Dated Notes.

C. Under a bank insolvency procedure the liquidator has two statutory objectives: (i) to work with the FSCS so as to ensure that as soon as reasonably practicable each eligible depositor has the relevant account transferred to another institution or it receives payment from the FSCS; and (ii) to wind up the affairs of the bank so as to achieve the best result for the bank's creditors as a whole.

In relation to the second statutory objective, the Bank considers that the best results for its creditors as a whole would not be achieved through a fire sale on day 1 of the process which would flood the market and drive down pricing. At the opposite end of the scale, a very long term run-off may result in higher nominal recoveries but it is likely to result in significant cost inefficiencies and not achieve the best result for creditors as a whole taking into account the cost of funding of the creditors. The Bank considers that the best result will lie somewhere in between and in practice would anticipate the insolvency office holder's strategy to be a combination of medium term run-off combined with regular portfolio sales. In particular, a bank liquidator would be influenced as to strategy by his creditors committee which would include the FSCS who would be the majority creditor (following pay out to eligible depositors), Hence, maximising return for the Bank's creditors as a whole would need to take account of the FSCS's cost of funding relating to the depositor payments it has made. The Bank understands that this is likely to be "market rate" funding cost.

The result in an administration would be similar. An administrator must submit his proposals to a creditors' meeting which may approve them without modification or approve them with modifications to which the administrator consents. An administrator has a responsibility to have regard to the views of the creditors and is entitled to give considerable weight to the views of a substantial majority of creditors about how to proceed.

The Bank has therefore assumed for the purposes of the insolvency analysis a five year run off and a sale of the rump at the end of year five. The Bank considers that this five year period is appropriate by reference to loan repayment profiles and economic factors and that it does not appear inconsistent with relevant precedents.

6. Would Holders of Existing Securities be entitled to compensation as a result of a resolution of the Bank?

Holders of Existing Securities would, except in the circumstances referred to in section 8 below, be third parties for the purposes of the compensation regime which must be established by HM Treasury pursuant to the Banking Act. The independent valuer appointed pursuant to any third party compensation order must apply the principles set out in section 4 above. Applying these principles to the insolvency analysis set out in section 5, under the Insolvency Treatment, no holder of Existing Securities would be entitled to any recovery at all in the hypothetical insolvency process for the Bank and the Actual Treatment cannot therefore be less favourable than the Insolvency Treatment in this case. There is therefore no basis on which Holders of Existing Securities would be entitled to compensation under an order made pursuant to the Banking Act as a result of a resolution of the Bank.

7. Could the Bank be entitled to compensation as a result of its resolution?

If a resolution of the Bank involves a transfer of all or part of its assets or liabilities, the Bank will be entitled to claim compensation as a transferor under the compensation regime which must be established by HM Treasury. The Bank believes that the most likely circumstances in which compensation may be payable to it as a transferor would be either if all or part of its assets were transferred at an undervalue (in which case it would be entitled to claim under a scheme compensation order) or if the assets which were transferred were subsequently realised (in which case it may be able to claim under a resolution fund order).

Although the Resolution Authorities have wide discretionary powers and although the Bank is not waiving or abrogating any right to claim compensation as a transferor in the event of its resolution, the Bank is not aware of any circumstances which would lead it to believe that it would be able to recover compensation following its resolution either at all or of an amount which would result in an indirect return to Holders of Existing Securities.

8. Could the Bank be resolved as a going concern?

Under Section 19 of the Banking Act, the Resolution Authorities have a power (the **Section 19 Power**), in connection with an order for the resolution of the Bank, to make an order converting securities from one class to another. The extent of the Section 19 Power has not been tested, but the Bank believes that this power may permit the Resolution Authorities to order that the Existing Securities are converted into New Ordinary Shares of the Bank in connection with its resolution.

Even if the Section 19 Power were capable of being exercised in this manner, the Bank considers that there is material uncertainty whether the Bank would be capable of continuing as a going concern following the exercise of the Section 19 Power in this manner. The Recapitalisation Plan for the Bank requires the Bank to hold additional Common Equity Tier 1 Capital of at least £1.5 billion by the end of 2014. If the Section 19 Power were exercised, the conversion of the Existing Securities into New Ordinary Shares of the Bank would produce Common Equity Tier 1 Capital of approximately £1.23 billion for the Bank, which is less than the £1.5 billion minimum requirement imposed by the PRA by the end of 2014. The Bank also considers it likely that, if the Section 19 Power were to be used, the PRA would determine that a larger amount of capital would be required to be held by the Bank in order to ensure market confidence and reduce the risks of a second resolution.

It is possible, although the extent of this power is also untested, that the PRA may have power under section 192(C) of FSMA to direct Banking Group, as a qualifying parent undertaking, to contribute all or any of its shares in CIS General Insurance, the proceeds of sale of CIS General Insurance and/or the deferred consideration payable to Banking Group for the sale of its shares in Co-operative Life Insurance and Asset Management, for the purpose of increasing the capital of the Bank. However, even if the PRA were, successfully, to exercise its power under section 192(C) of FSMA in this way, both the timing for receipt of the proceeds of sale of CIS General Insurance and Co-operative Life Insurance and Asset Management and the quantum of the proceeds are uncertain. Furthermore, the trustees of Pace have a guarantee from CIS General Insurance for the liabilities of that scheme, which would need to be released as part of the sale process. It is therefore uncertain how much, if any, proceeds will be generated by Banking Group from disposal of CIS General Insurance as a result of this requirement. It is therefore uncertain whether the capital generated from the exercise of the Section 19 Power together with the capital generated from the exercise of this power would produce total Common Equity Tier 1 Capital for the Bank of £1.5 billion by the end of 2014, or that this would generate sufficient total capital for the Bank to continue to operate as a going concern with the total capital required by the PRA.

Further, there is no certainty that if the Bank were to be recapitalised in this manner, without the agreement of Co-operative Group, that it would continue to enjoy the support of Co-operative Group. See the risk factors titled "*The Bank will continue to rely on Co-operative Group and the Co-operative brand. Co-operative Group will also continue to exert substantial influence over the Bank", "The Bank's operations are highly dependent on the proper functioning of IT and communication systems. Any significant delay in or failure of the Bank to re-engineer its existing IT platform to meet the requirements of its business strategy may adversely affect the future operational and financial performance of the business. "The Bank relies on the provision of a number of services (including certain critical functions) by Co-operative Group, including IT"* and *"The Bank is dependent on third party providers of services, IT, software, data and other assets*" in Section 2 (*Risk Factors*).

As an alternative, it is possible that the powers of the Resolution Authorities extend to an ability to convert all or part of the £892 million outstanding amount of senior unsecured bonds issued by the Bank (**Senior Bonds**) into another class of securities. If the Resolution Authorities concluded that they could exercise their power in this manner it would be possible for sufficient capital to be generated to enable the Bank to be resolved as a going concern by converting sufficient Senior Bonds to make up the deficit between the amount of Common Equity Tier 1 Capital generated by converting the Existing Securities and the amount of total capital which the Bank requires. However, the Bank is not aware whether or not the Resolution Authorities are contemplating the exercise of this power in this manner.

The Bank therefore considers that there are material uncertainties as to whether the Bank could be successfully resolved under the current terms of the Banking Act such that the Bank itself remained a going concern.

In October 2013 HM Treasury published a briefing (the **Treasury Briefing**) on proposed treasury amendments to the Banking Act to introduce a bail in power (the **Proposed Bail in Power**). The Bank understands that the Proposed Bail in Power is due to become law in the first quarter of 2014. The Treasury Briefing contains detailed drafting amendments to the Banking Act which would be needed in order to implement the Proposed Bail in Power. It would, in principle, be open to HM Government to introduce the Proposed Bail in Power as emergency legislation so that it was available to resolve the Bank should this become necessary. The Proposed Bail in Power includes the power to make an order which contains a provision for cancelling, modifying or changing the form of a liability owed by the Bank, which includes the power to convert a debt security into an equity security. The Treasury Briefing notes that exercise of powers in the course of a bail in should in general respect the creditor hierarchy and the principle of equal treatment of equally ranking creditors and that regulations will be made making clear that a no creditor worse off safeguard is to apply in relation to resolutions using the Proposed Bail in Power. The Bank is not aware whether or not HM Government are contemplating the introduction of the Proposed Bail in Power ahead of its scheduled enactment if it proves necessary for the Bank to be resolved. The Bank considers that there are material uncertainties as to whether such emergency legislation would be introduced, how the Bank would be resolved pursuant to any such legislation and what, if any, recovery Holders of Existing Securities might receive as a result of such a resolution.

9. Conclusion

For the reasons set out in this Part C, the Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to Holders of all classes of Existing Securities than resolution of the Bank.

5
EXPECTED TIMETABLE OF THE LIABILITY MANAGEMENT EXERCISE

The following section contains an indicative timetable for the Liability Management Exercise. Whilst the Bank currently expects to follow this timetable, the timetable is subject to change.

EXPECTED TIMETABLE FOR THE LIABILITY MANAGEMENT EXERCISE

The times and dates referred to below are indicative only and are subject to the right of the Bank and/or Co-operative Group to extend, re-open, amend and/or terminate the Exchange Offers or any of them at any time and the right of the Bank (if required or permitted by the Court) to amend and/or withdraw the Scheme at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank and/or Co-operative Group as soon as reasonably practicable by publication of a supplement to this Prospectus.

Scheme Events	**Dates and Times (all times are London time)**	**Offer Events**
Announcement of the Scheme	**4 November 2013**	**Announcement of the Exchange Offers**
Scheme announced.		Exchange Offers announced. Prospectuses published.
Practice statement letter sent to Scheme Creditors.		Offer period commences. Eligible Holders of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell their Existing Securities and/or vote in respect of the Proposals.
Announcement of Consideration Amounts in the Scheme	**On or around 14 November 2013**	
Announcement of the final Consideration Amounts and New Ordinary Shares Conversion Price.		
Scheme Convening Hearing	**18 November 2013**	
Initial Court hearing for leave to convene the Scheme Meeting.		
Explanatory Statement and Scheme Documents available	**19 November 2013**	
Explanatory Statement and Scheme Documents available to Scheme Creditors.		

Scheme Events	Dates and Times (all times are London time)	Offer Events
	4.30 p.m. on 29 November 2013	**Early Participation Deadline** The deadline by which the Early Participation Threshold must be achieved in order for Preference Shares 13% Bonds and 5.5555% Bonds to be exchanged or sold on the basis of the Early Consideration Amounts for such Existing Securities.
	4.30 p.m. on 6 December 2013	**Expiration Deadline** Deadline for receipt of all Exchange Instructions from Eligible Holders in respect of Preference Shares, 13% Bonds and 5.5555% Bonds.
Voting Instructions Deadline Deadline for receipt of all Account Holder Letters containing voting instructions in order for Holders to vote on the Scheme, elections to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer in the Scheme and confirming eligibility to receive Scheme Consideration under the Scheme on the Scheme Settlement Date.	**4.30 p.m. on 10 December 2013**	
Scheme Record Date Only those Holders who are Scheme Creditors as at the Scheme Record Date are entitled to attend and vote at the Scheme Meeting (unless the Bank, in its sole discretion, elects to recognise, for the purposes of the Scheme, a transfer of Dated Notes after the Scheme Record Date such that the transferee becomes a Scheme Creditor).	**10 December 2013**	

Scheme Events	Dates and Times (all times are London time)	Offer Events
Scheme Meeting Meeting of the Scheme Creditors to vote on the Scheme. The Bank will request the Court to convene the Scheme Meeting on 11 December 2013.	**11 December 2013**	**Meetings** Meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds held to consider the Extraordinary Resolutions pursuant to the Proposals. 1.00 p.m. in respect of the Preference Shares. 2.00 p.m. in respect of the 13% Bonds. 3.00 p.m. in respect of the 5.5555% Bonds.
	11 December 2013	**Offer Record Date** The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (if successfully completed).
Results Announcement Announcement of the results of the Liability Management Exercise	**12 December 2013**	**Results Announcement** Announcement of the results of the Liability Management Exercise.
Scheme Sanction Hearing Second Court hearing for sanction of the Scheme by the Court. The Bank will announce as soon as reasonably practicable after the Scheme Sanction Hearing whether or not the Scheme is sanctioned.	**16 December 2013**	
Filing of sanction order Sanction order (if granted) delivered to the Registrar of Companies. Scheme becomes effective in accordance with its terms.	**The date of the Scheme Sanction Hearing or the following business day**	

Settlement Date / Scheme Settlement Date	**18 December 2013**	**Settlement Date/ Scheme Settlement Date**
Expected settlement of the Scheme (subject to satisfaction of the Settlement Condition), including issue and delivery of New Ordinary Shares, Bank T2 Notes and Additional New Ordinary Shares.		Expected settlement of the Offers (subject to satisfaction of the Settlement Condition), including issue and delivery of Bank T2 Notes and Group Notes and payment of Accrued Dividends, Accrued Interest and other relevant amounts.

The above timetable may be impacted in certain respects if any of the Meetings in respect of the Preference Shares, the 13% Bonds and the 5.5555% Bonds are required to be adjourned. If the timetable is changed for any reason, the Bank and/or Co-operative Group will announce the new dates by publication of a supplement to this Prospectus.

If any of the Meetings are required to be adjourned, the Bank currently expects that the adjourned meeting(s) would be held on or around 27 December 2013 and the settlement date for the Offers and the Scheme will be postponed to on or around 31 December 2013. In such event, the Bank will announce the new dates by publication of a supplement to this Prospectus.

Unless stated otherwise or required by order of the Court, announcements in relation to the Liability Management Exercise will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent, the contact details for which are at the end of this Prospectus.

Holders are advised to check with any custodian, broker or other intermediary through which they hold their Existing Securities when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in the Liability Management Exercise.

6
DETAILS OF THE LIABILITY MANAGEMENT EXERCISE

The following section contains information relating to the Liability Management Exercise. The full terms of the Liability Management Exercise are set out in the Offer Memorandum attached as Appendix C (*Consent and Exchange Offer Memorandum*) to this Prospectus, and the following overview should be read in conjunction with, and is qualified entirely by, the full terms as set out in the Offer Memorandum.

DETAILS OF THE LIABILITY MANAGEMENT EXERCISE

*The following is an overview of certain information relating to the Liability Management Exercise. This overview does not purport to be complete and is qualified in its entirety by the more detailed information appearing elsewhere in this Prospectus, and in particular the information set out in the Consent and Exchange Offer Memorandum attached to this Prospectus as Appendix C (Consent and Exchange Offer Memorandum) (the **Offer Memorandum**). Holders of the Existing Securities should read the Offer Memorandum, and the other documents to which Holders are referred to therein, in full before making any decision as to whether or not to participate in the Liability Management Exercise.*

The Notes which are being offered pursuant to this Prospectus are referred to in this section as the "Bank T2 Notes".

1. THE LIABILITY MANAGEMENT EXERCISE

Existing Securities

The Liability Management Exercise is being conducted in respect of the securities listed below (together, the **Existing Securities**):

Preference Shares

- 9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) (the **Preference Shares**)

Perpetual Subordinated Bonds

- 13% Perpetual Subordinated Bonds* (ISIN: GB00B3VH4201) (the **13% Bonds**)
- 5.5555% Perpetual Subordinated Bonds* (ISIN: GB00B3VMBW45) (the **5.5555% Bonds** and, together with the 13% Bonds, the **Perpetual Subordinated Bonds**)

Dated Notes

- Floating Rate Callable Step-up Dated Subordinated Notes due 2016** (ISIN: XS0254625998) (the **2016 Notes**)
- 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**)
- 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**)
- Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**)
- 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**)
- 5.75% Dated Callable Step-up Subordinated Notes due 2024** (ISIN: XS0188218183) (the **2024 Notes**)
- 5.875% Subordinated Notes due 2033** (ISIN: XS0145065602) (the **2033 Notes**)

(together the **Dated Notes**)

---

* Issued by the Bank in replacement of Britannia Building Society permanent interest bearing shares on its merger with Britannia Building Society on 1 August 2009

** Originally issued by Britannia Building Society and assumed by the Bank at the time of the merger

Component parts of the Liability Management Exercise

The holders (**Holders**) of the Existing Securities are being invited, subject to applicable securities laws, to participate in the Liability Management Exercise in the following manner:

(i) Eligible Holders of the Preference Shares and the 13% Bonds are being invited to either:

(a) offer to exchange their Preference Shares and 13% Bonds for new 11 per cent. Final Repayment Subordinated Notes due 2025 (the **Final Repayment Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group; or

(b) offer to sell their Preference Shares and 13% Bonds to Co-operative Group and receive cash consideration payable in twelve equal instalments over twelve years up to (and including 2025) and represented by new Instalment Repayment Subordinated Notes (the **Instalment Repayment Notes** and, together with the Final Repayment Notes, the **Group Notes**) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group;

(ii) Eligible Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new 11 per cent. Subordinated Notes due 2023 (the **Bank T2 Notes**) to be issued by the Bank; and

(iii) the Holders of the Dated Notes are being invited to vote on proposals under a scheme of arrangement under Part 26 of the Companies Act 2006 (the **Scheme**) to authorise the Bank to exchange all Dated Notes for a combination of Bank T2 Notes and new ordinary shares (**New Ordinary Shares**) to be issued by the Bank. The Scheme will also provide that 62,500,000 additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration of £125 million pursuant to, and on the terms of, the Scheme.

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**). The offer in respect of the Dated Notes is being conducted by way of the Scheme.

In addition, the Bank is convening meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds, respectively, to vote on resolutions which, if passed, will (amongst other things) (i) enable the Bank to mandatorily effect the exchange or sale to Co-operative Group of Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable), which are not exchanged or sold pursuant to the Exchange Offers, on the same economic terms as those upon which Preference Shares, 13% Bonds and 5.5555% Bonds, respectively, are exchanged or sold to Co-operative Group (as the case may be) pursuant to the Exchange Offers (the **Proposals** and each a **Proposal**) and (ii) result in the holders agreeing to certain waivers and releases in favour of the Bank, Co-operative Group, their respective directors and certain other persons.

The Exchange Offers, the Proposals and the Scheme are collectively referred to as the **Liability Management Exercise**.

Conditionality

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise (i) each of the Proposals in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds must be approved by the Holders thereof at meetings convened for the purposes of voting on such Proposals (and, in the case of the Preference Shares, a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and the Proposals must be capable of being implemented in accordance with their terms, and (ii) the Scheme must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court, an office copy of the sanction order must be delivered to the Registrar of

Companies at Companies House and the Scheme must become unconditional in accordance with its terms (together referred to as the **Settlement Condition**), all as more fully described in the Offer Memorandum.

Successful completion of the Liability Management Exercise is conditional upon satisfaction of the Settlement Condition. **The Settlement Condition is not capable of being waived.** Accordingly, if the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged or sold pursuant to the Liability Management Exercise.

Early Participation Incentive

If the Early Participation Threshold is achieved by 4.30 p.m. (London time) on 29 November 2013 (the **Early Participation Deadline**), the amount of consideration which all Holders of Preference Shares, 13% Bonds and 5.5555% Bonds will be eligible to receive upon the exchange or sale of their Preference Shares, 13% Bonds and 5.5555% Bonds in the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be higher than if the Early Participation Threshold is not achieved by the Early Participation Deadline.

The **Early Participation Threshold** will be achieved by the Early Participation Deadline only if, by that time, at least 75 per cent. of the aggregate nominal amount outstanding of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds has been validly offered for exchange or sale and/or otherwise validly voted in favour of the Proposals (and not revoked).

Delivery of New Securities

The New Securities to be delivered upon successful completion of the Liability Management Exercise (being the Final Repayment Notes, the Instalment Repayment Notes, the Bank T2 Notes and the New Ordinary Shares) will be capable of being held in Euroclear, Clearstream, Luxembourg, CREST or in certificated form outside those clearing systems, and will be delivered to each Holder in the same manner in which such Holder holds its Existing Securities.

Offer restrictions

Holders who wish to participate in the Liability Management Exercise should do so only in compliance with applicable securities laws. The Exchange Offers and the Scheme are subject to certain offer restrictions, which are set out in the Offer Memorandum (in respect of the Exchange Offers) and the Explanatory Statement (in respect of the Scheme).

Further details

The separate offers in respect of the Preference Shares, the 13% Bonds, the 5.5555% Bonds and the Dated Notes are summarised briefly below, but these descriptions are subject to the more detailed offer terms and conditions set out in the Offer Memorandum and (in respect of the Dated Notes) the Explanatory Statement.

2. SUMMARY OFFERING TABLES

2.1 Preference Shares and 13% Bonds

The following table summarises the consideration that Holders of Preference Shares and 13% Bonds will be eligible to receive if their Preference Shares and 13% Bonds (as applicable) are exchanged or sold pursuant to the Liability Management Exercise:

		Early Consideration Amount[1] (per £1,000 nominal of Existing Securities)			*Late Consideration Amount[1] (per £1,000 nominal of Existing Securities)*		
Existing Securities	*ISIN*	*Final Repayment Notes[2]*	*OR[4]*	*Instalment Repayment Notes[3]*	*Final Repayment Notes[2]*	*OR[4]*	*Instalment Repayment Notes[3]*
Preference Shares[5]	GB0002224516	£601		£1,110	£551		£1,060
13% Bonds	GB00B3VH4201	£844		£1,560	£794		£1,510

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group.

3 New sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (having their last instalment payment date in 2025) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain subsidiaries of Co-operative Group. The Instalment Repayment Notes represent the instalments of consideration to be received by Holders whose Preference Shares or 13% Bonds are sold to Co-operative Group in the Liability Management Exercise.

4 The amounts of Final Repayment Notes and Instalment Repayment Notes specified in the table above are alternative options. A holder will not receive both of these amounts. Holders will be able to elect either the Final Repayment Notes option or the Instalment Repayment Notes option only.

5 The Early Consideration Amount and Late Consideration Amount for the Preference Shares are presented in this table on a "per £1,000 in nominal amount" basis for ease of comparison with the 13% Bonds. Preference Shares can be offered for exchange or sale in any whole multiple of £1 (subject to a minimum of £2 if a holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a holder elects the Instalment Repayment Notes option.

2.2 5.5555% Bonds

The following table summarises the consideration that Holders of 5.5555% Bonds will be eligible to receive if their 5.5555% Bonds are exchanged pursuant to the Liability Management Exercise:

Existing Securities	*ISIN*	*Early Consideration Amount[1] (per £1,000 nominal of Existing Securities)*	*Late Consideration Amount[1] (per £1,000 nominal of Existing Securities)*
		Bank T2 Notes[2]	Bank T2 Notes[2]
5.5555% Bonds	GB00B3VMBW45	£530	£480

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

2.3 Dated Notes

The following table summarises the consideration available to Holders of Dated Notes in the Scheme:

		Consideration Amount[1,5] (per £1,000 of Scheme Claim[4])		
Existing Securities	*ISIN*	*Bank T2 Notes[2]*	*New Ordinary Shares[3]*	*New Ordinary Shares Conversion Price[5]*
2016 Notes[4]	XS0254625998	£102.63	£897.37	
2019 Notes	XS0189539942	£102.63	£897.37	
April 2021 Notes	XS0620315902	£102.63	£897.37	£7.7718292
November 2021 Notes	XS0274155984	£102.63	£897.37	per share
2022 Notes	XS0864253868	£102.63	£897.37	
2024 Notes	XS0188218183	£102.63	£897.37	
2033 Notes	XS0145065602	£102.63	£897.37	

Notes:

1 The number of New Ordinary Shares and principal amount of Bank T2 Notes which a holder of Dated Notes will be eligible to receive in respect of its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

3 New Ordinary Shares to be issued by the Bank. If the Liability Management Exercise is successfully completed, Co-operative Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 New Ordinary Shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to Co-operative Group in consideration for its fresh injection of capital into the Bank through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued to holders of the Dated Notes in the Scheme in exchange for their Dated Notes, to be distributed in the Scheme *pro rata* amongst such holders based on their respective Scheme Claims (representing, based on the total value of Scheme Claims and the number of New Ordinary Shares issued in the Scheme to holders of Dated Notes, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 112,500,000 New Ordinary Shares; and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

4 A Holder's claim in the Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date (expected to be 10 December 2013), provided that a Holder's Scheme Claim in respect of Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

5 Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the Consideration Amounts and New Ordinary Shares Conversion Price in this table are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016. For the purpose of the indicative figures above, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on or around 14 November 2013 and, once determined, the Bank will announce the final Consideration Amounts and New Ordinary Shares Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final Consideration Amounts and New Ordinary Shares Conversion Price are not expected to differ materially from the indicative Consideration Amounts and New Ordinary Shares Conversion Price specified above.

The Scheme will also provide that 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

3. PREFERENCE SHARES OFFER

Exchange Offer

Holders of the Preference Shares are being offered a choice of two options:

(i) to offer to transfer their Preference Shares to Co-operative Group in exchange for Final Repayment Notes; or

(ii) to offer to sell their Preference Shares to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes.

Final Repayment Notes

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. Co-operative Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

<u>Instalment Repayment Notes</u>

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the Preference Shares) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon the sale of its Preference Shares to Co-operative Group will be equal to twelve times the annual dividend on those Preference Shares (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, Co-operative Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of dividends which such Holder would have received had it continued to hold those Preference Shares which it sells to Co-operative Group in the Liability Management Exercise.**

<u>*Holder election*</u>

Each Holder of the Preference Shares will have the opportunity to choose one of the two options available.

Since Co-operative Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their Preference Shares for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their Preference Shares for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) of the Offer Memorandum and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

<u>*Principal amount of Group Notes to be delivered upon exchange or sale of Preference Shares*</u>

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of Preference Shares (excluding the Additional Preference Shares referred to below) exchanged or sold to Co-operative Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its Preference Shares in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £601 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £551 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (subject to rounding).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its Preference Shares to Co-operative Group in the Exchange Offer for cash consideration payable in instalments under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,110 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to Co-operative Group (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,060 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to Co-operative Group (subject to rounding).

Accrued dividends

A Holder whose Preference Shares are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid dividends on its Preference Shares (other than Additional Preference Shares) from (and including) 30 November 2013 to (but excluding) the Settlement Date.

Preference Share dividend instalment scheduled for 30 November/Additional Preference Shares

The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise).

Under the terms of the Preference Shares, the Bank will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each Holder in lieu of cash payment (**Additional Preference Shares**). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday).

However, if the Liability Management Exercise successfully completes, then upon exchange or sale to Co-operative Group of those Additional Preference Shares, the Holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash (in pounds sterling) equal to the cash dividend which the Bank would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares.

Proposal

A meeting of the Holders of the Preference Shares is being convened in order for those Holders to vote on a proposed resolution which, if passed and implemented, would enable the Bank:

(i) to purchase and cancel any share capital of the Bank (which would include, without limitation, Preference Shares) from time to time, without the need for the further consent of the Holders of the Preference Shares; and

(ii) to mandatorily effect, at the Bank's option, the transfer to Co-operative Group of all (but not some only) of the Preference Shares, which are not offered for exchange or sale in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all Holders of the Preference Shares (i) a release, in favour of certain persons (including, amongst others, the Bank, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their Preference Shares; provided, however, that nothing in that resolution shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant Holder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant Holder in favour of the resolution proposed.

4. 13% BONDS OFFER

Exchange Offer

Holders of the 13% Bonds are being offered a choice of two options:

(i) to offer to transfer their 13% Bonds to Co-operative Group in exchange for Final Repayment Notes; or

(ii) to offer to sell their 13% Bonds to Co-operative Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes.

Final Repayment Notes

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. Co-operative Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

Instalment Repayment Notes

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the 13% Bonds) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early

Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon sale of its 13% Bonds to Co-operative Group will be equal to twelve times the annual interest on those 13% Bonds (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, Co-operative Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of interest which such Holder would have received had it continued to hold those 13% Bonds which it sells to Co-operative Group in the Liability Management Exercise.**

<u>*Holder election*</u>

Each Holder of the 13% Bonds will have the opportunity to choose one of the two options available.

Since Co-operative Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their 13% Bonds for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) of the Offer Memorandum and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

<u>*Principal amount of Group Notes to be delivered upon exchange or sale of 13% Bonds*</u>

The principal amount of Group Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of 13% Bonds exchanged or sold to Co-operative Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its 13% Bonds in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £844 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £794 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (subject to rounding).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its 13% Bonds to Co-operative Group in the Exchange Offer for cash consideration payable in instalments under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,560 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to Co-operative Group (subject to rounding); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,510 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to Co-operative Group (subject to rounding).

Accrued interest

A Holder whose 13% Bonds are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 13% Bonds from (and including) 31 July 2013 to (but excluding) the Settlement Date.

Deferred interest payment originally scheduled for 31 July 2013

In addition, as announced by the Bank on 12 July 2013, upon successful completion of the Exchange Offer the Bank will pay to all Holders of the 13% Bonds the deferred interest payment originally scheduled for 31 July 2013. Such payment will be made in cash on the Settlement Date.

Proposal

A meeting of the Holders of the 13% Bonds is being convened in order for those Holders to vote on a proposed resolution which, if passed and implemented, would result in amendments to the terms of the 13% Bonds to enable the Bank to mandatorily effect, at the Bank's option, the transfer to Co-operative Group of all (but not some only) of the 13% Bonds, which are not offered for exchange or sale in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over 12 years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all Holders of the 13% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 13% Bonds; provided, however, that nothing in that resolution shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant Holder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant Holder in favour of the resolution proposed.

5. 5.5555% BONDS OFFER

Exchange Offer

Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for Bank T2 Notes.

Bank T2 Notes

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly in arrear on each three-month anniversary of the issue date of the Bank T2 Notes up to (and including) the tenth anniversary of the issue date. The Bank will be obliged to repay the principal amount of the Bank T2 Notes on the tenth anniversary of their issue date.

Principal amount of Bank T2 Notes to be delivered in exchange for 5.5555% Bonds

The principal amount of Bank T2 Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive in exchange for every £1,000 in nominal amount of 5.5555% Bonds will depend upon whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. Accordingly, an Eligible Holder who validly offers to exchange its 5.5555% Bonds in the Exchange Offer will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £530 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged; or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £480 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged.

Accrued interest

A Holder whose 5.5555% Bonds are exchanged will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date.

Interest payment scheduled for 14 December 2013

The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully settles, the Bank will (in addition to the accrued interest referred to in the paragraph above) pay the deferred interest payment originally scheduled for 14 December 2013 (to all investors in the 5.5555% Bonds) upon successful completion of the Liability Management Exercise. Such payment will be made in cash on the Settlement Date.

Proposal

A meeting of the Holders of the 5.5555% Bonds is being convened in order for those Holders to vote on a proposed resolution which, if passed and implemented, would result in amendments to the terms of the 5.5555% Bonds to enable the Bank to mandatorily effect the exchange, at the Bank's option, of all (but not some only) of the 5.5555% Bonds, which are not exchanged in the Exchange Offer, on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer.

The proposed resolution also contains, on behalf of all Holders of the 5.5555% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, Co-operative Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 5.5555% Bonds; provided, however, that nothing in that resolution shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

The submission of a valid Exchange Instruction pursuant to the Exchange Offer will also constitute the relevant Holder's instructions to appoint the chairman of the meeting as proxy to vote on behalf of the relevant Holder in favour of the resolution proposed.

6. SCHEME IN RESPECT OF THE DATED NOTES

Nature of the Scheme

The Scheme is a scheme of arrangement under the laws of England and Wales. A scheme of arrangement is a formal procedure under Part 26 of the Companies Act 2006 which enables a company to agree a compromise or arrangement with its creditors or any class of its creditors in respect of its debts or obligations owed to those creditors. A scheme of arrangement requires the following to occur in order to become legally binding:

(i) the approval of a majority in number representing at least 75 per cent. in value of the creditors or class of creditors present in person or by proxy and voting at the meeting convened to approve the scheme of arrangement;

(ii) the approval of the court by the making of an order sanctioning the scheme of arrangement; and

(iii) the delivery of the court order sanctioning the scheme of arrangement to the Registrar of Companies.

If the scheme of arrangement is approved by the requisite majorities and sanctioned by the court and the order sanctioning the scheme of arrangement is delivered as set out above, the scheme of arrangement will bind all the creditors subject to it, both those creditors who voted in favour of it and those creditors who voted against it or did not vote at all.

A scheme of arrangement cannot be sanctioned by the court unless the court is satisfied, among other things, that the relevant provisions of Part 26 of the Companies Act 2006 have been complied with and an intelligent and honest person, a member of the class concerned and acting in respect of his own interest, might reasonably approve the scheme of arrangement.

Class composition

The Bank will propose that the Holders of the Dated Notes will vote together as one class at the Scheme Meeting.

Overview of Scheme Consideration

If the Scheme is sanctioned and implemented, all the Dated Notes, together with accrued and unpaid interest thereon up to (and including) the Scheme Record Date, will be exchanged on the Scheme Settlement Date for:

(i) a number of New Ordinary Shares in the Bank; and

(ii) a principal amount of Bank T2 Notes issued by the Bank.

The **Scheme Record Date** for the Scheme is currently expected to be 10 December 2013.

Scheme Consideration: accrued interest and Scheme Claims

A Holder's claim in the Scheme (its **Scheme Claim**) will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme

Claim in respect of 2016 Notes (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated as provided below.

The amount of a Holder's Scheme Claim will be used to determine the number of New Ordinary Shares and principal amount of Bank T2 Notes which such Holder will be entitled to receive in exchange for its Dated Notes if the Scheme is settled, as further described below. For the avoidance of doubt, no accrued interest will be paid in cash pursuant to the Scheme.

The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled on the Scheme Settlement Date.

The number of New Ordinary Shares and principal amount of Bank T2 Notes which a Holder will receive in exchange for its Dated Notes (on the basis of its Scheme Claim) if the Liability Management Exercise is successfully completed will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

Note: Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the percentages and Conversion Price given in the following paragraphs are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the 2016 Notes. For the purpose of those indicative figures, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on or around 14 November 2013 and, once determined, the Bank will announce the final percentages and Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final percentages and Conversion Price are not expected to differ materially from the indicative percentages and Conversion Price specified below.

Scheme Consideration: number of New Ordinary Shares

The number of New Ordinary Shares to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by:

(a) multiplying such Holder's Scheme Claim by 89.737* per cent.; and

(b) dividing the resulting figure by £7.7718292* (being the Conversion Price for the New Ordinary Shares) and, if necessary, rounding such figure down to the nearest whole number of New Ordinary Shares (any fractional amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

* *Indicative only – see the Note in the paragraph above.*

Scheme Consideration: principal amount of Bank T2 Notes

The principal amount of Bank T2 Notes to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by multiplying such Holder's Scheme Claim by 10.263* per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £10 (being the minimum denomination of the Bank T2 Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

* *Indicative only – see the Note in the paragraph above.*

Sterling-Equivalent amounts for the 2016 Notes

The **Sterling-Equivalent** of any euro amount in respect of a 2016 Note will, for the purposes of determining the Scheme Claim of a Holder of 2016 Notes (and for all other purposes under the Liability Management Exercise), be the amount in sterling determined by the Bank to be equivalent to such euro amount by reference to the Scheme FX Rate of £0.85644 per €1.00.

Early Participation Threshold not relevant

The number of new Ordinary Shares and principal amount of Bank T2 Notes which a Holder will receive in exchange for its Dated Notes (on the basis of its Scheme Claim as defined below) if the Liability Management Exercise is successfully completed will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

Additional New Ordinary Shares Offer

62,500,000 additional New Ordinary Shares (the **Additional New Ordinary Shares**) will be made available to Holders of the Dated Notes for subscription (at an effective subscription price of £2.00 per Additional New Ordinary Share) under the terms of the Scheme for an aggregate consideration of £125 million (the **Additional New Ordinary Shares Offer**).

All Holders of Dated Notes will be entitled to elect to subscribe for 62,500,000 Additional New Ordinary Shares. The allocation of such Additional New Ordinary Shares to a Holder of Dated Notes in respect of its election to participate in the Additional New Ordinary Shares Offer in accordance with the terms of the Scheme will be *pro rata* based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Scheme Record Date) who have elected to participate in the Additional New Ordinary Shares Offer subject to (i) a minimum election for that Holder of 50,000 Additional New Ordinary Shares (i.e. an effective aggregate subscription price of £100,000) and (ii) a maximum allocation of Additional New Ordinary Shares equal to the number of Additional New Ordinary Shares elected for by that Holder, provided always that the aggregate number of Additional New Ordinary Shares allocated to all Holders of Dated Notes under the Additional New Ordinary Shares Offer is no greater than 62,500,000.

The Bank has entered into an agreement with certain Holders of the Dated Notes (the **Purchasers**) on 4 November 2013 (the **Purchase Agreement**) (as described in more detail in paragraph 20.9 titled "*Purchase Agreement*" in Section 20 (*Additional Information*)). The terms of the Purchase Agreement provide that the Purchasers will subscribe for any Additional New Ordinary Shares unallocated or not taken up under the Additional New Ordinary Shares Offer. The Bank will pay the Purchasers a fee equal to 4 per cent. of £125 million (the **Purchaser Premium**).

All Holders of Dated Notes will be entitled to participate in a sub-purchase of the Additional New Ordinary Shares the subject of the Purchase Agreement (the **Sub-purchase Offer** and the sub-purchase of the Additional New Ordinary Shares the subject of the Purchase Agreement, the **Sub-purchase**). The Sub-purchase Offer will be available to all Holders of Dated Notes, including the Purchasers. To participate in the sub-purchase a Holder of Dated Notes (the **Sub-purchaser**) will be entitled to nominate the commitment that Holder is prepared to sub-purchase, subject to a maximum commitment of £125 million and a minimum commitment of £100,000. The allocation of sub-purchasing commitment to a Holder of Dated Notes that wishes to participate in the Sub-purchase Offer will, in the case of aggregate nominations being less than £125 million, be the amount of Sub-purchaser's nominations and, in the case of nominations in aggregate exceeding £125 million, be *pro rata* based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Record Date) who have elected to participate in the Sub-purchase Offer, subject to (i) a minimum commitment of £100,000 and (ii) a maximum commitment equal to the amount of the sub-purchasing commitment elected for by that Holder (the **Sub-purchasing Commitment**), provided always that the aggregate amount of all Sub-purchasing Commitments allocated to all Holders of Dated Notes that participate in the Sub-purchase is no greater than £125 million.

The Sub-purchasers will be required to enter into an agreement with Bank on or around the date of the Scheme Meeting (the **Sub-purchase Agreement**). The Bank will pay each Sub-purchaser a fee equal to 2 per cent. of their Sub-purchasing Commitment, provided that they comply with their obligations under the Sub-purchaser Agreement (the **Sub-purchaser Premium**). The aggregate Purchaser Premium payable to the Purchasers will be reduced in an amount equal to the aggregate Sub-purchaser Premium paid to the Sub-purchasers, such reduction to be allocated among the Purchasers based on their subscription commitment as set out in the Purchase Agreement.

To the extent that the aggregate allocation of Additional New Ordinary Shares to all Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than 62,500,000 Additional New Ordinary Shares, the Sub-purchasers pursuant to the Sub-purchase Agreement will be required to subscribe for such number of remaining Additional New Ordinary Shares up to their Sub-purchasing Commitments. If there are still Additional New Ordinary Shares to be issued, the Purchasers under the Purchase Agreement will be required to subscribe for the remaining Additional New Ordinary Shares in accordance with the terms of the Purchase Agreement (as described in more detail in paragraph 20.9 titled "*Purchase Agreement*" in Section 20 (*Additional Information*)). Furthermore, if a Holder of Dated Notes elects to participate in the Additional New Ordinary Shares Offer, or participates in the Sub-purchase Offer, but, in either case, fails to fund the purchase of its allocation of Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, or the Sub-purchasing Commitment, as applicable, the Purchasers will also be required to subscribe for those New Ordinary Shares in accordance with the terms of the Purchase Agreement.

The obligation of the Purchasers to subscribe for the Additional New Ordinary Shares is subject to certain conditions precedent.

Lock-up Arrangements

Each Holder of Dated Notes has the opportunity to enter into a lock-up arrangement (a **Lock-up Arrangement**) with the Bank pursuant to which such Holder will agree, amongst other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.

Scheme Settlement Date

The Scheme will provide that if the Scheme Settlement Date does not occur on or before 31 December 2013, the Scheme shall lapse and the compromises and arrangements provided by the Scheme shall be of no effect. Accordingly, no exchange of the Dated Notes shall occur pursuant to the terms of the Scheme if the Scheme has not settled on or before 31 December 2013.

7
HOW TO PARTICIPATE IN THE LIABILITY MANAGEMENT EXERCISE

The following section points Holders to the appropriate sections of the Offer Memorandum describing the procedures for participating in the Liability Management Exercise.

HOW TO PARTICIPATE IN THE LIABILITY MANAGEMENT EXERCISE

Descriptions of the procedures to be followed in order to participate in the Exchange Offers or the Proposals relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds are set out in Part 4 of Section C of the Offer Memorandum.

The procedures for participating in the Scheme are described in the Explanatory Statement.

Holders of Existing Securities are responsible for complying with all of the relevant procedures for participating in the Liability Management Exercise. None of the Bank, Co-operative Group, the Dealer Managers, the Exchange Agent, the Information Agent and the Registrars assumes any responsibility for informing holders of Existing Securities of irregularities with respect to any Exchange Instruction, voting or Lock-up Arrangements or Account Holder Letters. Non-compliance with the applicable procedures by a Holder could result in, among other things, an inability to validly offer Existing Securities for exchange or to attend and vote at the Scheme Meeting.

8
DESCRIPTION OF THE BANK

This section sets out information about the Bank and its businesses.

DESCRIPTION OF THE BANK

1. OVERVIEW

The Bank's strategy, which involves a four to five year turnaround plan, is to de-risk the Bank by becoming a commercial bank focused on retail and small and medium-sized (**SME**) franchise businesses in the UK, built around the Bank's existing brand and franchise strength. The Bank is differentiated from other banks in the UK market as it is recognised by its customers as being a fair, responsible and trusted bank. These positive attributes are underpinned by the values of the co-operative movement with which the Bank is associated. As at 30 June 2013, the Bank has just over 4.7 million customers, of which just over 4.6 million are retail and 0.1 million are business customers, and operates through a network of 324 branches, 22 corporate banking centres and 3 primary call centres, over 2,700 ATMs, the internet and digital channels.

The Bank had total assets of £46,632.3 million as at 30 June 2013 (£49,694.8 million as at 31 December 2012).

During 2012, the Bank had already begun to separate its business into two distinct areas: core and non-core. As part of the Bank's plan to simplify, de-risk and reshape its business and to address the underlying issues facing the Bank as discussed below, the Bank accelerated this process and has now finalised the shape and structure of the core and non-core businesses. The Core Business (as defined below) (which as at 30 June 2013 had total segment assets of £30,021.8 million and Basel III final rules credit risk weighted assets of £6,213.9 million) represents lines of activity that are consistent with the Bank's strategy and risk appetite, and includes the core retail and corporate banking businesses, treasury and certain other businesses. The core retail banking business product offering consists of a range of current accounts and money transmission services, lending and savings products, to individuals and households in the UK, while the core corporate banking business provides services to small and medium sized businesses.

The Non-core Business (as defined below) (which as at 30 June 2013 had total segment assets of £14,164.4 million and Basel III final rules credit risk weighted assets of £10,032.9 million) consists of those asset classes which are not consistent with the Bank's Core Business strategy and are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run-down or exit. Those assets which sit within the Non-core Business contain a significant part of the Bank's impairment risk. This includes the Optimum portfolio (a closed book of predominantly interest only, intermediary and acquired mortgage book assets), Illius (a residential property company) and non-core corporate banking assets (including loans to businesses with turnover greater than £25 million, commercial real estate loans, PFI loans, housing association loans and renewable energy asset finance).

The Bank is currently facing a number of financial pressures which, following a review of the financial position of the Bank, led the boards of the Bank and Co-operative Group to announce on 17 June 2013 that the Bank required an additional £1.5 billion of Common Equity Tier 1 Capital, as assessed by the PRA. To meet the capital shortfall, Co-operative Group and the Bank also announced initial details of a comprehensive Recapitalisation Plan which was intended to address the capital requirement. Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in risk weighted assets, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

The capital shortfall is a result of continuing losses incurred by the Bank in part driven by impairment charges to the carrying value of the Bank's loans, a significant proportion of which relates to corporate loans acquired as part of the merger with Britannia in 2009. Impairment charges for the six months ended 30 June 2013 were £496.0 million.

The Bank also has a high cost base relative to its revenue when compared to its peers. The Bank has an ageing IT platform that has suffered from under-investment in recent years and has failed to fully integrate Britannia into the Bank's operations, resulting in significant cost duplications in front, middle and back office functions and a significant overlap in the branch network. In addition, the Bank's revenues are impacted by it not having achieved sufficient penetration of its current account customer base and by it pricing certain products on terms more generous to customers than the market.

In response, the Bank has adopted a new business strategy which is targeted at addressing the issues identified above, reducing the overall risk profile of the Bank in the long term and restoring the Bank to health. The strategy is described in more detail below. Whilst the Bank has already taken a number of actions to try to address the challenges it faces, it is clear that it is in the early stages of turning itself around and that the legacy issues identified above will continue to have an impact on the Bank for some time.

2. KEY STRENGTHS

The Directors believe that the Bank's key competitive strengths are:

The Bank brand is strong and differentiated, recognised as being fairer, more responsible and more trusted than its competitors.

The Bank brand is strong and differentiated within the UK retail banking market as it has been recognised as being fairer, more responsible and more trusted than its competitors.

The Bank has a significant presence in communities through its branch network and is committed to supporting local communities through charitable events and outreach programs. These positive attributes are underpinned by the values of the co-operative movement.

The Bank's focus on social responsibility, together with its recognition as a fair, responsible and trusted Bank (Bank was 'Top Rated' and Smile was the winner in the 'Most Trusted' category at the uSwitch Current Account Awards in May 2013), have a particular resonance in the UK retail banking market where recent national and international events have led to historically low levels of trust in banks generally and have increased the desire for a compelling alternative to the big five high street banks.

Independent research has indicated that the Bank is ahead of its peers in the extent to which its customers considers it fair (+4 percentage points ahead of its nearest competitor in its peer group set) and responsible (+7 percentage points ahead of its nearest competitors in its peer group set) (Source: Hall and Partners June/July 2013).

There are significant and unique opportunities available to the Bank to leverage off Co-operative Group's member base.

Co-operative Group is the UK's largest mutual business, with more than 7.3 million actively trading members, employing over 95,000 people and operating over 4,800 stores across the UK. It is the UK's fifth largest food retailer by sales and the UK's leading convenience store operator by number of stores. Co-operative Group includes the UK's leading funeral services provider by number of funerals, the UK's third largest pharmacy chain by number of branches and a rapidly expanding legal services business.

The Bank believes it has a unique and as yet under-developed opportunity to leverage off Co-operative Group's existing member base and customer base, and to benefit from cross-selling opportunities (where appropriate for the customer) and Co-operative Group's national store network. For example, the Bank already offers a range of services in association with Co-operative Group businesses, allowing customers to take advantage of such opportunities provided by the wider Co-operative Group such as wills and funeral plans.

Award winning levels of customer satisfaction

The Bank's excellent levels of customer service are evidenced through both internal tracking of customer satisfaction and external awards.

The Bank ranked third among UK retail banking providers in the most recent Which? survey in September 2012, receiving a customer satisfaction score of 79 per cent., which was considerably higher than the big five UK retail banks (with satisfaction scores between 46 per cent. and 60 per cent.).

Customer service continues to be recognised as an area of excellence for the Bank across multiple delivery channels. At the uSwitch Current Account Awards in May 2013, the Bank won the 'Best In-branch Customer Services' category and was 'Top Rated' in a further eight categories including 'Best Telephone Customer Service'. Smile also won 'Best Online/Email Customer Service' and was 'Top Rated' for its current accounts and customer satisfaction.

Furthermore, over 75 per cent. of customers rated the bank 8 or higher out of 10 throughout 2012 for service and, in the latest scores from June 2013, 76 per cent. rated the Bank 8 or higher out of 10 (Source: Optimisa research to June 2013).

3. STRATEGY

The Bank is split into two business areas: the Core Business and the Non-core Business.

The Bank's overarching strategy, which involves a turnaround plan of approximately four-to-five years, is to leverage its brand strength and high levels of customer satisfaction to create, over time, an efficient and profitable bank with a reduced overall risk profile, in terms of liquidity capital and day-to-day operations, and to reduce its risk-weighted assets.

This will require it to simplify and focus its Core Business on retail banking and SME customers where the Bank feels it has strong existing market credentials, customer relationships and expertise, whilst achieving significant operational efficiencies. The Bank is targeting a return on equity on its Core Business over a longer term period of low double digit per cent. The Bank currently expects to be in a position to seek controlled Core Business customer lending and deposit growth from 2015.

Those assets which are not consistent with the Bank's business strategy and classified as part of the Non-core Business will be actively managed to achieve the most appropriate asset value on an individual portfolio basis or targeted for run down or exit. The Bank intends to reduce Non-core Business net loans (meaning gross loans net of provisions) to less than £11.5 billion by 31 December 2014 and to continue deleveraging the Non-core Business thereafter at a slower pace. The Bank will also target the deleveraging of the Non-core Business in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital that is released from the reduction in risk weighted assets, with the overall intention of achieving Non-core Business deleveraging that does not materially reduce the Common Equity Tier 1 Capital ratio of the Bank as a whole.

The successful implementation of the new strategy will be dependent on completion of the Liability Management Exercise which is the cornerstone of the Recapitalisation Plan

Strategy for the Core Business

To provide a compelling alternative in UK retail and SME banking, building on the Bank's co-operative brand strength and the Bank's high levels of customer satisfaction.

The Bank has a strong and differentiated brand with high levels of customer satisfaction. The Bank's core strategy is to build on the strengths of its brand and the recognition amongst its customers of being a fair, responsible and trusted bank, to deliver a proposition focused on core relationship banking in the UK retail and SME banking sectors.

To significantly improve its retail product mix and enhance returns through appropriate cross-selling of products and repricing of uneconomic products.

The Bank intends to significantly improve its retail offering through a rejuvenated set of retail banking product propositions. The Bank currently has a large number of products (including legacy products which it no longer offers but continues to service) and will seek to streamline its retail product offering to a less complex range of balance sheet products which are simple, transparent on fees and interest charged and fairly priced, thereby also reinforcing the Bank's brand and customer loyalty. These will include mortgages, unsecured loans, credit cards, current accounts and savings accounts. The Bank will still continue to offer ancillary financial services products, such as insurance, through its distribution network, partnering with third party providers who adhere to the same standards and principles as the Bank.

The Bank intends to better leverage its brand and customer loyalty to improve cross-selling of its products to existing franchise customers (where appropriate for the customer), in particular products such as Bank-branded unsecured lending and residential mortgage lending. The Bank will also seek to restructure or exit from uneconomic legacy products and, where possible, move towards market pricing on products which have previously been priced below market, where consistent with its principle of fair pricing.

Introduce a simplified SME proposition focusing on building relationships with SME customers.

The Bank intends to focus on providing services to SMEs with turnover of typically up to £25 million. The Bank will support its SME customers by offering simple business banking products and services with some targeted growth in larger 'plain vanilla' lending to SME customers. The Bank will also seek to attract new customers by cross-selling its banking products and services (where appropriate) to customers and members of the wider Co-operative Group. The majority of the Bank's SME customers will be served primarily through self-service channels with a small number of relationship managers supporting the Bank's largest SME customers. Given the nature of its customer base, the Bank's SME business will remain deposit-oriented.

Cost saving programme orientated around targeted business simplification and improvements in operating efficiency.

Whilst maintaining the Bank's differentiated customer service proposition, the Bank plans to secure substantial long-term cost savings, targeting a cost-to-income ratio for the Core Business of less than 60 per cent. in the longer term through a significant cost saving programme. The Bank will seek to deliver these cost savings through (i) the simplification of the Bank's product offering, allowing for efficiency gains in the Bank's operations and IT functions; (ii) greater levels of self-service through the reorientation of the Bank's distribution model towards digital and other self-service channels; (iii) business process re-engineering (both IT and non-IT enabled) which will reduce middle and back office costs; (iv) delayering of management; and (v) full integration of Britannia within the Bank.

Significant reorientation of the Bank's distribution channels towards digital and self-service channels, improving the customer experience and reducing the Bank's service costs.

In line with customer demand and developments in the UK retail banking market, the Bank, in partnership with an established digital provider, will seek to significantly enhance its digital and self-service channels to allow its customers to access its products and services when and where they choose. It is expected that over time digital channels will be customers' preferred point of contact.

These enhancements are intended to allow the Bank to reduce its call centre and branch footprint whilst maintaining its market-leading levels of customer service. Between 30 June 2013 and the end of 2014, the Bank expects to significantly rationalise its branch network by at least 15 per cent. of its current estate (as at 30 June 2013) of 324 branches and migrate basic transactions onto a predominantly self-service basis, in particular through the digital channel. Similarly, the Bank expects to rationalise its network of corporate banking centres where it can be achieved without undue detriment to customer service, thereby mitigating the risk of attrition. Call centres will primarily support the digital service offering and the branch network will focus on providing face-to-face support to customers, allowing the Bank to maximise the value generated by its high levels of customer service. In the short term, the full integration of Britannia will remove existing duplication in the Bank's branch network, and the Bank also intends to close certain non-profitable branches. Customer needs will also continue to be met through alternative channels including via ATMs and limited service branch offerings in Co-operative Group stores to complement the network.

Significant re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank.

As a result of historical under-investment (amongst other factors), a number of the Bank's IT systems now, or will soon, require their hardware and operating systems to be updated and improved. The Bank has undertaken a review of its overall IT requirements and has agreed a new IT development plan which is to be executed in four phases (remediation, digital catch-up, simplification and strategic optimisation) and has been designed to meet the requirements of its Core Business strategy.

The primary focus for 2014 and 2015 will be remediation of the existing system issuer to ensure the Bank can meet its on-going commitments to regulators and customers and the creation of an IT platform which allows the Bank to provide new digital channel applications to enable appropriate online products, specifically web-based and mobile banking, and functionality for its customers. The execution of the Bank's turnaround plan will result in significant costs being incurred over the next three financial years and the Bank has currently budgeted in the region of £500 million in connection with the re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank, its cost saving programme and the re-orientation of the Bank's distribution channels. Within this amount, total investment spend on transformation including IT remediation, digital catch-up and other IT initiatives in the next three years of approximately £400 million to £450 million is currently budgeted, of which approximately 40 to 45 per cent. is currently expected to be capitalised.

The Bank will seek to leverage opportunities from its relationship with Co-operative Group – Co-operative Group membership, its large store footprint and its broad product offering all present compelling and under developed opportunities.

The Bank will seek to deliver value to its customers and shareholders by better leveraging opportunities which are uniquely available to the Bank by virtue of its broad relationship with the wider Co-operative Group.

Co-operative Group membership is a significant pillar of the Bank's customer proposition, and the Bank will work alongside group companies within the wider Co-operative Group to target the membership and respective customer bases allowing members and customers to take advantage of opportunities and benefits provided by the Bank and the broader Co-operative Group.

The Bank will seek to further develop arrangements for it to benefit from Co-operative Group's physical footprint of over 4,800 stores across the UK to deliver banking services, such as ATMs and in-store Bank branches, to the Bank's customers. This will also enable the Bank to continue to deliver its market-leading level of customer service supplementing its physical network of branches and supporting its reorientation towards digital and self-service channels. The Bank's proposition may, in turn, include increased focus on introductions to products and services offered by Co-operative Group businesses, such as wills and funeral plans.

Strategy for the Non-core Business

The Non-core Business consists of those asset classes which are not consistent with the Bank's Core Business strategy and which are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit. The Bank's approach to achieving the most appropriate value on an individual portfolio basis means that these Non-core Assets will be managed to achieve optimal economic outcomes, after taking into consideration capital requirements, liquidity provisioning (both past and future), the nature of the assets, the underlying trends of value of such assets, returns and therefore the ability to improve economic outcomes over time by proactive management. Depending on the asset, this may involve the sale or refinancing of the asset or holding the asset until maturity. In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns.

The Non-core Assets contain a significant part of the Bank's impairment risk. Approximately 50 per cent. of the Non-core Assets relate to Optimum, a closed book of predominately interest-only, intermediary and acquired mortgage book assets. The Optimum portfolio, in line with the life of the book, will be run down over the longer term due to the nature of the assets. The key focus will be on arrears and default management, adhering to conduct standards whilst ensuring efficient use of funding and capital.

In support of this business strategy, the Bank is establishing an experienced team which will actively manage this business and oversee a controlled run-off and exit of the assets and intends to put in place a lean, agile and cost efficient operational and governance structure with the focus on achieving deleveraging targets which are set on an annual basis and allow for future operating cost reductions in line with the asset run off.

4. HISTORY AND DEVELOPMENT OF THE BANK

The Bank was originally formed as the banking department of the Co-operative Wholesale Society Limited (**CWS**), the then Co-operative Group in 1872. CWS changed its name on 14 January 2001 to Co-operative Group (CWS) Limited. Co-operative Group (CWS) Limited changed its name to Co-operative Group Limited following the merger with United Co-operatives Limited on 29 July 2007.

The Bank as a separate legal entity was incorporated as The Co-operative Bank Limited in October 1970. In July 1971, the business formerly carried on by the banking department of Co-operative Group Limited was transferred to and vested in the Bank. This was followed, in June 1973, by the transfer of the business of the banking department of the former Scottish Co-operative Wholesale Society to the Bank.

The Bank obtained clearing bank status in 1975 and was granted recognised status by the Bank of England under the terms of the Banking Act 1979. In 1981, the Bank re-registered under the Companies Act 1980 as a public company and was re-registered on 10 January 1993 with its present name. On 19 June 2002, Co-operative Group transferred its entire shareholding in the Bank to Co-operative Financial Services Limited (now named Co-operative Banking Group Limited (**Banking Group**)), a newly incorporated Industrial and Provident Society. The ultimate parent of the Bank remained Co-operative Group. A summary of the structure of Banking Group is set out in paragraph 5 titled "*Business Overview*" of this Section 8 (*Description of the Bank*).

On 21 January 2009, the boards of Britannia and Banking Group jointly announced their proposal to merge (the **Merger**). The Merger became effective on 1 August 2009 through a transfer of the business, assets and liabilities of Britannia to the Bank under the Building Societies Act 1986. Prior to the Merger, Britannia was the UK's second largest building society in terms of total consolidated assets. At the date of this document, the retail residential lending and savings franchise transferred from Britannia and the pre-Merger businesses of the Bank, continue to trade as separate businesses under the "Britannia", "Co-operative Bank" and "smile" brand names respectively.

On 19 July 2012, Co-operative Group announced that non-binding heads of terms had been agreed with Lloyds Banking Group plc for the acquisition of 632 branches with an estimated 4.8 million banking customers (the **Verde Business**). On 24 April 2013, Co-operative Group announced that it had withdrawn from the process to acquire the Verde Business, after the boards of directors of both the Bank and Co-operative Group decided that it was not in the best interests of Co-operative Group's members to proceed with the acquisition.

On 17 June 2013, the boards of the directors of Co-operative Group and the Bank announced that they had completed a capital review of the Bank's capital position and concluded that the Bank required an additional £1.5 billion of aggregate Common Equity Tier 1 Capital. To meet the capital shortfall, Co-operative Group and the Bank announced the initial details of the Recapitalisation Plan which was intended to address this capital requirement. Further details of the Bank's capital position as at 30 June 2013 and the Bank's capital position as calculated in accordance with Basel III, together with an overview of the Bank's forecast capital position following the implementation of the Liability Management Exercise is set out in Section 13 (*Capital Adequacy*) and Section 16 (*Financial Information*).

On 21 October 2013, Co-operative Group and the Bank announced that they had been engaging with different bondholder constituents and seeking to balance the requirements and expectations of these parties. It was further announced that they expected that many elements of the Recapitalisation Plan would be materially different to the outline provided on 17 June 2013. The Recapitalisation Plan consists of the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities surrendered in the Liability Management Exercise. See Section 4 (*Letter from the Chairman of the Bank, Background to and Reasons for the Recapitalisation Plan and Potential Consequences of Holders Failing to Support the Liability Management Exercise*) and Section 6 (*Details of the Liability Management Exercise*) for further details of the Liability Management Exercise. At least £1 billion of Common Equity Tier 1 Capital will be generated in 2013 if the Liability Management Exercise is successful, with £333 million of Common Equity Tier 1 Capital being expected to be contributed by Banking Group under the 2014 Commitment.

Under the Recapitalisation Plan, Co-operative Group, which will hold 30 per cent. of the equity in the Bank, will remain the Bank's largest single shareholder by far, which will enable it to maintain significant influence over how the Bank operates.

The Bank has suffered a number of credit rating downgrades by Moody's and Fitch, most notably a six notch downgrade by Moody's on 9 May 2013 of the deposit and senior debt ratings to Ba3 from A3, taking the Bank below investment grade rating and in June 2013, the Bank's long-term credit rating was further downgraded by Fitch and Moody's. For further details, please see the paragraph titled "*Liquidity and Funding*" in Section 12 (*Operating and Financial Review*).

On 12 July 2013, Co-operative Group and the Bank announced the launch of an independent review, to be chaired by Sir Christopher Kelly, into the events that led to the recent announcement of the Recapitalisation Plan to address the Bank's £1.5 billion capital shortfall, the decision to merge the Bank with Britannia in 2009 and the proposed acquisition of the Verde Business (the **Kelly Review**). The Kelly Review will include an analysis of strategic decision making, management structures, culture, governance and accounting practices and aspects of the role of the Bank auditors. The intention is to present the findings of the Kelly Review to Co-operative Group's members at its annual general meeting in May 2014.

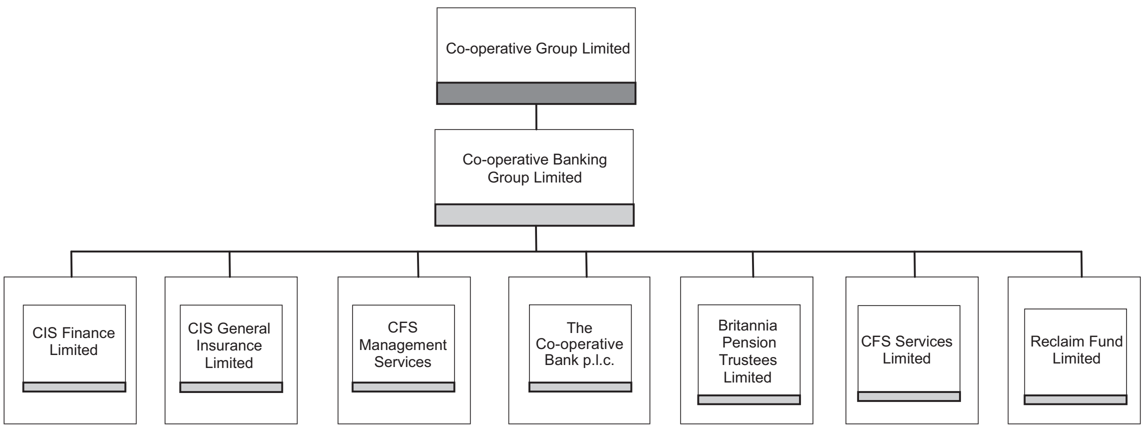
Since the Bank announced its Recapitalisation Plan, it has been undertaking a strategic review on improving its longer term financial and operational performance and has developed a strategy to return the Bank to profitability over the longer term. For further details please see paragraph 3 "*Strategy*" in this Section 8 (*Description of the Bank*).

Going forward, the Bank intends to explore the possibility with the UK Listing Authority of seeking a premium listing of the Ordinary Shares on the Official List within 12 months of completion of the Liability Management Exercise, subject to meeting the necessary eligibility criteria.

5. BUSINESS OVERVIEW

The Bank is currently a subsidiary of Banking Group and Co-operative Group is the ultimate holding entity of the Bank and Banking Group. The current structure of Banking Group is set out in the structure chart below:

Group Structure



A. The Core Business and the Non-core Business

Following the Merger, the Bank was initially organised into a structure with two key divisions, being (i) the retail division; and (ii) the corporate and markets division (**CAM**). CAM consisted of corporate banking, treasury, the Optimum portfolio (a closed book of predominately interest-only, intermediary and acquired mortgage book assets), Platform (the Bank's intermediary mortgage brand) and business services. In 2011 the CAM division became the 'corporate and business banking' division (**CABB**).

During 2012, as part of the outcome of a strategic review, the Bank's management decided to undertake a transformational restructuring of the Bank and focus on strengthening its retail and business banking operations. As part of this initiative the Bank refined the operating segments on which it reported by separating its assets into core (being those assets consistent with the Bank's strategy and risk appetite) and non-core (being those assets not consistent with the Bank's strategy and risk appetite). More specifically, the Bank separated CABB into core and non-core segments and moved Platform from the CABB business into the 'Retail' business. The non-core assets were primarily a set of CRE exposures which were non-performing as well as a number of other assets acquired as part of the acquisition of Britannia, being the Optimum portfolio and Illius (a residential property company).

In 2013, as the strategy of the Bank developed to focus on serving retail and SME customers and as part of the Bank's plan to simplify and reshape itself as announced on 17 June 2013, the core and non-core business activities constituted in 2012 were redefined as:

(i) Retail and SME Banking (the **Core Business**); and

(ii) Co-operative Asset Management (the **Non-core Business**).

The newly constituted Core Business and Non-core Business activities came into effect during August 2013 and as a result, certain assets which were previously classified as part of the core business are now classified as part of the Non-core Business. Under the current core and non-core business segments (i.e. the Core Business and Non-core Business) the majority of corporate banking assets which were previously classified as part of the core business (pre-August 2013) are now classified as part of the Non-core Business and as such will be managed to achieve the most appropriate asset value on an individual portfolio basis or will be targeted for run-down or exit. A table setting out the key divisions used for managing the Bank between 1 January 2010 and 30 June 2013 (as described above) is set out below:

<table>
<tr><th>2010</th><th>2011</th><th>2012/H1 2013</th><th>H2 2013</th><th></th></tr>
<tr><td>Retail</td><td>Retail</td><td>Retail (incl Platform)</td><td rowspan="2">Retail Banking
BACB (Business and Commercial Banking)</td><td rowspan="3">Represents the Core Business</td></tr>
<tr><td>CAM
(Corporate and Markets)</td><td>CABB
(Corporate and Business Banking)</td><td>CABB
(Corporate and Business Banking)</td></tr>
<tr><td rowspan="2">Corporate
Optimum/Platform
Business Services
Treasury</td><td>Corporate (including Platform) Optimum</td><td>Optimum
Corporate non-core
Other CABB (non-core)</td><td>Treasury/other (including Unity Trust Bank)</td></tr>
<tr><td>Treasury</td><td>Treasury</td><td rowspan="2">CoAM
Corporate, Optimum, Illius</td></tr>
<tr><td>Other</td><td>Other</td><td>Other</td></tr>
</table>

As at 30 June 2013, total segment assets in the old core and non-core business were £34,356.3 million and £9,829.9 million, respectively. For the same date, based on the newly constituted Core Business and Non-core Business, total segment assets in the Core Business and Non-core Business would have been £30,021.8 million and £14,164.4 million, respectively. Sixty-two per cent. of the Basel III final rules credit risk weighted assets of the Bank as at 30 June 2013 are now in the Non-core Business.

(a) ***The Core Business***

The Core Business represents lines of business that are consistent with the Bank's strategy and risk appetite. It continues to concentrate on supporting individual and business customers, where the Bank has strong market credentials, customer relationships and expertise. These business areas of the Core Business are the Bank's:

(i) core retail banking business, which trades as "The Co-operative Bank", "Britannia" and "smile", together with the Bank's intermediary brand, "Platform", and includes retail secured and unsecured lending (**Retail Banking**);

(ii) core business and commercial banking business (**BACB**); and

(iii) treasury and the Unity Trust Bank (**Treasury/other**).

Each of the above areas is described in further detail below.

(b) ***The Non-core Business***

The Non-core Business consists of those asset classes which are not consistent with the Bank's business strategy, are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit, and contain a significant part of the Bank's impairment risk. These asset classes include non-core corporate banking assets, consisting of six asset classes, the Optimum portfolio, and the Illius portfolio. Each of these assets is described in further detail below.

(c) ***Certain financial information in respect of the Core Business and the Non-core Business***

The historical financial information of the Bank set out in this Section 8 (*Description of the Bank*) and Section 15 (*Segmental Financial and Other Information*), reflects the divisions of the Bank as presently managed, i.e. the Core Business and Non-core Business, which came into effect during August 2013. This financial information is unaudited and has been extracted from the Bank's internal management systems for the relevant periods.

The following table sets out certain unaudited financial information relating to the Core Business and the Non-core Business for the six months ended 30 June 2013.

Table 1: Segmentation of the Bank's activities for the six months ended 30 June 2013

	For the six months ended 30 June 2013 (unaudited)					
	Core Business					
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*	*Non-core Business*	*Total for the Bank*
			(£millions)			
Operating result	0.9	12.9	17.9	31.7	(489.3)	(457.6)
Gross loans and advances to customers	17,760.5	1,093.7	–	18,854.2	14,931.3	33,785.5
Segment assets	17,797.1	979.5	11,245.2	30,021.8	14,164.4	44,186.2
Customer deposits	28,132.8	4,655.3	–	32,788.1	1,485.6	34,273.7

B. Core Business

The Core Business represents activity consistent with the Bank's risk appetite and strategy. The Core Business is further split into three business areas: (i) Retail Banking; (ii) BACB; and (iii) Treasury/other.

Each of these areas is described in further detail below.

B.1 Core Business: Retail Banking

Retail Banking offers a range of financial products and services to individuals and households throughout the UK, trading as "The Co-operative Bank", "Britannia" and "smile" together with the Bank's intermediary brand "Platform".

The Bank has just over 4.6 million Retail Banking customers and is a clearing bank operating across multiple delivery channels with a range of current accounts and money transmission services, lending products and savings products. The Bank distributes its retail products through branches, call centres and via the internet and mobile banking. See paragraph (c) titled "*Distribution*" below for further details on the distribution of products.

As part of its business strategy, the Bank intends to introduce new products that are simple, transparent on fees and interest charged and fairly priced.

(a) Retail Banking Products

(i) ***Mortgage lending***

As at 30 June 2013, the Bank had a total outstanding mortgage portfolio of £14.2 billion issued under the Co-operative Bank brand and the Britannia brand and a total outstanding mortgage portfolio of £2.1 billion issued under the Platform brand. As at 30 June 2013, the Bank's total issued mortgage lending secured on residential property (excluding buy-to-let) was £15.2 billion and the total issued buy-to-let mortgage portfolio was £1.1 billion. The Bank's total mortgage lending of £16.3 billion represents an estimated 2.1 per cent. of total UK mortgage balances (as at 30 June 2013).

During the six months ended 30 June 2013, the Bank's gross new lending amounted to £1.5 billion (which includes further advances) and net new lending was £0.4 billion.

The majority of the Bank's mortgage lending portfolio consists of UK residential mortgage loans to individuals that are fully secured on a first priority basis on the residential property of the borrower on terms which allow for repossession and sale of the property if the borrower fails to comply with the terms and conditions of the loan. As a result, and in line with other residential mortgage lenders, the Bank's residential mortgage lending carries lower risk than many other types of lending.

The Bank's mortgage lending can take the form of either prime residential lending (where the borrower is the owner and occupier of the mortgaged property and meets the Bank's credit requirements for prime lending) or buy-to-let lending (which are loans advanced to borrowers who intend to let the mortgaged property). In addition, the Bank also has a stock of historical residential mortgage loans which were advanced to borrowers who self-certified their income and to other borrowers who do not meet the Bank's prime borrower credit requirements.

As at 30 June 2013, the percentage of the Bank's outstanding mortgage portfolio which comprises prime residential mortgages was 92.4 per cent. of the total portfolio.

The following table sets out a breakdown of the Retail Banking mortgage portfolio by type on a gross basis as at 30 June 2013.

Table 2: The Retail Banking mortgage portfolio by type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Product Type	*(£millions)*	*(percentages)*
Prime	15,068.3	92.4
Buy-to-let	1,086.5	6.7
Non-conforming and self-certified	150.4	0.9
Total	16,305.2	100.0

The following table sets out the geographical distribution of the Retail Banking mortgage loans on a gross basis as at 30 June 2013.

Table 3: Regional analysis of the Retail Banking mortgage loans as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Region	*(£millions)*	*(percentages)*
London & South East	6,171.3	37.8
Northern England	3,097.3	19.0
Midlands & East Anglia	3,684.2	22.6
Wales & South West	2,087.6	12.8
Other	1,264.8	7.8
Total	16,305.2	100.0

The Bank's residential mortgage loans are currently generally granted for an average term of 22.5 years. However, the typical life of the Bank's residential mortgage lending (for a customer's initial mortgage with the Bank) is approximately 2.5 years after drawdown as a result of the volume of customer redemptions, with the volume of customer redemptions being a characteristic of the UK residential mortgage market affecting all UK mainstream residential mortgage lenders, together with the relative characteristics of the Bank's product mix, the volume of new mortgage lending by the Bank and general customer retention patterns. All of these factors influence the average life of the Bank's residential mortgage lending.

The Bank currently offers fixed rate and lifetime tracker rate mortgages. Fixed rate mortgages have a set rate for an initial set period, after which the rate reverts to the Bank's standard variable rates, which is set at the Bank's discretion.

The Bank's fixed rate mortgages currently offer a term of two, three, five or ten years, with the fixed rate charge determined by the loan-to-value ratio of the mortgage in question.

Lifetime tracker mortgages have a set methodology for determining a variable rate during the term of the mortgage, unlike the fixed rate mortgages which offer a set rate for an initial period. The Bank's lifetime tracker rate products bear interest at a variable rate that is a fixed percentage above the Bank of England's base rate.

To reduce the costs associated with early repayment of mortgages and to recover a portion of the costs of mortgage incentives, in line with its competitors, the Bank imposes early repayment charges on some of its mortgage products. The early repayment charges apply for repayment made prior to the expiration of the fixed or tracker rate for the particular product.

The following table sets out the breakdown of the Retail Banking mortgage portfolio by interest rate on a gross basis as at 30 June 2013.

Table 4: Breakdown of Retail Banking mortgages by interest rates product as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Products	*(£millions)*	*(percentages)*
Fixed rate mortgages	7,419.5	45.5
Floating rate mortgages	8,885.7	54.5
Total	16,305.2	100.0

The Bank utilises an automated credit scoring system to assist in minimising credit risk on mortgage lending. The Bank's credit procedures for mortgage lending take into account the applicant's credit history, loan-to-value (**LTV**) ratio criteria, income multiples and an affordability calculation, or shock test, that tests the applicant's ability to service the loan at higher interest rates. The average LTV ratio of new mortgage lending during the six months ended 30 June 2013 was 65.0 per cent. The indexed LTV ratio for the Bank's entire mortgage portfolio was 44.3 per cent. at 30 June 2013 (based on the latest property valuations available). Only 1.8 per cent. of the Bank's total mortgage book has an indexed LTV ratio in excess of 100 per cent., based on value of the property.

As at 30 June 2013, the Bank's buy-to-let mortgage portfolio was £1.1 billion or 6.7 per cent. of the Bank's total outstanding retail banking mortgage portfolio. The majority of the Bank's buy-to-let mortgages (88 per cent. as at 30 June 2013) comprise of interest-only mortgages. Other than buy-to-let mortgages, the Bank does not offer new customers interest-only mortgages. Rather, the Bank will typically require that new mortgages are repayment mortgages, where customers are required to repay the interest and part of the capital outstanding during the term of the loan. However, there are a number of historical mortgages within the Bank's residential mortgage portfolio which are structured on an interest-only basis and there may be circumstances where the Bank is required to allow existing customers to move onto another of the Bank's mortgage products on an interest-only basis. As at 30 June 2013, the proportion of interest-only mortgages in the Bank's mortgage portfolio was 22.7 per cent. or £3.7 billion out of £16.3 billion of outstanding mortgage balances.

Table 5 sets out the LTV and arrears information of the Retail Banking mortgage portfolio on a gross basis, broken down by product type as at 30 June 2013.

Table 5: LTV breakdown of Retail Banking's mortgage loans by product type as at 30 June 2013

	As at 30 June 2013 (unaudited)			
	Prime	*Buy-to-let*	*Non-conforming and self-certified*	*Total*
	(percentages)			
Average LTVs	43.4	61.7	50.9	44.3
New business LTVs	65.0	65.8	54.8	65.0
Book by indexed LTVs				
<= 50%	36.0	12.0	33.4	34.4
<= 75%	38.5	80.1	60.0	41.4
<= 100%	23.6	7.8	6.0	22.4
> 100%	1.9	0.1	0.6	1.8
Percentage of accounts with > 2.5% arrears	0.3	0	1.9	0.3
	(£ millions)			
Gross customer balances	15,068.3	1,086.5	150.4	16,305.2
New lending[1]	1,481.1	57.0	1.6	1,539.7

1 Excludes further advances for the period

The proportion of the Bank's Retail Banking mortgage accounts with greater than 2.5 per cent. in arrears was 0.3 per cent. as at 30 June 2013, as compared with the CML industry average of 1.40 per cent. as at 30 June 2013.

As part of the Bank's strategy, the Bank intends to offer a simple range of market aligned mortgage products (not interest-only products) without complex features, aimed at its relationship customers and consistent with its risk appetite and market conditions.

(ii) ***Unsecured lending***

The unsecured lending products offered by the Bank consist of personal unsecured loans, credit cards and overdraft facilities (as detailed below).

The following table sets out the Retail Banking unsecured lending balances on a gross (including credit commitments) basis split by product type, as at 30 June 2013.

Table 6: Breakdown of the Retail Banking unsecured lending balances (including credit commitments), split by product type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Product type	*(£millions)*	*(percentages)*
Personal unsecured loans	723.2	19.6
Credit cards	2,597.2	70.6
Overdrafts	362.7	9.8
Total unsecured lending balances	3,683.1	100.0

Personal unsecured loans

The majority of the Bank's personal unsecured lending portfolio comprises fixed rate lending either to customers who have an existing relationship with the Bank (classified as personal loans) or to customers with no broader relationship with the Bank (classified as direct loans). Direct loans can be sourced through one of the Bank's introducer or affinity relationships, including the Bank's affinity relationship with the Automobile Association, which generates a significant proportion of the Bank's direct loans. A majority of the Bank's new personal unsecured lending business is presently to customers holding a current account with the Bank.

The Bank's personal unsecured lending portfolio is composed of the following product types: personal loans, direct loans, career development loans, loans sourced by 'smile' and non-standard "advance" accounts and legacy flexible personal loans.

As at 30 June 2013, the Bank's total personal unsecured loans portfolio was £662.9 million (drawn balances) and comprised 121,000 customer accounts.

The table below sets out the Retail Banking personal unsecured loan portfolio on a gross basis, broken down by product type, as at 30 June 2013.

Table 7: Breakdown of the Retail Banking personal unsecured loan portfolio (including credit commitments) by product type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Product type	*(£millions)*	*(percentages)*
Personal and direct loans	607.5	84.0
Career development loans	76.7	10.6
'smile' personal loans	36.4	5.0
Non-standard advances and legacy flexible loans	2.6	0.4
Total	723.2	100.0

As with all unsecured personal lending, there is a greater risk of loss on unsecured personal lending as compared to residential mortgage lending because the Bank has no security if the borrower defaults on the loan. Accordingly, unsecured personal lending products bear higher interest rates than the Bank's residential mortgage products. In addition, the Bank uses an automated credit scoring system that is designed to evaluate a borrower's ability to repay the loan and imposes a maximum limit on the size of unsecured personal loans, and risk-based pricing is used in certain circumstances. The Bank presently has approximately 1.6 million current accounts, of which 0.09 million hold a personal loan with the Bank, which is approximately 5.6 per cent.

As part of its strategy, the Bank intends to reduce the number of direct loans and focus its unsecured personal lending on its existing primary banking customers and offer simple products that are priced in line with the UK market. The Bank intends to impose risk-based pricing capabilities to manage risk costs.

Credit cards

The Bank has approximately 699,000 credit card accounts of which 398,000 were active during the month of June 2013 (in that the relevant account recorded a debit or a credit during that month being sufficient to constitute activity for these purposes).

As at 30 June 2013, the Bank's credit card portfolio contained receivables of £548 million, with the proportion of such balances bearing interest being 65.5 per cent.

The characteristics of the Bank's current credit card product range are as follows:

(a) the platinum credit card is targeted at customers who value a fixed annual percentage rate (**APR**) and offers a fixed rate APR for a five year period;

(b) the clear credit card is targeted at customers who value one standard APR that applies to all transactions, including cash withdrawals, purchases and balance transfers;

(c) the 'think' credit card offers customers an ethical benefit and rewards customers for conducting transactions with the Bank's "think partners" with a low APR for a fixed period; and

(d) the members' credit card offers cashback to customers at a preferential rate when used in the Co-operative food stores (as compared to the rate offered on all other spend).

A majority of the new credit cards issued by the Bank are the clear credit card and the members' credit card.

In addition, the Bank's credit card portfolio includes a £111.5 million portfolio (including credit commitments) purchased from Northern Rock in 2003 which has been closed to new business since the end of 2007.

The table below sets out the Retail Banking credit card portfolio on a gross (including credit commitments) basis, broken down by product type, as at 30 June 2013.

Table 8: Breakdown of the Retail Banking credit card portfolio by product type as at 30 June 2013 (including credit commitments)

	As at 30 June 2013 (unaudited)	
Product type	*(£millions)*	*(percentages)*
Platinum	376.9	14.5
'Classic'	634.5	24.3
smile	274.5	10.6
Clear Card	202.4	7.8
Northern Rock	111.5	4.3
Affinity relationships	586.0	22.6
Gold	393.9	15.2
Variable rate loans	17.5	0.7
Total	2,597.2	100.0

The Bank markets and processes credit card applications itself (using its credit scoring system), and credit card holders receive differing credit limits, depending on their credit score. Credit limits are regularly reviewed in line with customer need and risk appetite.

Most of the debit activity on the Bank's credit card portfolio arises as a result of spending at merchants, with small elements of cash advance and balance transfer.

The Bank's credit card asset quality remains strong and is monitored constantly both for new and existing exposures. Its percentage of credit card balances one payment in arrears was 3.5 per cent. as at 30 June 2013, compared with an industry average benchmark of 4.0 per cent. (Source: FICO® Benchmark Reporting Service quarterly UK cards data). The Bank has a 2 per cent. market share of the UK credit card market based on customers and a 1 per cent. UK market share of credit card outstanding balances with 50 per cent. of its credit card holders receiving other products from the Bank. As part of its strategy the Bank intends to further simplify its credit card proposition and re-price new accounts in line with the UK market and to take into account risk, focusing on growing its branded credit card portfolio (with a particular focus on sales to existing banking customers thereby deepening the core banking relationship).

Overdrafts

Overdrafts are offered to customers with current accounts with the Bank. In line with peers in the market, the Bank offers two types of overdraft; formal overdrafts and informal overdrafts. Formal overdrafts are where an overdraft is requested by the customer and agreed to in writing by the Bank. Informal overdrafts are where a customer, although not having formally requested an overdraft, may pay or withdraw money from their account in excess of the credit balance of the account or up to an agreed overdraft limit. Formal overdraft facilities are reviewed each year.

As at 30 June 2013, the Bank had aggregate formal and informal overdraft balances of approximately £62 million.

(iii) ***Savings and current accounts***

As at 30 June 2013, the Bank had approximately 680,380 primary current accounts (being accounts that on average turnover £800 or more per month) and £28.1 billion of retail customer deposit balances, representing an estimated 2 per cent. of total UK retail savings balances. The Bank's prime current account base has grown by 23 per cent., from 553,262 at the end of 2010 to 680,380 as at 30 June 2013, with growth being 8 per cent. in 2012 and 2.5 per cent. in the period ended 30 June 2013. The Bank offers a range of savings products and current accounts. The Bank offers a standard Current Account and a Current Account Plus. In addition, the Bank also offers a basic current account, called Cashminder directed at simple, in-credit banking and the Bank also maintains a book of historic packaged/fee-paying current accounts which are not presently part of the Bank's on-sale product range.

The Bank offers a range of savings products including term, limited access and easy access products, with or without an individual savings account (**ISA**) wrapper. The Bank's fixed rate savings accounts earn a fixed rate of interest for a chosen term and funds therein cannot be withdrawn until maturity.

The Bank's strategy is to simplify the range of current accounts and savings products with price varying by term, access and amount whilst addressing the needs of target customers. The Bank intends to migrate from expensive fixed-term deposits to variable rate funding. The Bank also intends to maintain competitive pricing of instant access and notice accounts to grow a short-term savings book. A compelling current account proposition with enhanced digital capability is planned to appeal to target customers. The Bank intends to leverage the broader Co-operative Group membership base to drive growth in current accounts.

The table below sets out deposits within the Retail Banking segment, broken down by deposit type, as at 30 June 2013.

Table 9: Breakdown of the Retail Banking deposits as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Retail deposits	*(£millions)*	*(percentages)*
Current accounts	3,450.6	12.3
Term deposits	10,310.7	36.6
Instant access accounts	7,940.8	28.2
ISAs & others	6,430.7	22.9
Total	28,132.8	100.0

(b) ***Certain financial information in respect of the Retail Banking Segment***

Set out below is certain key financial information in respect of the Core Business's Retail Banking segment.

(i) ***Operating Results and Assets and Liabilities of the Retail Banking Segment***

The following table illustrates the financial performance of the Retail Banking segment, by setting out the operating results for Retail Banking for the six months ended 30 June 2013.

Table 10: Financial performance of the Retail Banking segment for the six months ended 30 June 2013

Retail Banking	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	203.5
Non-interest income	65.0
Total income	268.5
Operating costs	
Steady state	(235.0)
Strategic initiatives	(7.8)
	25.7
Impairment losses	(24.8)
Operating result	0.9

The following table sets out total assets, liabilities and risk-weighted assets of the Retail Banking segment as at 30 June 2013.

Table 11: Total assets, liabilities and risk-weighted assets of the Retail Banking segment as at 30 June 2013

Retail Banking	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	17,760.5
Net loans and advances to customers	17,583.9
Segment assets	17,797.1
Customer deposits	28,132.8
Segment liabilities	27,969.4
Risk-weighted assets (B2)	2,384.7
Risk-weighted assets (B3 final rules)	2,384.7

(ii) ***Key Performance Indicators of Retail Banking***

The following table provides a breakdown of the key performance indicators in relation to the Retail Banking segment, as at and for the six months to 30 June 2013.

Table 12: Breakdown of key performance indicators of the Retail Banking segment as at and for the six months ended 30 June 2013

	As at and for the six months ended 30 June 2013 (unaudited)
Retail Banking	
Net interest margin bps(1)	230
Cost-to-income ratio(2)	87.5%
Non-performing loans ratio(4)	2.2%
Non-performing loans coverage(5)	54.7%
Loan-to-deposit ratio(6)	63.1%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(4) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

(5) The loan-to-deposit ratio is calculated by dividing gross customer loans by customer deposits.

(c) ***Distribution***

Overview

The Bank offers a broad multi-channel proposition to customers, covering branch, telephony, online, mobile, intermediary/broker (through Platform) and in-store throughout the wider Co-operative Group.

Branches

Branches remain important to the Bank's customers, and a branch presence is currently considered by the Bank to be a significant factor in maintaining the level of the Bank's brand awareness, consideration and advocacy with both the Bank's current customers and potential customers. In addition, branches are responsible for the acquisition of a proportion of the Bank's new current accounts and broader deposit-taking activity.

At the point of the merger with Britannia, the Bank's branch network was 345 branches (including four offshore and five in-stores) under the separate Co-operative Bank and Britannia brands. As at 30 June 2013, there were 324 branches with a target of rationalising by at least 15 per cent. of the Bank's branch network by the end of 2014 operating under a single high street brand (being the Co-operative Bank brand). In the short term, the full integration of Britannia will involve the removal of existing duplication in the Bank's branch network and the Bank also intends to close certain non-profitable branches.

Offshore branches include three branches located in the Isle of Man and a branch in Guernsey (supported by an agency arrangement in Jersey). Savings balances for each business as at 28 June 2013 were £892 million and £423 million respectively with a portfolio of mortgage assets totalling £171.0 million in Guernsey. As part of the Core Business's rationalisation programme, plans were announced in August 2013 to exit the Guernsey business.

Call centres

There are three primary call centre locations: Leek, Stockport and Skelmersdale. The call centres of the Bank (all of which are based in the UK) are open 24 hours a day and 7 days a week to service customers manage simple transaction requests and address customer needs across the full product range.

Internet

The Bank provides internet banking through the Co-operative Bank-branded and smile-branded websites. The Co-operative Bank-branded site is part of the Bank's multi-channel offer and has 1.17 million registered users with 0.71 million active users (unique users in the three months May 2013 to July 2013 inclusive). Internet banking, current accounts, unsecured loans, credit cards, mortgages and savings products are all available under the Co-operative Bank brand.

'Smile' was launched in 1999 as the UK's first full internet bank and as at 30 June 2013 had approximately 340,000 customers. In the period May 2013 to July 2013 (inclusive), there were 154,896 user log-ins. The 'smile' branded website continues to win consumer awards such as the Current Account Provider of the Year in 2013 (Consumer Money Facts Awards), joint top score for Best Overall Current Account (2013 uSwitch Current Account Awards) and Most Trusted Current Account Provider (2013 Moneywise Awards). Current accounts, saving products, unsecured loans, credit cards, and mortgages are all available under the 'smile' brand.

ATMs and in-store Bank branches

The Bank has over 2,700 ATMs, primarily located in Co-operative Group's food stores. These ATMs offer an important service to local communities and also allow the Bank a physical presence beyond the reach of its own branch network. A broader "in-store banking" concept is currently being trialled under various formats. There are at present seven such sites within Co-operative Group food stores where staff support customers with basic sales and transaction servicing; where appropriate this will supplement the traditional channel.

Platform

Intermediary remains an important channel to the Bank, in particular for mortgage origination, of which 12.9 per cent., being £2.1 billion out of £16.3 billion as at 30 June 2013, is sourced through the Bank's Platform brand in the broker market.

Platform is one of the few lenders operating a dedicated brand within the UK intermediary market. Platform has historically achieved approximately 1 per cent. share of total intermediary new business completions. The market competitiveness of the Bank's interest rates allows the Bank to drive new business volumes as required.

Launched in February 2003, Platform was created from the merger of Platform Home Loans and Verso, both subsidiaries of Britannia. Platform is focused on prime residential mortgages and buy-to-let intermediary lending. This offers flexibility to the Bank in terms of market participation, product and pricing and, given the specialist nature of the broker market, this approach enables the Bank to access segments of the mortgage market that would be harder to reach through the Co-operative Bank brand. Intermediaries range from large UK insurance companies (including Legal & General and Sesame Bankhall Group) to small independent mortgage advisers.

Distribution strategy

Whilst branches remain important to the Bank's customers, increasingly the value of other distribution routes – notably digital – is being observed in the UK market. Over the medium term, the Bank's strategy is to move towards a more digitally enabled offering that is less branch intensive, and facilitates broader customer self-service options for the Bank's customers' everyday transactional needs, at the same time retaining the richness of the branch proposition to support important transactional milestones for customers with complex needs. In this future distribution model:

- the remote channels (internet and digital), which currently have limited functionality, will become the primary point of contact for the Bank's customers looking for information on their account, simple product queries, simple transactions and simple sales;
- the Bank's call centres will primarily support the remote channels (via callback facilities and appointment booking) and will cater for more complex queries (such as complaints) and emergency support. It will also provide simple transaction services and information to customers for whom digital is not an option, although operators' availability will be increasingly restricted;
- the Bank's branch network will provide face-to-face support for customers at critical moments, for example, during complex transactional decisions, when the Bank has made a mistake, when a life event causes financial problems or in emergencies. The branches' secondary role will be to help customers use the Bank's digital services and provide simple transaction services and information to customers for whom digital is not an option;
- Co-operative Group food stores and ATMs will also continue to provide self-service to customers for basic transactions and will be a source of account information; and
- the Bank's Platform brand will remain a key channel to the market and there will be continual selective usage of intermediary mortgages.

B.2 Core Business: BACB

BACB targets and services small and medium sized businesses which will typically (i) have a turnover of less than £25 million; (ii) have borrowing requirements of less than £5 million; and (iii) otherwise meet the Bank's risk appetite. In line with the strategy of the Core Business, BACB will have a particular focus on being a fair, responsible and trusted relationship bank and, hence, will continue to offer services on commercial terms, to charities, social businesses and co-operatives.

BACB does not offer banking services to certain sectors, customers and in respect of assets which (i) cannot be supported by the Bank's Core Business retail platform; (ii) fail to deliver a positive net interest margin for the Bank; or (iii) are non-performing or defaulting.

(a) ***BACB segments***

BACB is split into the following three sub-segments:

- business banking (**Business Banking**);
- relationship-managed banking (**Relationship-managed Banking**); and
- specialist banking (**Specialist Banking**).

The BACB segment is deposit rich in that deposits are materially higher than its loan portfolio. The Bank intends to simplify the services and products it offers so that they are more akin to retail products. The three sub-segments of the BACB are set out in further detail below.

(i) ***Business Banking***

This sub-segment of BACB offers banking services to small business customers and primarily targets those business customers with low physical cash/cheque needs and borrowing requirements. The service it offers includes access to branches and corporate banking centres, telephone banking and online services. Customers within this sub-segment do not, however, have a relationship manager. Products that are available to these customers include: (i) current accounts; (ii) savings accounts (fixed term, notice and instant access); (iii) bank cards; (iv) business overdrafts; and (v) small ticket term-lending of up to £100,000. The Business Banking sub-segment has approximately 93,367 customers.

(ii) ***Relationship-managed Banking***

The Relationship-managed Banking sub-segment of the BACB offers the following additional products to its customers: (i) larger secured and unsecured lending (including simple term unsecured financing of up to £5 million and products linked to government schemes); (ii) multiple accounts; and (iii) deposit accounts for larger amounts (instant access, notice, fixed term and treasury accounts).

One of the primary differences between the Business Banking and Relationship-managed Banking sub-segments is that Relationship-managed Banking customers are provided with a relationship manager. The Relationship-managed Banking sub-segment services has approximately 3,977 customers.

(iii) ***Specialist Banking***

The Specialist Banking sub-segment of the BACB services charities, co-operatives, public sector bodies and social businesses. The products and services it offers are consistent with those offered to customers within the Business Banking and Relationship-managed Banking sub-segments. The Specialist Banking sub-segment services has approximately 939 customers.

BACB had £4.7 billion of customer deposit balances and £1.1 billion loan portfolio amount on a gross basis as at 30 June 2013, as set out in the following table.

Table 13: Breakdown of BACB deposits and loan portfolio spilt by sub-segment as at 30 June 2013

	BACB deposits as at 30 June 2013 (unaudited)		*BACB Loan portfolio as at 30 June 2013 (unaudited)*	
	(£millions)	*(percentages)*	*(£millions)*	*(percentages)*
Business Banking	1,360.3	29.2	28.5	2.6
Relationship-managed Banking	2,142.2	46.0	804.1	73.8
Larger charities	772.9	16.6	61.3	5.6
Larger co-operatives	379.9	8.2	195.1	18.0
Total	4,655.3	100.0	1,089.0	100.0

As at 30 June 2013, BACB's total undrawn commitments were £0.6 billion.

(b) ***Certain financial information in respect of BACB***

Set out below is certain key financial information in respect of the Core Business's BACB segment.

(i) ***Operating Results and Assets and Liabilities of BACB***

The following table illustrates the financial performance of the BACB segment, setting out the operating results for the BACB for the six months ended 30 June 2013.

Table 14: Financial performance of the BACB segment for the six months ended 30 June 2013

BACB	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	34.4
Non-interest income	7.7
Total income	42.1
Operating costs	
Steady state	(25.3)
Strategic initiatives	(2.5)
	14.3
Impairment losses	(1.4)
Operating result	12.9

The following table sets out the total assets, liabilities and risk-weighted assets of the BACB segment as at 30 June 2013.

Table 15: Total assets, liabilities and risk-weighted assets of the BACB segment as at 30 June 2013

BACB	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	1,093.7
Net loans and advances to customers	1,083.2
Segment assets	979.5
Customer deposits	4,655.3
Segment liabilities	4,655.3
Risk-weighted assets (B2)	1,192.4
Risk-weighted assets (B3 final rules)	1,192.4

(ii) ***Key Performance Indicators of BACB***

The following table provides a breakdown of the key performance indicators in relation to the BACB segment as at and for the six months to 30 June 2013.

Table 16: Breakdown of the key performance indicators of the BACB segment as at and for the six months to 30 June 2013

BACB	*As at and for the six months ended 30 June 2013 (unaudited)*
Net interest margin bps(1)	685
Cost-to-income ratio(2)	60.1%
Non-performing loans ratio(3)	2.3%
Non-performing loans coverage(4)	41.3%
Loan-to-deposit ratio(5)	23.5%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(4) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

(5) The loan-to-deposit ratio is calculated by dividing gross customer loans by customer deposits.

B.3 Core Business: Treasury/other

The core responsibilities for the Bank's Treasury department are to ensure a strong and stable liquidity base, provide diverse sources of wholesale funding to the Bank, manage market risk within risk appetite and deliver a strong financial performance on the investment portfolio. During the first half of 2013 the Bank has placed a significant focus on increasing its high quality liquid asset portfolio whilst at the same time reducing its non-investment portfolio where strategically appropriate. 'Other' comprises Unity Trust Bank, a subsidiary bank operating in the corporate banking and social economy sectors on behalf of trade unions.

The following table illustrates the financial performance of the Treasury/other segment, by setting out the operating results for the Treasury/other segment for the six months ended 30 June 2013:

Table 17: Financial performance of the Treasury/other segment for the six months ended 30 June 2013

Treasury/other	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	6.6
Non-interest income	28.3
Total income	34.9
Operating costs	
Steady state	(14.8)
Strategic initiatives	(1.5)
	18.6
Impairment losses	(0.7)
Operating result	17.9

The following table sets out the total assets, liabilities and risk-weighted assets of the Treasury/other segment as at 30 June 2013.

Table 18: Total assets, liabilities and risk-weighted assets of the Treasury/other segment as at 30 June 2013

Treasury/other	*As at 30 June 2013 (unaudited) (£millions)*
Segment assets	11,245.2
Segment liabilities	9,791.5
Risk-weighted assets (B2)	1,398.9
Risk-weighted assets (B3 final rules)	2,636.8

B.4 Certain financial information in respect of the Core Business

Set out below is certain key financial information in respect of the Core Business as a whole.

(a) ***Operating Results and Assets and Liabilities of the Core Business***

The following table illustrates the financial performance of the Core Business by setting out its operating results for the six months ended 30 June 2013.

Table 19: Operating results of the Core Business for the six months ended 30 June 2013

Core Business	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	244.5
Non-interest income	101.0
Total income	345.5
Operating costs	
Steady state	(275.1)
Strategic initiatives	(11.8)
	58.6
Impairment losses	(26.9)
Operating result	31.7

The following table sets out the total assets, liabilities and risk-weighted assets of the Core Business as at 30 June 2013.

Table 20: Total assets, liabilities and risk-weighted assets of the Core Business as at 30 June 2013

Core Business	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	18,854.2
Net loans and advances to customers	18,667.1
Segment assets	30,021.8
Customer deposits	32,788.1
Segment liabilities	42,416.2
Risk-weighted assets (B2)	4,976.0
Risk-weighted assets (B3 final rules)	6,213.9

(b) ***Key Performance Indicators of the Core Business***

The following table provides a breakdown of the key performance indicators in relation to the Core Business as at and for the six months ended 30 June 2013.

Table 21: Breakdown of key performance indicators of the Core Business as at and for the six months ended 30 June 2013

	As at 30 June 2013 (unaudited)
Core Business	
Net interest margin bps(1)	158
Non-interest income/Total income	29.2%
Cost-to-income ratio(2)	79.6%
Cost of risk bps(3)	29
Non-performing loans ratio(4)	2.2%
Non-performing loans coverage(5)	53.9%
Loans-to-deposit ratio	57.5%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The cost of risk is calculated by dividing the annualised impairment charge by average assets.

(4) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(5) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

C. Non-core Business

The Non-core Business consists of asset classes of the Bank that are not consistent with the Bank's Core Business strategy. In July 2013, Co-operative Asset Management (**CoAM**) was established by the Bank to oversee proactive management, disposal and run-off of these non-core asset classes in accordance with CoAM's strategic objective (the **Non-core Assets**). CoAM is the successor to the Bank's legacy CABB non-core segment (part of which used to be designated in the old core business) which was established in 2012. CoAM contains a significant part of the Bank's impairment risk.

C.1 CoAM

(a) ***CoAM's strategic objectives***

CoAM's principal objective is to optimise the realisation of the Non-core Assets over the medium term, with the Non-core Assets being managed to achieve the most appropriate asset value on an individual portfolio basis, or targeted for run down or exit.

In attempting to achieve this objective, CoAM aims to:

- achieve an exit from the Non-core Assets over the medium term, depending on the tenor and nature of each particular class of Non-core Asset;
- meet CoAM's capital usage targets for each year;
- avoid negative impacts on the Bank's Core Business strategy;
- minimise impact on the Bank's customers;
- maintain the Bank's wider reputation as being a fair, responsible and trusted bank; and
- manage conduct risk issues.

(b) ***CoAM's asset management strategy***

CoAM is the portfolio manager of the Non-core Assets, and has established specific management plans for each asset class. CoAM intends to use the full suite of asset management options at its disposal, including (but not limited to): (i) single loan and portfolio sales; (ii) optimisation of funding structures utilising wholesale markets, central banks and capital markets; (iii) establishing joint ventures to share risk; and (iv) appointing third parties to work out certain types of assets, all to ensure that its objectives are achieved in the most efficient manner for the Bank. As a result of the focus on achieving the most appropriate asset value on an individual portfolio basis. CoAM does not intend to dispose of Non-core Assets in order to satisfy any short-term liquidity needs which may arise from time to time.

(c) ***CoAM's asset management expertise***

The Bank is assembling a team of experienced asset management professionals who will work together with the Bank's existing relationship teams and back office functions. The asset management professionals are split into the following five functions:

(i) a portfolio optimisation team focused on asset management strategies for each Non-core Asset class. Specific emphasis is placed on portfolio design and distribution, market solutions, quantitative analysis and deal execution. This team will also manage the Optimum portfolio on behalf of the workout teams;

(ii) a corporate specialist sectors team, which manages the relationship with CoAM's underlying customers on an industry sector basis;

(iii) a recoveries, workouts and restructuring team which manages Non-core Assets for the medium term once the decision has been made to place the asset into workout, which is a status that could be extended until maturity of the relevant asset;

(iv) a business management and operations team which manages CoAM's operations (including monitoring compliance with service level standards by service providers) and analyses performance of the Non-core Assets; and

(v) the Optimum residential mortgage management team which works in conjunction with Western Mortgage Services, who manage the platform for these assets. The Bank previously considered disposing of Western Mortgage Services; this is currently on hold.

(d) ***CoAM infrastructure***

The CoAM operating model is designed to run and manage the Non-core Assets by utilising the Bank's existing legacy IT infrastructure. However, CoAM may look to outsource the provision of certain services to third party providers, including general IT, loan primary servicing and data management, to improve CoAM's cost efficiency and reduce any potential impact caused by the Core Business' IT strategy (as outlined in paragraph 7 below) such as CoAM requiring systems that are no longer supported by the Core Business.

The Bank has been conducting a data remediation exercise for the purpose of improving CoAM's ability to monitor, analyse and manage the Non-core Assets, by improving the quality and accuracy of the Bank's data on its existing loan stock. This remediation exercise will deliver a dataroom covering all asset classes, and centrally collate all facilities, collateral and derivative documentation and is expected to complete by the end of the first quarter of 2014.

(e) ***Funding***

The Non-core Business is funded by a combination of deposits of the Non-core Business and by the Core Business. The Non-core Business' total deposit portfolio as at 30 June 2013 was £1,485.6 million, comprising deposits from corporate (£495.2 million), deposits from the public sector (£641.2 million) and others (£349.2 million).

C.2 Non-core Assets

The Non-core Assets are identified on the basis of the following criteria:

- assets which cannot be supported by the Bank's Core Business retail platform. These include assets which are (i) lending assets which are not aligned with the Core Business' retail and SME focus going forward; (ii) corporate assets where the borrower typically has a turnover in excess of £25 million; (iii) customers that require more complex banking support for transactions (eg guarantees or letters of credit); or (iv) lending assets with a loan to value ratio of greater than 80 per cent.;
- assets which fail to deliver a positive net interest margin for the Bank including liquidity costs and/or a return on capital above the cost of capital;
- non-performing or defaulting assets; or
- assets with a risk weighted asset of greater than 60 per cent.

The Non-core Assets comprise eight asset classes with total outstanding loans of £15.0 billion with a net carrying value of £14,048 million and fair value of £11,040.4 million as at 30 June 2013.

The table below sets out a breakdown of the Non-core Business' total outstanding loan portfolio on a gross basis as at 30 June 2013.

Table 22: Non-core Business loan portfolio as at 30 June 2013

	As at 30 June 2013 (unaudited)	
Non-core Business	*(£millions)*	*(percentage)*
Optimum	7,281.4	48.7
Corporates	1,681.6	11.2
CRE	3,462.4	23.1
PFI	1,055.6	7.1
Housing associations	930.7	6.2
Local authorities	25.8	0.2
REAF	524.9	3.5
Total gross customer balances	14,962.4	100.0

As at 30 June 2013, local authorities portfolio of the Non-core Business had risk weighted assets (on a Basel II and III basis) of £11 million.

The table below sets out the maturity profile of the Non-core Business' loan portfolio as at 30 June 2013.

Table 23: Non-core Business loan portfolio maturity profile as at 30 June 2013

	As at 30 June 2013 (unaudited)			
Maturity profile (£millions):	*<1 year*	*1-3 years*	*3-5 years*	*>5 years*
Optimum	53.4	167.2	236.8	6,824.0
Corporates	292.8	446.3	438.7	503.8
CRE	713.6	1,038.6	645.8	1,064.3
PFI	15.1	6.5	–	1,034.0
Housing associations	17.5	7.5	11.7	894.1
Local authorities	6.6	16.1	–	3.1
REAF	2.6	9.4	0.5	512.4
Total	1,101.6	1,691.6	1,333.5	10,835.7

CoAM also has exposure to £1.4 billion of undrawn balances. This is a mixture of revolving credit facilities and stage drawdown primarily in the Corporates, REAF, PFI and CRE portfolios.

In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns.

C.3 Non-core Asset Classes

(a) ***Optimum***

Optimum was created following the merger with Britannia and is a closed book of non-prime intermediary and acquired mortgage book assets including non-prime residential mortgages (both income verified and self-certified), buy-to-let and other non-conforming mortgages. The Optimum gross customer balances as at 30 June 2013 stood at £7.3 billion.

The management of the Optimum portfolio is the subject of significant work to devise an appropriate asset management strategy. The current status on the portfolio is:

- as at 30 June 2013, the Optimum portfolio comprised 28.9 per cent. buy-to-let mortgages, 35.1 per cent. non-conforming, 26.7 per cent. self-certified and 9.3 per cent. specialist prime. As at 30 June 2013, 24 per cent. of the Optimum portfolio by value has a loan-to-value ratio of greater than 100 per cent. (23,505 accounts), (equivalent to £3.2 billion) and 16.5 per cent. of the portfolio is currently in arrears (by any amount/possession) (equivalent to £1.2 billion), which is a significantly greater level relative to the 0.9 per cent. for the Core Business retail mortgage portfolio;
- the Optimum portfolio is predominantly an interest-only mortgage book (78 per cent. of the Optimum portfolio is comprised of interest-only mortgages);
- many customers are reluctant to redeem their residential mortgages or are unable to redeem due to a high loan-to-value or because the interest rate offered is favourable relative to those currently available in the market. In addition, 85.9 per cent. of the Optimum portfolio are variable rate mortgages which track the Bank of England base rate or LIBOR. This therefore prevents the Bank from passing any increases in its cost of funding to these customers. As a result of these and other factors, 83.4 per cent. of the portfolio (equivalent to £6 billion) is classified by the Bank as not in line with current risk policy and is likely to be non-rebankable at the current time and is being proactively managed on an amortising basis where possible;
- the run-off profile of the Optimum portfolio is typical for a residential mortgage book of its vintage;
- the weighted average maturity for the Optimum book is seven years. The Bank's strategy with regard to the Optimum book is based upon a natural amortisation of the book;
- over 60 per cent. of the Optimum portfolio is encumbered; as a result the ability of CoAM to sell or otherwise dispose of the Optimum portfolio is severely restricted prior to the run-off of these notes;
- Calico is a second-loss trade on approximately 24 per cent. of the total book nominal value. This transaction provides second-loss protection on a loan-by-loan basis on a pool of approximately £1.8 billion of assets;
- As at 30 June 2013, 16.5 per cent. of the portfolio were non-performing, coverage ratio was 12.4 per cent., risk weighted assets were £3,842.9 million (calculated on a Basel II and Basel III basis). The Optimum portfolio of loans had a fair value and carrying value was £5,384.8 million and £7,115.3 million respectively, as at 30 June 2013. As at 30 June 2013, the Optimum portfolio of loans had a undrawn commitment was £nil million. As at 30 June 2013, the risk-weighted asset ratio of the Optimum portfolio was the equivalent of 72 per cent. without taking into account the impact of the Calico second-loss trade; and

- the Optimum portfolio may present a significant credit risk on a single risk shock factor (interest rate rise) or on a multiple stress basis. There may also be conduct risks inherent in the book that may result in additional provisions. See the risk factor titled "*Worsening economic and market conditions and/or increasing interest rates could result in increased mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*" in Section 2 (*Risk Factors*).

CoAM's ultimate objective is to exit the Optimum portfolio. However, as large-scale asset sales are unlikely, the Bank expects to have to hold a significant proportion of the Optimum portfolio for many years in run-off, with natural amortisation of the portfolio taking place.

As a result, CoAM's priorities are to manage the credit and conduct risk associated with the Optimum portfolio as effectively as possible, to deleverage the unencumbered portfolio where this meets CoAM's strategic objectives and to transform the operational effectiveness of the management of the portfolio by implementing a cost effective and efficient operating model, which may include appropriate outsourcing arrangements, such as outsourcing to Western Mortgage Services.

As at 30 June 2013 the Optimums outstanding loan portfolio on a gross basis was £7,281.4 million. The table below sets out a breakdown of the Optimum outstanding loan portfolio as at 30 June 2013.

Table 24: Optimum portfolio by type as at 30 June 2013

	As at 30 June 2013 (unaudited)	
	(£millions)	*(percentages)*
Non-conforming	2,553.7	35.1
Buy-to-let	2,107.6	28.9
Self-certificated	1,944.9	26.7
Prime	675.2	9.3
Total	7,281.4	100

The following table sets out the geographical distribution of the Optimum portfolio as at 30 June 2013.

Table 25: Geographical distribution of the Optimum portfolio as at 30 June 2013

Optimum	*As at 30 June 2013 (unaudited)*	
Region	*(£millions)*	*(percentages)*
London & South East	3,276.7	45.0
Northern England	1,507.2	20.7
Midlands & East Anglia	1,252.4	17.2
Wales & South West	844.6	11.6
Other	400.5	5.5
Total	7,281.4	100.0

The following table sets out the LTV ratio of the Optimum portfolio, broken down by type as at 30 June 2013.

Table 26: LTV breakdown by product of the Optimum portfolio as at 30 June 2013

			As at 30 June 2013 (unaudited)		
Optimum	*Non-conforming*	*Buy-to-let*	*Self-certificated*	*Prime*	*Total*
			(percentages)		
Average LTVs	80.9	79.1	76.9	77.9	79.2
Book by indexed LTVs					
<= 50%	5.8	5.7	7.8	7.4	6.5
<= 75%	16.7	28.1	22.8	11.4	21.2
<= 100%	44.6	51.7	49.8	49.1	48.3
> 100%	32.9	14.5	19.6	32.1	24.0
Percentage of accounts with >2.5% arrears	4.5	0.2	1.9	1.9	2.3
Gross customer balances (*£ million*)	2,553.7	2,107.6	1,944.9	675.2	7,281.4

(b) ***Illius***

Illius is a £0.2 billion diverse portfolio of 1,364 repossessed properties managed through Co-operative Group Property. The portfolio is geographically diverse, making it inefficient to manage, and is under-maintained. Less than 17 per cent. of the properties in the Illius portfolio are located in the South East region of the UK. Many of the properties have historically not been maintained to a high standard.

Illius was established in the second quarter of 2008 as a vehicle to mitigate losses from the Britannia buy-to-let mortgage book. The underlying strategy was to buy-in at arm's length and market value repossessed properties with the intention that they would be held and sold at a higher value at a future date.

As at 30 June 2013, the carrying value of the Illius assets was estimated to be £16 million higher than the value of the portfolio if it was sold as an entire portfolio and an adjustment was booked for this in accordance with accounting policies. Illius' total risk weighted assets as at 30 June 2013 were £153.0 million (calculated on a Basel II basis and on a Basel III basis).

It is intended for the Illius portfolio to be disposed of over the next three to four years.

(c) ***Corporates***

Corporates is a £1.7 billion portfolio made up of leveraged, syndicated and relationship connections. A significant proportion of deleveraging activity since 30 June 2013 has been from this portfolio, totalling £0.5 billion. Further deleveraging is expected, with an immediate focus on expired or nearly-expired facilities, customers with a greater perceived ability to refinance and developing strategies for the large non-performing exposures. Large undrawn exposures will be reviewed in order to identify where limits can be removed. This portfolio along with certain CRE relationships are part of CoAM rebanking exercise where the relationship benefit is expected to generate a near-par disposal, whereas an outright sale of the financial asset may deliver a sub-par outcome.

As at 30 June 2013, the portfolio had gross loans of £1,701.6 million and net loans of £1,518.2. 32.9 per cent. of the portfolio is non-performing with 48.9 per cent. non-performing loans coverage ratio. It also has exposure to £625.2 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £1,450.8 million (calculated on a Basel II basis) and £1,460.6 million (calculated on a Basel III basis).

(d) ***CoAM CRE***

As at 30 June 2013, this portfolio had gross loans of £3.5 billion (and net loans of £2.9 billion). Approximately £3.4 billion is drawn across 799 borrowers and 1,340 loans. Approximately 57 per cent. of the portfolio is non-performing with 37.5 per cent. non-performing loans coverage ratio. The weighted average maturity of the portfolio is 4.2 years and approximately £2.1 billion will either mature in less than one year (£418 million) or is already in default (£1,638 million) based on drawn balances. Relative to other portfolios of the Non-core Assets, this portfolio consumes significant capital with risk weighted assets of £2.1 billion (on a Basel II basis) and £2.3 billion (on a Basel III basis) as at 30 June 2013. As at 30 June 2013, the portfolio had exposure of £135 million of undrawn commitments.

The strategy for the non-performing part of this portfolio is to identify and execute exit options on a case-by-case basis by means of, for example, a refinancing, restructuring, enforcement or consensual sale. This commenced with a strategic asset review in August 2013 and will continue until the end of the year.

The following table sets out the geographical distribution of the CoAM CRE portfolio on a gross basis as at 30 June 2013.

Table 27: Regional analysis of CoAM CRE portfolio as at 30 June 2013

CoAM CRE portfolio	*As at 30 June 2013 (unaudited)*	
Region	*(£millions)*	*(percentages)*
London & South East	1,190.7	33.1
Midlands & East Anglia	550.4	15.3
North West	787.8	21.9
Wales & South West	269.8	7.5
Northern England	384.9	10.7
Other	413.7	11.5
Total	3,597.3	100.0

The following table sets out the industry segments of the CoAM CRE portfolio on a gross basis as at 30 June 2013.

Table 28: Analysis of CoAM CRE portfolio by industry sector as at 30 June 2013

CoAM CRE portfolio	*As at 30 June 2013 (unaudited)*	
Industry	*(£million)*	*(percentages)*
Retail	1,054.0	29.3
Office	809.4	22.5
Industrial	456.9	12.7
Residential	586.4	16.3
Other	690.6	19.2
Total	3,597.3	100.0

The following table sets out the LTV coverage information relating to the CoAM CRE portfolio by property type as at 30 June 2013.

Table 29: LTV coverage information relating to the CoAM CRE portfolio by property type as at 30 June 2013(1)

CoAM CRE portfolio			*As at 30 June 2013 (unaudited)*		
Property type	*Average (£millions)*	*LTV (percentages)*	*Provision & FV*	*Collateral (£millions)*	*Expected performance*
Commercial development	268.7	101.7	18.8	79.5	10.2
Residential investment	363.4	82.0	45.6	155.4	0.5
Commercial investment	2,897.0	110.2	571.3	967.7	48.7
Hotels	68.2	76.4	1.6	15.5	–
Total	3,597.3	106.0	637.3	1,218.1	59.4

Note:

(1) The sum of the provision and fair value, collateral, and expected performance columns in this table equal the amount of impaired loans and therefore shows how the impaired balances are covered.

(e) ***Project Finance Initiatives and Project Finance (PFI)***

This is a £1.1 billion portfolio of predominantly low margin, long-dated loans to finance public private partnership, project finance initiatives, such as schools, universities and hospitals and roads.

As at 30 June 2013, the portfolio had gross loans £1,068.1 million and net loans of £1,055.7 million. 2.3 per cent. of the portfolio is non-performing with 51.2 per cent. non-performing loans coverage ratio. It also has exposure to £194.4 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £1,125.6 million (calculated on a Basel II basis and Basel III basis).

The portfolio faces certain challenges including legislative constraints and the general market downturn. The sale of these non-core assets is likely to have an adverse impact on capital given the low market pricing. Therefore, these non-core assets will be considered for disposal on a case-by-case basis so that only those assets whose disposal is capital neutral are selected for disposal, with other assets planned to be held in maturity. Additional strategies are being considered, such as securitisation on or creating specific servicing solutions (outsourcing).

(f) ***Housing Association***

This is a £0.9 billion portfolio across long-dated (the average life of the loans is 20 years), predominantly low margin and high credit quality assets.

As at 30 June 2013, the portfolio had loans (gross and net) of £941.7 million. It has no non-performing loans. It also has exposure to £153.3 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £525.8 million (calculated on a Basel II and Basel III basis).

There is limited opportunity to refinance the portfolio and a sale of the portfolio would be at a significant loss and capital destructive. These long-dated assets are planned to be held to maturity to reflect the expected loss and capital impact on sale. Additional strategies are being considered such as securitisation.

(g) ***Renewable Energy and Asset Finance (REAF)***

This is a £0.5 billion portfolio of specialised energy lending, mainly relating to wind farms, as well as combined heat and power and hydro.

As at 30 June 2013, the portfolio had gross loans £531.2 million and net loans of £518.8 million. 1.8 per cent. of the portfolio is non-performing with 133.3 per cent. non-performing loans coverage ratio. It also has exposure to £115.3 million of undrawn commitments (as at 30 June 2013). Total risk-weighted assets were £615.8 million (calculated on a Basel II and Basel III basis).

The REAF portfolio has low yields and approximately a third of its projects are still in the development phase.

A portfolio sale is deemed to be the optimum exit strategy for these assets. This will take the form of a standalone renewable business through a fund structure which may include REAF staff in the on-going management. The Bank is advancing a fund structure in this regard.

C.4 Certain financial information in respect of the Non-core Business

Set out below is certain key financial information in respect of the Non-core Business as a whole.

(a) ***Operating Results and Assets and Liabilities of the Non-core Business***

The following table illustrates the financial performance of the Non-core Business by setting out operating results for the six months ended 30 June 2013.

Table 30: Operating results for the Non-core Business as at 30 June 2013

Non-core Business	*For the six months ended 30 June 2013 (unaudited) (£millions)*
Net interest income	4.5
Non-interest income	5.8
Total income	10.3
Operating costs	
Steady state	(28.0)
Strategic initiatives	(2.5)
	(20.2)
Impairment losses	(469.1)
Operating result	(489.3)

The following table sets out the total assets, liabilities and risk-weighted assets of the Non-core Business as at 30 June 2013.

Table 31: Assets and liabilities of the Non-core Business as at 30 June 2013

Non-core Business	*As at 30 June 2013 (unaudited) (£millions)*
Gross loans and advances to customers	14,931.3
Net loans and advances to customers	14,048.8
Segment assets	14,164.4
Customer deposits	1,485.6
Segment liabilities	1,485.6
Risk-weighted assets (B2)	9,782.0
Risk-weighted assets (B3 final rules)	10,032.9

(b) ***Key Performance Indicators of the Non-core Business***

The following table sets out key performance indicators for the Non-core Business as at and for the six months to 30 June 2013.

Table 32: Key performance indicators for the Non-core Business as at 30 June 2013

	As at 30 June 2013 (unaudited)
Non-core Business	
Net interest margin bps(1)	6
Non-interest income/Total income	56.3%
Cost-to-income ratio(2)	271.8%
Cost of risk bps(3)	628
Non-performing loans ratio(4)	25.0%
Non-performing loans coverage(5)	31.2%
Loans-to-deposit ratio	1,005.1%

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(3) The cost of risk is calculated by dividing the impairment charge by average assets.

(4) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(5) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

6. INVESTMENT PLAN

The Bank will be required to make significant levels of investment to execute its turnaround plan. A high percentage of these investments will be IT related to make its platform fit-for-purpose and provide the minimum levels of functionality required by the strategy. These investments are expected to contribute to cost savings and revenue uplift.

These investments can be classified into three categories according to level of criticality:

- Mandatory: investments critical for the on-going business. This includes investments in regulatory compliance, risk remediation, resilience activities and management information. Of the three categories, this requires the largest amount of investment;
- Enablement of the strategy: investments critical to allow the Bank to be able to deliver its strategic plan. This includes investments in digital catch-up, improving product pricing and credit decisioning, branch closure and non-IT related process optimisation; and
- Delivery of the strategy: investments required in executing the strategic plan. This includes investments in systems rationalisation, channel optimisation and integration, enabling customer self-service and automating processes and workflow.

The execution of the Bank's turnaround plan will result in significant costs being incurred over the next three years, and the Bank has currently budgeted in the region of £500 million in connection to the re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank, its cost saving programme, and the reorientation of the Bank's distribution channels. Within this amount, total investment spent on transformation, including IT remediation, digital catch-up and other IT initiatives in the next three years of approximately £400 to £450 million is currently budgeted, of which approximately 40 to 45 per cent. is currently expected to be capitalised.

See the section below for more details on the Bank's plans with regards to IT.

7. TECHNOLOGY/IP/IT

IT Systems and Infrastructure

The core of the Bank's information technology (**IT**) systems architecture is IBM's mainframe technology, which supports current, savings and loan account processing for the Bank's customers.

Midrange platforms, which are primarily provisioned on versions of IBM AIX, Solaris and Wintel, support additional services such as payments, fraud monitoring and finance, as well as savings account processing for Britannia customers and the teller and call centre applications. The Bank's credit card, mortgage and ATM systems are externally hosted using industry recognised third parties such as First Data Corporation, Wincor Nixdorf Limited and Sopra Group Limited.

IT Organisation and Suppliers

The IT team consists of approximately 400 people. The team manages, oversees and controls the existing IT for the Bank and any changes to the Bank's IT. The primary areas covered by the IT team are service, IT development, and IT security and risk management. The IT team's staff provide primary points of contact for the Bank for service management and business and IT change, and are accountable for service, IT security and risk management, and change and innovation.

Co-operative Group provides IT support to the Bank pursuant to a services agreement dated May 2013. This support includes the provision of data centres, hardware (computers), networks, supplier management and programme office resources and IT support for business areas shared with Co-operative Group (such as finance, human resources, marketing and IT). See paragraph 8 titled "*Separation*" of this Section 8 (*Description of the Bank*) and paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*) for details of which of these services Co-operative Group may cease to provide under the New IT Services Agreement (as defined in paragraph 20.1(a) titled "*IT Services Agreement*" in Section 20 (*Additional Information*).

The majority of the Bank's software is supported by a third party, Steria Limited (**Steria**). The Bank also uses Steria for application development and project management. These out-sourcing arrangements are regularly reviewed with the focus being on reducing cost and improving delivery certainty. This supervision takes the form of weekly service reviews, monthly governance forums that formally review performance and annual reviews of key obligations and commercials.

Security

The security of the Bank's IT systems is an area of importance, with an internal team responsible for all IT security build-and-run activities. There have been and continue to be challenges in IT security similar to those experienced by industry peers. These relate to areas of control weakness such as identity and access management and the reliance on legacy security infrastructure, in addition to a continually evolving cybersecurity-threat landscape.

These issues have been assessed by the Bank, documented and are well understood. This has resulted in the Bank spending £4.7 million on security technologies during 2013, investing in identity and access management, firewall refresh, security monitoring and addressing legacy security infrastructure. These phased programmes of work will continue into 2014 and aim to address critical risks, including strengthening the internal IT security team and aligning policy and supporting controls to industry standards eg ISO27001 and PCI-DSS. While there have been tangible improvements in security controls, the need for continued investment to further remediate the risks to appropriate levels and maintain them within risk appetite has been recognised.

The Bank is also working towards full compliance with the Payment Card Industry Data Security Standard, which is a common set of security standards developed by the major card providers to ensure that payment card data is processed, stored and transmitted securely.

Business Continuity

Co-operative Group provides management of business continuity and disaster recovery arrangements, and provision of work area recovery sites.

The Bank has business continuity plans for each operational area, reviewed on a quarterly basis, in line with internal control standards and risk policy requirements. Each operational area completed a business impact analysis and call cascades. Testing includes work-area recovery testing and scenarios testing supported by education and awareness.

Work-area recovery for the Bank predominantly consists of syndicated third party work-area recovery at a number of recovery sites. This is supplemented by a combination of cross-site agreements to allow priority areas to move to an alternate major occupancy, and contact centres have the ability to transfer customer servicing activities to alternative locations. Treasury has a dedicated work-area recovery capability.

Business continuity plan owners are supported by co-ordinators within each business unit who facilitate plan updates and testing and liaise with Co-operative Group.

The business continuity framework is under review to deliver the required level of confidence in the Bank's ability to continue priority operations during and post any major incidents. This includes:

- Resourcing the Bank with incident management and business continuity colleagues with appropriate skills and experience.
- Agreeing the strategy for business continuity management and the risk appetite for business continuity.
- Reviewing the business impact analysis and business continuity plans.
- Establishing a formal action plan and governance to ensure delivery of improvements.

The Bank currently receives IT disaster recovery services from Co-operative Group through the Existing IT Service Agreement which includes an annual schedule for testing the IT disaster recovery of the systems, services and third party provisions. A number of approaches are adopted; including technical testing at a component level, business end-user testing and live proving of contingency infrastructure. This service is expected to be brought back into the Bank.

A review of the Bank's disaster recovery provision was undertaken in 2013 and concluded that the current approach provides limited assurance of the ability to recover services in the event of a full disaster recovery invocation.

As a result, a remediation programme has been initiated to review and update the strategy, policies, procedures and technical recovery plans to ensure they are aligned to business recovery objectives and where appropriate, identify technology for remediation.

Intellectual Property

The information and processes the Bank uses may be protected by patents, copyrights in software or other materials, rights in databases, rights in confidence or other intellectual property rights owned by third parties. The Bank seeks to obtain such licences or consents in respect of any intellectual property rights owned by third parties that it identifies as necessary to its business.

Recent Developments and Current Position

Recent developments include (i) the launch of a new credit card platform, (ii) new fraud and financial crime management systems, (iii) improved security systems, including two factor authentication (which requires the customer to authenticate himself using credentials generated by a chip and pin card reader) and (iv) a new credit decision making engine (which manages credit checks used in, for example, the account opening process).

The Bank continues to comply with on-going regulatory changes, such as Faster Payments transfers (**Faster Payments**) and Seven Day Account Switching (**Seven Day Account Switching**). Faster Payments is the transfer of funds between clearing banks, typically within a 15 second timeframe, moving from the previous three-day BACS cycle. Seven Day Account Switching provides for the ability to transfer customer accounts between banks, including all direct debits and standing orders, within seven days.

Since 2012, two new IBM Z196 mainframes have been installed to run the core banking systems, and during 2011 and 2012 a new telephone call centre system was implemented using Avaya and Genesys technologies.

As a result of historical underinvestment (amongst other factors), the Bank's digital offerings significantly lag behind its competitors and a number of the Bank's IT systems now, or will soon, require both hardware and operating systems to be refreshed. The existing IT systems have a number of known resilience-related risks (which are under active management). These fall broadly into the categories of: disaster recovery, design of IT systems and single points of failure, end of life technology and third party suppliers. There are also issues with the Bank's ability to quickly launch new products on its platform. It had previously been intended to replace key IT systems (including the existing core banking platform, and the applications that support the branch, internet and call centre channels) with a new core software platform which was being developed or, had the planned acquisition of the Verde Business gone ahead, the IT systems used by Lloyds TSB. The Bank subsequently decided to cease the implementation of these IT plans and following that decision reported a write-down on its IT assets of £148.4 million in its interim accounts for the six months ended 30 June 2013. Since then, the Bank has undertaken a review of its overall IT requirements against the backdrop of its new business strategy, and has agreed a new IT development plan which is to be exercised in phases and has been designed to meet the requirements of the Core Business strategy of the Bank, as outlined below.

Future Plans

To meet the requirements of the Core Business strategy and address the issues outlined above, the Bank has adopted a strategy of 'incremental build' which involves progressive re-engineering of the existing IT platform. This includes: introduction of new digital channel applications with improved capabilities; enhancements to the core mainframe platform to allow for simpler product development and management; installing an enterprise data warehouse; delivering improved reporting and analytics; and improved security, process and workflow automation. The re-engineering will be combined with simplification of IT systems in order to reduce operating costs; for example, the rationalisation of existing savings and mortgage platforms.

The Bank's IT team recognises that the delivery of this plan will require engagement with industry-leading third parties to assist it with the implementation of this strategy.

In parallel to the enhancement of the core platform, the Bank shall continue to support its non-core operations, which may, whilst it deleverages its Non-core Assets, impact its ability to drive savings from the rationalisation of its IT systems.

8. SEPARATION

8.1 Separation of Services

Current Position

Certain functions of the Bank are centralised and carried out by Co-operative Group. There are currently two key arrangements in place pursuant to which the Bank receives the supply of services, assets and/or personnel:

Project Unity

Between 2011 and 2013 the Bank transferred a number of functions and a substantial number of personnel to Co-operative Group and entered into arrangements pursuant to which Co-operative Group would provide certain services to the Bank. This project is known within the Bank as "Project Unity" (**Project Unity**). In connection with Project Unity, Co-operative Group, CFSMS and the Bank entered into two key agreements:

- the Existing IT Services Agreement, dated 5 July 2012, in relation to the provision by Co-operative Group of certain IT services to the Bank and other members of Banking Group; and
- a Professional Services Master Services Agreement, dated 14 February 2013, pursuant to which the same parties entered into a number of individual service contracts in relation to the provision of certain other services by Co-operative Group to the Bank and other members of Banking Group.

The Unity Agreements were negotiated on an arm's-length basis, although taking into account that services provided under the Unity Agreements are provided, on an "at cost" or "pass-through" basis, with no margin added by Co-operative Group.

CFSMS Arrangements

References to **CFSMS Arrangements** relate to arrangements between CFSMS (an indirect subsidiary of Co-operative Group) and the Bank regarding the provision of services, personnel and on-supply of certain third party services and assets to the Bank. CFSMS was established as a direct 100 per cent. subsidiary of Banking Group in 2005, to enable economies of scale through the sharing of employees and sourcing of third party services across Banking Group, including the Bank, Reclaim Fund Limited, CIS General Insurance and Co-operative Life Insurance and Asset Management.

CFSMS also holds a significant proportion of the fixed assets of Banking Group and is the primary counterparty to a large proportion of third party contracts for the provision of services to, and licences used by, Banking Group. Ownership of those assets and the benefit of and obligations under those arrangements currently remain with CFSMS. In addition, many of the Bank's personnel are employed or engaged by CFSMS and seconded to, and are under the control of, the Bank and CFSMS also procures and provides assets and services for the benefit of the Bank.

The Bank is therefore highly dependent on CFSMS to provide personnel and services to conduct its day-to-day activities. CFSMS's obligations to Bank in relation to its provision of assets and personnel are governed by an agreement dated 16 February 2006. Under that agreement, the Bank provides CFSMS with an indemnity for all liabilities, losses, damages, costs and expenses of any nature incurred as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided to the Bank.

Proposed changes

Since the announcement of the Bank's recapitalisation plan on 17 June 2013 (the **17 June Plan**), the Bank and Co-operative Group have been working to amend certain provisions of the Project Unity and CFSMS Arrangements to ensure those arrangements were suitable for the circumstances of a listing of the Bank on the London Stock Exchange with Co-operative Group as a significant majority shareholder. Those updated arrangements were close to finalisation prior to the announcement on 21 October by Co-operative Group that it was in discussions with bondholders and that many elements of any recapitalisation plan for the Bank would be materially different to the outline provided on 17 June 2013.

As described in this document, under the terms of the Liability Management Exercise, Co-operative Group will retain a 30 per cent. interest in the Bank. This change to the 17 June Plan has required the Bank and Co-operative Group to revisit, in a very short timeframe, the appropriateness of Project Unity and the CFSMS Arrangements as an operating structure for the Bank as there would be significant adverse cost impacts if the Project Unity and CFSMS Arrangements were to continue in the form envisaged for the 17 June Plan following completion of the Liability Management Exercise, principally arising from VAT becoming payable in respect of the services, as the Bank and Co-operative Group will no longer be in the same VAT group. In addition, as CFSMS is a wholly-owned, indirect subsidiary of Co-operative Group, the Bank does not consider it appropriate for the provision of personnel or supply of certain third party services and assets to the Bank to be housed in an entity that, on completion of the Liability Management Exercise, will cease to be in the same group as Bank. In the time available it has not been possible for the Bank and Co-operative Group to finalise the basis on which the services currently provided by CFSMS and Co-operative Group will be provided to the Bank following completion of the Liability Management Exercise.

As a result, the Bank and Co-operative Group have agreed certain high level principles (the **Separation Principles**) that will govern future discussions between the Bank and Co-operative Group regarding the separation arrangements between the Bank and Co-operative Group. The parties intend to document arrangements to resolve certain separation matters in a manner consistent with the Separation Principles. The Separation Principles include an overarching agreement to act in good faith and, amongst other things:

- A commitment that, until appropriate alternative arrangements for Project Unity and the CFSMS Arrangements are agreed, Co-operative Group will continue to provide services to the Bank under the same terms that such services are currently provided.
- For those costs allocated by Co-operative Group in its sole discretion, the Bank and Co-operative Group will take reasonable steps to avoid the Bank incurring costs incremental to those it currently incurs.
- Co-operative Group and the Bank will mitigate costs arising for Co-operative Group or the Bank from (i) Co-operative Group being a less than 50 per cent. shareholder of the Bank or (ii) agreed steps taken in connection with the separation process (acknowledging that the Bank shall be under no obligation to accept the transfer of any assets or liabilities that are not wholly or predominantly related to the continuing business of the Bank).
- An additional mark-up (of no more than 20%) may be charged by Co-operative Group for services provided under Project Unity after completion of the Liability Management Exercise but not in respect of the first 12 months in respect of all services. The following exceptions apply to the 12 month general arrangement: (i) pension administration services, and (ii) IT services (where no mark-up shall be applied for the first 24 months).
- Costs will be allocated between the Bank and Co-operative Group on an equitable basis.
- A working group consisting of representatives from the Bank and Co-operative Group will be established to address and oversee the separation work-stream.

Consistent with the Separation Principles, Co-operative Group and the Bank have also agreed the following basis on which Project Unity and the CFSMS Arrangements will be unwound, with the intention that as many of the steps as possible will be implemented, without undue prejudice to either party, prior to the completion of the Liability Management Exercise:

(a) ***Project Unity***

(i) *Back to Bank*

The scope of services to be provided under the Existing IT Services Agreements and the Professional Services Master Services Agreement will be amended such that the significant majority of these services will be taken back into the Bank. Certain services, such as in relation to pensions and IT, may be provided for a longer period although the details of the scope of such services and the relevant time periods remain under discussion between Co-operative Group and the Bank. The longest of these time periods is likely to be in relation to IT services, the separation of which is estimated will take between one and three years. It is anticipated that the Bank will require membership services to continue to be provided by Co-operative Group under the Bank's proposed new ownership structure.

(ii) *Interim arrangements*

It is still intended that the amendments to the Unity Agreements contemplated for the 17 June Plan will be made to ensure that those services which have not be taken back into the Bank before completion of the Liability Management Exercise are provided on appropriate terms, and the service contracts will be updated accordingly to reflect the detailed services that are no longer required. The parties have agreed that, following completion of the Liability Management Exercise, an additional mark-up (of no more than 20 per cent.) may be charged by Co-operative Group for services provided under the Unity Agreements, but not in respect of the first 12 months in respect of all services. The following exceptions apply to the 12 month general arrangement: (i) pension administration; (ii) IT Services (where the 20 per cent. mark-up shall not be applied for the first 24 months). A summary of the current Project Unity agreements, together with the proposed amendments to them as contemplated for the 17 June Plan, is set out in paragraph 20.1 titled "*Project Unity*" in Section 20 (*Additional Information*). The Bank and Co-operative Group are considering whether any additional amendments (including to the scope of the services and key terms) are required to the Project Unity agreements to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

(iii) *Costs*

It is not possible for the Bank to predict exactly which of the services will have been returned to the Bank by the time of completion of the Liability Management Exercise. However, if no change were made to the current arrangements, other than the changes envisaged for the 17 June Plan, then the incremental costs to Bank for those services would be in the region of £8 to £12 million per annum, arising principally as a result of VAT charges.

(b) ***CFSMS Arrangements***

(i) *Back to Bank*

The continuation of the CFSMS Arrangements contemplated for the 17 June Plan would be materially prejudicial to Bank and the Bank and Co-operative Group have agreed, in principle, that alternative arrangements are required to be put in place which may involve the transfer of assets, third party contracts, and employees from CFSMS to the Bank or of CFSMS itself to the Bank. The Bank is in on-going discussions with Co-operative Group regarding the precise structure of these alternative arrangements (which may involve the provision of services from Co-operative Group to the Bank or from the Bank to Co-operative Group).

(ii) *Interim arrangements*

In contemplation of the 17 June Plan, the Bank and CFSMS agreed that:

- CFSMS will establish a small dedicated management team to deal with contract management following Banking Group's disposal of insurance subsidiaries; and
- the CFSMS management team will manage CFSMS' supplies to the Bank (comprising services seconded employees, and third party services and assets) to ensure these meet the requirements of the CFSMS-Bank 2006 Agreement.

The Bank and CFSMS also agreed to replace the CFSMS-Bank 2006 Agreement with a new agreement (the **CFSMS-Bank Framework Agreement**).

As with the Project Unity arrangements described above, it is still intended by the Bank that the CFSMS-Bank Framework Agreement contemplated for the 17 June Plan will be finalised between the parties and, to the extent that the arrangements described in paragraph (b)(i) above cannot be implemented before completion of the Liability Management Exercise, will be entered into between the Bank and CFSMS.

The CFSMS-Bank Framework Agreement will be based on the form of the Unity Agreements (as amended) and will address the current arrangements in respect of personnel of the Bank who are employed or engaged by CFSMS, the provision of services by CFSMS and the on-supply by CFSMS of third party supplies of assets and services. In addition, the agreement will address the following further areas: governance of the allocation of charges between the Bank and all other entities receiving services from CFSMS; allocation of personnel who provide services both to the Bank and other Co-operative Group entities, detailed audit rights; the ability of the Bank to direct CFSMS to take action against third party suppliers and the governance arrangements for CFSMS' supplies to the Bank. A summary of the proposed CFSMS-Bank Framework Agreement is set out in paragraph 20.2 titled "*CFSMS – Framework Agreement*" in Section 20 (*Additional Information*). The Bank and Co-operative Group are considering whether any additional amendments are required to the CFSMS-Bank Framework Agreement to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

(iii) *Costs*

It is not currently possible for the Bank to confirm whether the arrangements described in paragraph (b)(i) can be implemented by the time of completion of the Liability Management Exercise. However, if no change were made to the CFSMS Arrangements, other than the changes envisaged for the 17 June Plan (including the entry into of the CFSMS-Bank Framework Agreement), then the incremental costs to Bank for those services would be in the region of £50 to £60 million per annum, arising principally as a result of VAT charges.

8.2 **Other Separation Arrangements**

Since Co-operative Group will own 30 per cent. of the Bank, rather than the significant majority interest identified in the 17 June Plan, there are a number of other areas of the relationship between the Bank and Co-operative Group which will, over time, require further discussions.

However, in light of the ownership structure of the Bank that will exist assuming successful completion of the Liability Management Exercise, as referred to above, the Bank and Co-operative Group have agreed a number of pensions matters as detailed in paragraph 20.10 titled "*Pensions Undertaking*" in Section 20 (*Additional Information*). In addition, the Bank and Co-operative Group have agreed certain high level principles that will govern the future discussions on other areas of separation and seek to assist in ensuring that the interests of both parties (and of other stakeholders in the respective organisations) are protected. These principles, which have been developed to ensure that the Bank's Recapitalisation Plan can, if successful, be completed before 31 December 2013, include, among other things, an agreement to act in good faith; appropriate mitigation of avoidable costs whilst balancing the other commercial interests of the parties; and the preservation of relationships with shared third party suppliers.

9. DIVIDEND POLICY

The Directors intend to focus on and prioritise returning the Bank to health in the future. The Bank is in the early stages of being turned around and will continue to be impacted by legacy issues for some time, and as such, the Directors do not expect the Bank to pay dividends in the near future. In any event, the Bank has agreed with the PRA not to make any dividend payments until further notice without the prior consent of the PRA.

Notwithstanding the above, the Directors will reconsider the Bank's dividend policy as appropriate as the Bank continues to develop and implement its strategy, taking into account such factors as the Bank's capital and financial position, cash requirements and liquidity and profits available as well as, in particular, the Bank's regulatory outlook, capital position, regulatory requirements, investment needs and principal relevant risk factors subsisting at the time.

The Bank can give no assurance that it will pay any dividends in the future, nor, if a dividend is paid, what the amount of such dividend will be.

9
DIRECTORS, SENIOR MANAGEMENT, EMPLOYEES AND CORPORATE GOVERNANCE

DIRECTORS, SENIOR MANAGEMENT, EMPLOYEES AND CORPORATE GOVERNANCE

1. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

1.1 DIRECTORS

The following table lists the names, positions and ages with respect to current Directors.

Name	Position	Age
Richard Pym	Chairman	64
Niall Booker	Chief Executive Officer	55
Rodney Jensen Bulmer	Executive Director, Core Business and Deputy Chief Executive	43
John Richard Coates	Non-Executive Director	62
Anne Margaret Gunther	Non-Executive Director	58
Richard Graeme Barclay Hardie	Non-Executive Director	52
Merlyn Vivienne Lowther	Non-Executive Director	59
Euan Angus Sutherland	Non-Executive Director	44
Bennett Lyle Edward Reid	Non-Executive Director	59
William Gennydd Thomas	Non-Executive Director	53
Kathrine Bancroft	*Company Secretary*	

Richard Pym – Chairman

Richard joined the Board as Chairman in June 2013. He is a Chartered Accountant, has over 21 years' experience in financial services and has held a series of senior roles, including Group Chief Executive of Alliance & Leicester plc. He is currently Chairman of UK Asset Resolution Limited, Bradford & Bingley plc, Northern Rock (Asset Management) plc, Brighthouse Group plc and Nordax Finans AB (publ).

Niall Booker – Chief Executive Officer

Niall joined the Board in June 2013. He has held a variety of senior roles at HSBC in a career of more than 30 years spanning retail and corporate banking. Most recently, he was group managing director and chief executive officer of HSBC North America Holdings Inc. In this role he had responsibility for working through the issues in HSBC Finance Corporation, where he was chief executive officer, including working closely with the regulators of HSBC North America Holdings.

The terms of Niall's employment with the Bank are not yet finalised.

Rodney Jensen Bulmer – Executive Director, Core Business and Deputy Chief Executive

Rodney joined the Board in May 2013. Rodney has 21 years' experience in the industry. He joined Banking Group in October 2007 and became Sales Director in July 2008. Following the merger with Britannia Building Society in August 2009, Rodney became Managing Director Retail. He joined Banking Group from Santander UK plc where he held the position of director of retail direct. Rodney is currently a director of Mutualplus Limited, The Co-operative Academy of Manchester and Co-operative Bank Financial Advisers Limited.

Rodney has resigned from the Bank and announced his intention to leave the business and step down from the Board of the Bank no earlier than 31 March 2014. Until his departure Rodney will continue to play an important role in the running of the business and in particular the detailed work being undertaken by the Bank in relation to the LME.

John Richard Coates – Non-Executive Director

Richard joined the Board in January 2013. He has over 25 years' experience in the retail financial services sector. Richard was a senior partner at KPMG from 1985 to 2003 in its retail financial services practice. He joined Northern Rock plc as a non-executive director in August 2008 and chaired its audit committee from January 2010 until its acquisition by Virgin Money in January 2012. He is currently a non-executive director of the Police Mutual Assurance Society.

Anne Margaret Gunther – Non-Executive Director

Anne joined the Board in September 2011. She has 35 years' experience in a range of financial services environments. She was chief executive of Standard Life Bank and then chief executive of Norwich and Peterborough Building Society, securing its merger with the Yorkshire Building Society. Anne is chair of the Warwick Business School and is a non-executive director of MBNA Limited and of the North, East and West Devon NHS Clinical Commissioning Group.

Richard Graeme Barclay Hardie – Non-Executive Director

Graeme joined the Board in May 2013. He was previously managing director of NatWest retail bank and executive director, retail banking at Abbey National Bank plc. He was a senior adviser, retail markets at the Financial Services Authority (as it was known) and non-executive director at Metro Bank (UK) Limited. He is currently a non-executive director of FNZ (UK) Ltd and is a director of Northpoint Consultancy Services Limited.

Merlyn Vivienne Lowther – Non-Executive Director

Merlyn joined the Board in September 2011. She was Chief Cashier of the Bank of England from 1999 to 2004 and a non-executive director of Schroders plc from 2004 until 2013 where she chaired its audit and risk committee from 2010 until 2013. She is currently a trustee of the Winston Churchill Memorial Trust and The Henry Smith Charity.

Euan Angus Sutherland – Non-Executive Director

Euan joined the Board in August 2013. He is currently Group Chief Executive of Co-operative Group. He was formerly group chief operating officer of Kingfisher plc and was previously chairman of B&Q and chief executive officer of Kingfisher UK & Ireland. He is currently a non-executive director of Super Group plc.

Euan is on the Board of the Bank as a nominee director of Co-operative Group, and is intended to constitute a nominee director for the purposes of the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013.

Bennett Lyle Edward Reid – Non-Executive Director

Ben joined the Board in June 2009. He has spent over 30 years in the mutual societies sector becoming Chief Executive of The Midcounties Co-operative in 2006. He became a director of Co-operative Group in May 2000. He is a Fellow of the Chartered Association of Certified Accountants and Institute of Co-operative Directors, the Chair of the Walsall Healthcare NHS Trust and was recently appointed to the Board of Governors of the University of Wolverhampton.

Ben is on the Board of the Bank as a nominee director of Co-operative Group, and is intended to constitute a nominee director for the purposes of the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013.

William Gennydd Thomas – Non-Executive Director

Bill joined the Board of Bank in October 2013. He is a former senior vice President of HP Enterprise Services and was on the main board of EDS Finance Limited as executive-vice president. He has IT expertise and is an experienced leader and general manager with a track record in leading major change in large organisations. He has extensive commercial and operational experience, working domestically and internationally with both public and private sector organisations. Bill is chair of the advisory board at Cranfield University School of Management and is on the management and board of Leeds University Business School. He is currently a non-executive independent director of XChanging plc, GFI SA and Balfour Beatty plc.

1.2 SENIOR MANAGEMENT

In addition to the Executive Directors, the current members of the senior executive management team with responsibility for day-to-day management of the Bank's business are:

John Baines – Chief Financial Officer

John has been providing his services as Chief Financial Officer to the Bank since April 2013 under a contract for the provision of services. He was most recently chief financial officer of Aldermore Bank plc, having spent the previous eight years at RBS where he was initially chief financial officer of the wealth management division, being appointed as chief executive officer of the division in 2006. John qualified as a chartered accountant 25 years ago and, prior to RBS, held a number of senior finance roles in investment banks, including spending six years at each of UBS and JP Morgan.

Grahame McGirr – Chief Risk Officer and Head of CoAM

Grahame has been providing his services as Chief Risk Officer to the Bank since 1 February 2013 under a contract for the provision of services. Grahame has 16 years' experience in the industry. Prior to joining Banking Group, Grahame had a career with Barclays, where he was Head of Portfolio Trading, and Investec. Following the financial crisis, Grahame was part of the team that restructured Northern Rock, followed by a period at The Royal Bank of Scotland.

Liam Coleman – Treasurer

Liam has been providing his services as treasurer to the Bank since June 2013 and has 25 years' experience in the industry. Previously Liam was deputy group treasurer and group head of capital management at RBS from February 2011 to June 2013 and he worked at Nationwide Building Society from 1996 to 2011 ultimately as group director, treasury where he had responsibility for all of the treasury activities of the Society. Earlier in his career, Liam worked at NatWest in corporate banking and at Hambros and Bank of Tokyo-Mitsubishi in corporate and structured finance. Liam is currently a non-executive director of Great Western Hospitals NHS Foundation Trust.

Julie Harding – HR Director

Julie has been providing her services as HR Director to the Bank since October 2013 under a contract for the provision of services. She has had both a domestic and international career in banking with HSBC in the commercial and retail sectors and brings to the Bank extensive experience of leading major change programmes. Julie has leadership experience in Australia, Brazil and the UK.

Robert Rickert – Chief Operating Officer

Robert joined the Bank as the Chief Operating Officer in October 2013. He is tasked with bringing technology and operations under one accountability, that of the Chief Operating Officer. The intention behind combining these two functions is to improve process efficiency, customer experience, effective controls, provide a tighter risk framework and clearer end-to-end customer focused processes. Robert has over 25 years of leadership experience with more than 15 years focused on technology and operations and he has a track record across a number of different industries primarily in financial services.

Robert has held senior leadership roles most recently with UBS, where he was Head of Group Operations Technology, and Barclays and DTZ.

1.3 PERSONNEL

Number of personnel

The number of people providing services to the Bank (either as employees of the Bank or its subsidiaries, or via secondment arrangements) on a full-time equivalent basis, by the main category of activity, as at 30 June 2013 and in each of the three years ended 31 December 2012, 2011 and 2010 is set out below:

	Number of personnel on a full-time equivalent basis			
	As at 30 June	*As at 31 December*		
Area	*2013*	*2012*	*2011*	*2010*
IT	790	850	1,150	990
Operations & Support	2,930	2,950	2,390	2,690
Corporate & Business Banking	450	400	430	590
Finance	290	360	410	570
Human Resources	200	190	300	370
Miscellaneous	40	10	–	–
Retail Banking	2,650	2,690	3,390	3,990
Risk	210	330	460	360
Total	7,560	7,780	8,530	9,560

Note: The figures in the table above are approximate. The allocation of employees to Bank activity is the Bank's best view based on records available from internal management information systems.

The breakdown of the employing entities of the personnel on a full-time equivalent basis as at 30 June 2013 and in each of the three years ended 31 December 2012, 2011 and 2010 is shown below:

	Number of personnel on a full-time equivalent basis			
	As at 30 June	*As at 31 December*		
Employing Entity	*2013*	*2012*	*2011*	*2010*
CFSMS	5,530	5,600	6,130	6,920
The Bank	1,630	1,710	1,910	2,070
Platform Home Loans Limited	20	40	90	130
Western Mortgage Services Limited	300	340	360	400
Britannia International Limited	30	40	40	40
Co-operative Group	50	50	0.0	0.0
Total	7,560	7,780	8,530	9,560

Note: The figures in the table above are approximate. The allocation of employing entity shown is the Bank's best view based on the records available from internal management information systems.

It is standard practice for all new employees to be engaged on CFSMS contracts of employment (except for staff employed in the Isle of Man who are employed by Britannia International Limited). Approximately 73.0 per cent. on a full-time equivalent basis of personnel who work on Bank activity are engaged on CFSMS contracts of employment. The people employed by CFSMS who provide services to the Bank are seconded to, and are under the control of, the Bank. Further details on the role and arrangement with CFSMS, and the proposals to change the current arrangements, can be found in (i) paragraph 8 titled "*Separation*" in Section 8 (*Description of the Bank*) and (ii) paragraph 20.2 titled "*CFSMS-Bank Framework Agreement*" in Section 20 (*Additional Information*). Those individuals shown in the table above as being employed by Co-operative Group provide services to the Bank pursuant to the Unity Agreements. In addition to these individuals, a number of people provide services to the Bank in addition to providing services to other members of Co-operative Group pursuant to the Unity Agreements. These persons are not included in the figures in this paragraph 1.3. Further details on the Unity Agreements can be found in paragraph 20.1 titled "*Project Unity*" in Section 20 (*Additional Information*).

Certain Banking Group employees are historically employed on Bank contracts. Not all Bank employees are fully dedicated to Bank activities due to the shared service model used across Banking Group.

During the six months to 30 June 2013, the Bank had on average approximately 2,620 employees working on a temporary or part-time basis (490 of whom were on a temporary basis and 2,130 permanent employees who worked part-time).

2. CORPORATE GOVERNANCE

The UK Corporate Governance Code, published by the Financial Reporting Council in September 2012 (the **UK Corporate Governance Code**), sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. The UK Corporate Governance Code recommends that at least half the board of directors (excluding the Chairman) should comprise "independent" non-executive directors. The UK Corporate Governance Code states that the board should determine whether a director is independent in character and judgement and whether there are any relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement.

The Directors support high standards of corporate governance. As at the date of this Prospectus and on completion of the Liability Management Exercise, the Bank will comply with the UK Corporate Governance Code, except as set out further below. The Bank's Board of Directors currently comprises two Executive Directors (including the Chief Executive Officer) and eight Non-Executive Directors (including the Chairman). The Bank regards John Richard Coates, Anne Margaret Gunther, Richard Graeme Barclay Hardie, Merlyn Vivienne Lowther and William Gennydd Thomas as independent Non-Executive Directors, within the meaning of "independent" as defined in the UK Corporate Governance Code.

A number of appointments to the Board and senior management are required. Following completion of the Liability Management Exercise, the Bank intends to appoint a finance director to the Bank's Board. Grahame McGirr is currently both head of CoAM and CRO; following completion of the Liability Management Exercise the expectation is that a new CRO will be appointed allowing Grahame McGirr to focus solely on CoAM. In addition, as Rodney Bulmer, the current Deputy Chief Executive Officer of the Bank and the Executive Director responsible for the Bank's Core Business, has given notice to terminate his contract and is expected to leave the Bank no earlier than March 2014, a replacement will need to be found for him and executive representation on the Board will need to be considered.

In order to further strengthen the Bank's Board of Directors and its independence, recruitment is underway to appoint a further two independent non-executive directors one of whom is intended to be from a commercial banking background and one from a human resources background. Following this recruitment, and on the assumption that there will be no other changes to the composition of the Board, there are expected to be seven independent non-executive directors on the Board resulting in a Board which is compliant with the UK Corporate Governance Code.

The UK Corporate Governance Code also recommends that a board should appoint one of its independent non-executive directors to be the senior independent director (the **SID**). The SID should be available to shareholders if they have concerns that the normal channels of Chairman, Chief Executive Officer or other executive directors have failed to resolve, or for which such channel of communication is inappropriate. The Bank does not currently have a SID as at the date of this Prospectus. It is intended that the prospective independent non-executive director who is intended to be recruited from a commercial banking background be appointed as the SID following his/her appointment to the Bank's Board of Directors.

2.1 Nominee Directors

As referred to in the Relationship Agreement, for so long as it remains a bona fide co-operative society, the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, provide Cooperative Group with the right to appoint and, once appointed, remove (i) up to two persons to the Board provided that Co-operative Group controls directly or indirectly 25 per cent. or more of the voting rights exercisable at a general meeting of the Bank; or (ii) one person to the Board provided that Cooperative Group controls directly or indirectly 20 per cent. or more, but less than

25 per cent., of the voting rights exercisable at a general meeting of the Bank. A summary of the Articles of Association of the Bank is set out in paragraph 12, titled "*Summary of the Bank's Articles of Association*" in Section 20 (*Additional Information*) of this Prospectus. It is intended that Euan Angus Sutherland and Bennett Lyle Edward Reid will constitute the first such nominees of Co-operative Group for the purposes of the Articles of Association.

Subject to certain conditions, the Relationship Agreement also provides a mechanism for the appointment of up to two persons (in each case, after having been identified for such purpose by the Purchasers): (i) nominated by the holders of the Dated Notes at or around the time of the Scheme Meeting; and (ii) to the extent the holders of the Dated Notes have not so nominated, approved by the shareholders other than Co-operative Group or Banking Group (and for these purposes, a person is 'approved' if less than 25 per cent. of relevant votes disapprove of the relevant person within a specified timeframe).

2.2 Roles and responsibilities of the Board

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

Implementation of the strategy set by the Board and the management and day-to-day running of the Bank is delegated to the Chief Executive Officer with the exception of the matters reserved to the Board. Such reserved matters include decisions on strategic and long-term objectives, the approval of published financial statements, major acquisitions and disposals, significant investments and other capital expenditure and risk management policies.

2.3 Board Committees

In addition to those matters reserved to the Board, the Board has established Audit, Remuneration, Nomination and Risk Committees to complement the Board's activities and to ensure the Bank follows best practice in corporate governance matters including compliance with the UK Corporate Governance Code. All committees are compliant with the UK Corporate Governance Code.

A further board committee has been established in connection with the Recapitalisation Plan, namely the Values and Ethics Committee. The Articles of Association of the Bank set out the purpose and composition of the committee and it will play an important role in relation to the Bank's commitment (as set out in the Articles of Association) to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement, having regard to the highest standards of ethical principles and with the idea of being recognised as a good corporate citizen and contributing to building a stronger and sustainable society. The Bank will promote and conduct its business in such manner in relation to:

(a) how it relates to, communicates with, balances the interests of, and otherwise deals with, its stakeholders; and

(b) how it applies the profits of the Bank, in accordance with the dividend policy set out in its Articles of Association.

A summary of the Articles of Association is set out in paragraph 12, titled "*Summary of the Bank's Articles of Association*" Section 20 (*Additional Information*) of this Prospectus.

Further details of the committees are set out below.

(a) **Audit Committee**

In accordance with the requirements of the UK Corporate Governance Code, the Audit Committee is made up of at least three members who are all independent non-executive directors and includes at least one member with recent and relevant financial experience. Membership shall include at least one member of the Risk Committee. The Audit Committee currently comprises Richard Graeme Barclay Hardie, Merlyn Lowther and Anne Margaret Gunther and is chaired by John Richard Coates, all of whom are independent non-executive directors. The Audit Committee will meet at least six times a year. The Audit Committee has responsibility for, amongst other things, the monitoring of the integrity of the financial statements of the Bank. It focuses in particular on compliance with accounting standards and the rules of the FCA and ensuring that an effective system of internal financial control is maintained. The ultimate responsibility for reviewing and approving the annual report and accounts, and the half-yearly reports, remains with the Board.

The terms of reference of the Audit Committee cover such issues as the membership and frequency of meetings, as mentioned above, together with requirements of any quorum for, and the right to attend, meetings. The duties of the Audit Committee covered in the terms of reference are: financial reporting, internal controls, internal audit, external audit and reporting responsibilities. The terms of reference also set out the authority of the Audit Committee to carry out its duties.

(b) **Remuneration Committee**

In accordance with the requirements of the UK Corporate Governance Code, the Remuneration Committee is made up of at least three members who are all independent non-executive directors. The Remuneration Committee is chaired by Anne Gunther, an independent non-executive director, and its other members are Richard Graeme Barclay Hardie and John Richard Coates. When the prospective independent non-executive director with the human resources background is appointed, it is intended that they shall take over the role of chair. The Remuneration Committee, which meets at least twice a year, has responsibility for the establishment, implementation and maintenance of the Bank's policy on all aspects of remuneration for the Executive Directors and certain senior executives of the Bank, and shall determine, within the terms of the agreed policy and in consultation with the Chairman and/or Chief Executive Office of the Bank, as appropriate, the specific remuneration packages for each of the Executive Directors, the Chairman of the Bank and certain senior executives of the Bank, including pension rights and any compensation payments and the implementation of any incentive arrangements. It is also responsible for setting and recommending to the Board the overarching principles and parameters of the remuneration policy across the Bank to ensure an overall coherent approach to remuneration in respect of all employees. Further, the Remuneration Committee has responsibility for ensuring compliance with all regulatory requirements in respect of remuneration.

The terms of reference of the Remuneration Committee cover such issues as membership and frequency of meetings, as mentioned above, together with the requirements for quorum and the right to attend meetings. The duties of the Remuneration Committee covered in the terms of reference relate to the following: setting the principals and parameters for the overall remuneration policy for the Bank, determining and monitoring policy on and setting level of remuneration for Executive Directors and certain senior executives, including: contracts of employment, performance-related pay, pension arrangements, remuneration reporting and disclosure, incentive schemes and remuneration consultants. The terms of reference also set out the reporting responsibilities and the authority of the Remuneration Committee to carry out its duties.

(c) **Nomination Committee**

In accordance with the requirements of the UK Corporate Governance Code, the Nomination Committee is made up of at least three members, the majority of whom are independent non-executive directors and currently comprises Richard Graeme Barclay Hardie, John Richard Coates and is chaired by Richard Pym. The Nomination Committee will meet at least twice a year.

The Nomination Committee is responsible for considering and making recommendations to the Board in respect of appointments to the Board and the Board Committees (in consultation with the chairs of those committees). It is also responsible for keeping the structure, size and composition of the Board under regular review, and for making recommendations to the Board with regard to any changes necessary. The Nomination Committee also considers succession planning for Executive Directors, non-executive directors and certain senior executives, taking into account the challenges and opportunities facing the Bank, and the skills and expertise that will be needed on the Board in the future and keeps under review the leadership needs of the organisation.

The terms of reference of the Nomination Committee cover such matters as membership and frequency of meetings as stated above together with the quorum requirements for, and the right to attend, meetings. The duties of the Nomination Committee covered in the terms of reference relate to reviewing and recommending the Board composition, succession planning for Executive Directors, non-executive directors and certain senior executives, keeping up to date on strategic issues and commercial changes affecting the Bank, identifying and nominating candidates for Board vacancies and evaluation of candidates for the Board. The terms of reference also set out the authority of the Nomination Committee to carry out its duties.

(d) **Risk Committee**

The Risk Committee is responsible for the risk management framework and for providing oversight and advice to the Board in relation to current and potential future risk exposures of the Bank and future risk strategy, reviewing and approving various formal reporting requirements, and promoting a risk awareness culture within the Bank.

The Risk Committee is currently made up of four members who are all independent non-executive directors and is chaired by Richard Graeme Barclay Hardie. The other members are Merlyn Lowther, Anne Gunther and John Richard Coates. It is expected that the Chief Financial Officer and the Chief Risk Officer will normally be invited to attend all or part of each meeting. The Risk Committee will normally meet at least four times a year.

The terms of reference of the Risk Committee cover such issues as membership and frequency of meetings, together with the requirements for quorum for, and the right to attend, meetings. The duties of the Risk Committee covered in the terms of reference are in relation to: reviewing and challenging the design and implementation of the risk management framework, risk profile, risk appetite, management's risk mitigation and control remediation actions, challenging and exercising oversight of capital and liquidity management policy, and the management and control of all significant risks. The terms of reference also set out the authority of the Risk Committee to carry out its duties.

(e) **Values and Ethics Committee**

The Values and Ethics Committee (the **V&E Committee**) is constituted by the Articles of Association of the Bank. It comprises a minimum of five and a maximum of seven members, of whom: (A) the majority must be independent Directors; and (B) at least five must be Directors. The chairman is an independent director specifically appointed for the role. Co-operative Group has the right to appoint and remove one of the members of the committee (who must be a Director) while it indirectly or directly holds 20% or more of the Ordinary Shares in the Bank.

The V&E Committee shall recommend to the Board for its approval and adoption the co-operative values and ethical policies of the Bank and shall represent, monitor, and advise the Board on matters concerning all stakeholders in their dealings with the Bank in line with the commitment of the Bank to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement under the Bank's Articles of Association. For so long as Co-operative Group remains both a bona fide co-operative society and holds directly or indirectly 20% or more of the Ordinary Shares of the Bank, the articles concerning the V&E Committee may be amended or repealed only with the prior written consent of Co-operative Group in addition to the passing of a special resolution approving such changes. The V&E Committee shall meet at least twice in any one financial year of the Bank and shall prepare an annual report for approval by the Board which, subject to such approval, shall be included in the annual report and accounts of the Bank.

The terms of reference of the V&E Committee covers such issues as membership and frequency of meetings, together with the requirements for quorum for, and the right to attend, meetings. The responsibilities of the V&E Committee covered in the terms of reference involve monitoring and reporting to the board on:

(i) customer satisfaction levels (with a focus on service levels and on the product offering in the light of the Bank's ethical policies, in each case assessed by reference to relevant customer metrics);

(ii) alignment of treatment of the Bank's customers with its values and ethical policies;

(iii) alignment of employee training and culture with its values and ethical policies;

(iv) corporate social responsibility, community investment, environmental and other projects and activities of the Bank;

(v) the establishment of a clear 'ethical' policy and 'ethical' strategy informed by customer consultation that aligns with the commercial strategy and is reviewed annually;

(vi) the extent to which executive remuneration policies are consistent with the Bank's values and ethical policies;

(vii) provision of products and services to sectors/organisations with clear social justice or community benefit purpose;

(viii) the development of products and services with 'ethical' features;

(ix) the Bank's approach to improving the social and environmental impacts of the Bank's own operations; and

(x) the choice of suppliers, partners and third party relationships which should be informed by the Bank's 'ethical' policy.

The V&E Committee's chairman shall attend the Bank's annual general meeting to answer any shareholder questions on the V&E Committee's activities and on the report of the V&E Committee in the Annual Report and Accounts of the Bank. All members of the V&E Committee shall also attend the annual general meeting.

10
CAPITALISATION AND INDEBTEDNESS

CAPITALISATION AND INDEBTEDNESS

The following table sets out a summary of the Bank's capitalisation as at 30 June 2013, extracted from the audited Interim Financial Information.

Capitalisation

	As at 30 June 2013 (£ millions)
Shareholders' equity	
Share capital	418.8
Other reserves	30.7
Retained earnings	532.0
Total capitalisation	981.5[1]

Notes:

1 There has been no material change to the Bank's capitalisation since 30 June 2013.

Indebtedness

The following table sets out the Bank's net indebtedness as at 31 August 2013, extracted from the Bank's accounting records and is unaudited.

	As at 31 August 2013 (£millions)
Cash and balances with central banks	4,672.7
Loans and advances to banks	53.6
Trading securities	–
Liquidity	4,726.3
Current Financial Receivable	–
Current – deposits by banks	(2,079.8)[1]
Current – customer accounts and capital bonds	(30,814.8)
Current – debt securities in issue	(96.3)
Current – other borrowed funds	(178.1)
Current – amounts owed to other Co-operative Group undertakings	(60.2)
Current Financial Debt	(33,229.2)
Net Current Financial Indebtedness	(28,502.9)
Non-current – deposits by banks	(879.5)
Non-current – customer accounts and capital bonds	(4,217.4)
Non-current – debt securities in issue	(4,341.4)
Non-current – other borrowed funds	(1,157.0)
Non-Current Financial Indebtedness	(10,595.3)
Net Financial Indebtedness	(39,098.2)
Indirect and Contingent Indebtedness:	
Guarantees and irrevocable letters of credit	119.9
Documentary credits and short-term trade-related items	1.5
Forward asset purchases and forward deposits placed	136.2
Undrawn formal standby facilities, credit lines and other commitments to lend (including revocable and irrevocable commitments)	3,878.1[2]

Notes:

(1) Includes £1,984.3 million secured on investment securities sold under sale and repurchase agreements.

(2) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,268.2 million.

11
SELECTED FINANCIAL INFORMATION

Consolidated income statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
					(Unaudited)
		(£millions)		*(£millions)*	
Income	771.2	817.6	821.8	355.8	385.1
Operating costs – steady state	(568.2)	(548.2)	(555.5)	(303.1)	(282.8)
Operating costs – strategic initiatives	(14.8)	(13.4)	(26.0)	(14.3)	(9.2)
	188.2	256.0	240.3	38.4	93.1
Impairment losses	(468.7)	(114.9)	(95.8)	(496.0)	(91.9)
Operating result	(280.5)	141.1	144.5	(457.6)	1.2
Significant items	(85.1)	(53.3)	(55.5)	(34.6)	(39.3)
Intangible asset impairment	(150.0)	–	–	(148.4)	–
Customer redress (including PPI)	(149.7)	(90.0)	(4.3)	(163.0)	(40.0)
Share of post-tax profits from joint venture	1.2	0.2	0.7	0.3	0.6
Financial Services Compensation Scheme levies	(24.8)	(14.5)	(11.5)	0.1	(0.8)
Fair value amortisation	15.2	86.3	(14.2)	(8.2)	19.7
Profit (loss) before taxation and distributions	(673.7)	69.8	59.7	(811.4)	(58.6)
Profit-based payments to members of Co-operative Group	–	(15.6)	(10.8)	–	–
Profit (loss) before taxation	(673.7)	54.2	48.9	(811.4)	(58.6)

Consolidated balance sheet of the Bank and its subsidiaries as at 31 December 2012, 2011 and 2010 and as at 30 June 2013

	As at 30 June	*As at 31 December*		
	2013	*2012*[1]	*2011*	*2010*
	(£millions)	*(£millions)*		
Assets				
Loans and advances to customers	32,932.9	33,693.7	34,132.3	35,144.1
Cash and balances at central banks	5,402.1	5,433.0	6,696.6	1,735.6
Loans and advances to banks	1,737.5	1,904.1	2,006.5	2,394.1
Investment securities	5,082.6	6,889.8	4,571.0	4,903.1
Derivative financial instruments	804.3	818.8	975.8	975.6
Other assets	672.9	834.0	573.4	428.8
Total assets	46,632.3	49,573.4	48,955.6	45,581.3
Liabilities				
Amounts owed to customers	34,922.3	36,772.5	36,420.4	34,114.7
Wholesale liabilities	3,517.8	3,612.0	3,302.7	2,938.6
Debt securities in issue	4,610.0	4,713.7	4,164.8	4,212.2
Derivative financial instruments	662.7	967.6	1,087.9	702.4
Other liabilities	656.7	398.8	447.9	564.9
Other borrowed funds	1,248.1	1,258.6	1,258.8	975.4
Total liabilities	45,617.6	47,723.2	46,682.5	43,508.2
Total equity	1,014.7	1,850.2	2,273.1	2,073.1
Total liabilities and equity	46,632.3	49,573.4	48,955.6	45,581.3

1 Note: On 29 August 2013, the Bank published its interim financial report for 2013. The 2012 balance sheet comparatives contained in the interim financial report were represented to reflect that certain deferred tax liabilities could not be offset against the deferred tax assets. As a result, the 'Other assets', and 'Total assets', 'Other liabilities', 'Total liabilities' and 'Total liabilities and equity' each increased by £121.4 million.

Consolidated cash flow statement of the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
	(£millions)			*(£millions)*	
Net cash flows from operating activities	805.2	3,470.2	(1,333.5)	(1,978.9)	(1,654.5)
Net cash flows from investing activities	(2,344.7)	831.9	2,220.6	1,842.2	(194.2)
Net cash flows from financing activities	(34.7)	183.1	128.8	(47.2)	(51.2)
(Decrease) increase in cash and cash equivalents	(1,574.2)	4,485.2	1,015.9	(183.9)	(1,899.9)
Cash and cash equivalents at the beginning of the period	7,888.4	3,403.2	2,387.3	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,314.2	7,888.4	3,403.2	6,130.3	5,988.5

Key performance indicators for the Bank and its subsidiaries for the financial years ended 31 December 2012, 2011 and 2010 and for the six months ended 30 June 2013 and 2012

The following table sets out selected consolidated financial information which is unaudited but which has been derived from the Bank's consolidated financial statements for the financial years ended 31 December 2012, 2011 and 2010, and the Bank's interim financial information for the six months ended 30 June 2013 and 2012.

	Financial year ended 31 December			*Six months ended 30 June*	
	2012	*2011*	*2010*	*2013*	*2012*
Net interest margin (bps)(2)	111	123(1)	135	104	103
Non-interest income/Total income	29.2%	24.3%	23.1%	30.0%	35.3%
Cost-to-income ratio(3)	73.7%	67.0%	67.6%	85.2%	73.4%
Cost of risk (bps)(4)	139	35	28	146	28
Non-performing loans ratio(5)	10.9%	8.4%	8.4%	12.3%	9.6%
Non-performing loans coverage(6)	28.6%	27.1%	27.1%	33.8%	24.1%
Core Tier 1 ratio	8.8%	9.6%	9.6%	4.9%	9.6%
Loans-to-deposit ratio	91.6%	93.9%	102.5%	94.3%	100.5%

Notes:

(1) Excluding £37.2 million of Treasury/other profits.

(2) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(3) The cost-to-income ratio is calculated by dividing steady state costs by total income.

(4) The cost of risk is calculated by dividing the impairment charge by average assets.

(5) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(6) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

12
OPERATING AND FINANCIAL REVIEW

OPERATING AND FINANCIAL REVIEW

The following discussion which relates to the Bank's results of operation for the financial periods ended 30 June 2013 and 2012 is based on and should be read in conjunction with the Interim Financial Information, which is set out in "*Part A*" in Section 16 (*Financial Information*).

The Interim Financial Information has been prepared in accordance with the requirements of the Prospectus Directive and the Listing Rules and in accordance with IFRS as adopted by the EU and the basis of preparation included in note 1 in the Interim Financial Information. The historical financial information set out in this Section 12 (*Operating and Financial Review*) reflects the segments of the business in place during the six-month period ended 30 June 2013, and the core and non-core businesses as then constituted. See below for a description of the core and non-core businesses, and see Section 21 (*Important Legal Information*) for further information.

Prospective investors should read the following discussion together with the whole of this Prospectus, including Section 2 (*Risk Factors*) and the Interim Financial Information (including the related notes) and should not rely solely on the information set out in this Section 12 (*Operating and Financial Review*).

The operating and financial review of the Bank for the years ended 31 December 2012, 2011 and 2010 can be found on pages 6 to 9 of the financial statements of the Bank for the year ended 31 December 2012, pages 5 to 7 of the financial statements of the Bank for the year ended 31 December 2011, and pages 5 to 8 of the financial statements of the Bank for the year ended 31 December 2010, respectively, which have been incorporated by reference into this document. Such reviews reflect the segments of the business as operated during the relevant reporting periods.

The following discussion includes certain forward-looking statements that, although based on assumptions that the Bank's management considers to be reasonable, are subject to risks and uncertainties that could cause actual events or conditions to differ materially from those expressed or implied in this Section 12 (*Operating and Financial Review*). Among the important factors that could cause the Bank's actual results, performance or achievements to differ materially from those expressed in such forward-looking statements are those factors that are discussed in Section 21 (*Important Legal Information*) and Section 2 (*Risk Factors*) in this Prospectus. In addition, certain regulatory issues also affect the Bank's results of operations and are described in Section 17 (*Supervision and Regulation*). All statements other than statements of historical fact, such as statements regarding the Bank's future financial position and risks and uncertainties related to the Bank's business, plans and objectives for future operations, are forward-looking statements.

OVERVIEW

The Bank's strategy, which involves a four to five year turnaround plan, is to de-risk the Bank by becoming a commercial bank focused on retail and SME franchise businesses in the UK, built around the Bank's existing brand and franchise strength. The Bank is differentiated from other banks within the UK market as it is recognised by its customers as being a fair, responsible and trusted bank. These positive attributes are underpinned by the values of the co-operative movement, with which the Bank is associated. As at 30 June 2013, the Bank has approximately 4.7 million customers, of which just over 4.6 million are retail and 0.1 million are business customers, and operates through a network of 324 branches, 22 corporate banking centres and 3 primary call centres, over 2,700 ATMs, the internet and other digital channels.

In the six-month period to 30 June 2013, the Bank was managed through two distinct divisions:

- Core – The 'core' business represented activity consistent with the strategy and risk appetite for the Bank. This includes the retail, core corporate and business banking and treasury/other segments. Core corporate and business banking (**CABB**) comprised corporate banking, business banking and business services, and effectively consisted of all the key business-to-business elements of the Bank. The Retail Banking business (trading as The Co-operative Bank, Britannia and 'smile') offered a range of financial products and services to individuals and households throughout the UK. Retail also included Platform (the intermediary mortgage business). Included in the Treasury/other segment were the results of the treasury activities of the business and the results of Unity Trust Bank.

- Non-core – Non-core business lines included activities not congruent with the then strategy of the Bank, which were targeted for run-down or exit. These non-core lines contain the majority of the impairment risk for the Bank, and predominately included the Corporate non-core businesses, Optimum (a closed book of predominantly interest-only, intermediary and acquired mortgage book assets) and Illius (the residential property company) both of which originated from the non-member Britannia business prior to merger.

The Bank had total assets of £46,632.3 million as at 30 June 2013 (£49,694.8 million as at 31 December 2012).

KEY FACTORS AFFECTING RESULTS OF OPERATIONS

The Bank is going through a difficult period. It has incurred significant losses for the six months ended 30 June 2013, primarily arising from significant additional impairment charges, intangible asset impairment and customer redress provisions, and has announced a regulatory capital shortfall of £1.5 billion that the Bank intends to address by the end of 2014 through a Recapitalisation Plan discussed in further detail below. In addition, the Bank has suffered a number of credit rating downgrades by Moody's and Fitch, most notably a six notch downgrade by Moody's on 9 May 2013 to Ba3 from A3, taking the Bank below investment grade rating. These factors, together with general economic conditions in the UK and increasing regulatory capital and liquidity requirements, have had, and will continue in the short to medium term to have, a significant impact on the Bank's results of operations.

The launch of the Recapitalisation Plan

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014), and the remaining £163 million by 31 December 2014).

On 17 June 2013, the PRA made the following statement:

"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5 billion in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative Group to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion of Common Equity Tier 1 Capital following the announcement of the Bank's interim results for the six month period ended 30 June 2013. The PRA also reconfirmed that this requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress. The Liability Management Exercise is intended to generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 Capital by the end of 2013. Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged pursuant to the Liability Management Exercise.

The contributions that a successful Liability Management Exercise would provide by the end of 2013 would increase the Bank's Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496.0 million incurred for the six month period ended 30 June 2013 and potential impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

The Recapitalisation Plan

The key objective of the Recapitalisation Plan is to strengthen significantly the Bank's Common Equity Tier 1 Capital base and to refocus the Bank's strategy around its strength in core relationship retail banking providing current accounts, residential mortgages and savings products to retail customers and SMEs. The Liability Management Exercise forms a critical element of the Recapitalisation Plan. The Liability Management Exercise is intended to generate at least £1 billion of the £1.5 billion of Common Equity Tier 1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital for the Bank; and
- second, to the extent that Existing Securities are exchanged or issued for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), the amount of that discount will also be recognisable as Common Equity Tier 1 Capital (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**) and certain proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the **Proposals**). The offer in respect of the Dated Notes is being conducted by way of the Scheme. The Liability Management Exercise will only be successfully completed if the entire principal amounts of the Existing Securities are exchanged pursuant to the Liability Management Exercise.

The Scheme will also provide that 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription on the terms of the Scheme as described in the Explanatory Statement (the **Additional New Ordinary Shares Offer**).

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this Prospectus as the Liability Management Exercise. In addition, as part of the Liability Management Exercise, a proportion of the New Ordinary Shares issued in exchange for Existing Securities will be delivered to Co-operative Group in exchange for the issue by Cooperative Group to the Holders of certain of the Existing Securities (being Preference Shares and 13% Bonds) of a Final Repayment Notes and/or Instalment Repayment Notes (the **Group Notes**). Each such Holder will have the opportunity to choose whether it would prefer to receive Final Repayment Notes and/or Instalment Repayment Notes (if the Liability Management Exercise is successfully completed) or a combination of the two, each to be issued by Co-operative Group pursuant to the Group Notes.

In addition, the Bank expects that capital created through interest savings on the Existing Securities surrendered in the Liability Management Exercise net of any coupon payments on the New Securities should contribute an additional amount of Common Equity Tier 1 Capital towards the Recapitalisation Plan, beyond that created as a result of the Liability Management Exercise. The Bank currently estimates that net interest savings should result in allowable Common Equity Tier 1 Capital in the region of £40 million during the course of 2014.

2014 Commitment

Under the Recapitalisation Plan, Banking Group has agreed to contribute £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately prior to the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

As announced on 17 June 2013, Banking Group is expecting to satisfy the 2014 Commitment from the net proceeds of the sale by Banking Group of Royal London (CIS) Limited (formerly known as Co-operative Insurance Society Limited) and Royal London Asset Management (CIS) Limited (formerly known as The Co-operative Asset Management Limited) (together **Co-operative Life Insurance and Asset Management**) and the net proceeds of the proposed sale of CIS General Insurance Limited (CIS General Insurance) (together the **Insurance Proceeds**). The sale of Co-operative Life Insurance and Asset Management to The Royal London Mutual Insurance Society Limited (**Royal London**) completed on 31 July 2013. The total consideration for the sale is £219.0 million, of which £39.0 million has already been paid to Banking Group. Payment of the remaining £180 million (as deferred consideration) is subject to the approval of the court under a transfer of the life insurance fund of Co-operative Life Insurance Society Ltd (now named RL (CIS) Ltd) into Royal London under Part VII of FSMA. There is no certainty as to timing or outcome of the court process and therefore no certainty as to when the deferred consideration may be received by Banking Group or if it will be received at all. In respect of the disposal of CIS General Insurance, the Bank has been told that, whilst Co-operative Group is currently in discussions with various interested parties to sell CIS General Insurance, as at the date of this Prospectus, no legally binding agreement to sell CIS General Insurance has been entered into and any such agreement may, when entered into, be subject to various conditions precedent.

To provide support to Banking Group's obligations under the Undertaking to Pay should the Insurance Proceeds not materialise or be insufficient to satisfy the Undertaking to Pay, Banking Group has entered into an intra-group loan with Co-operative Group and the Bank (the **Intra-group Loan**). The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (see paragraph 20.6 titled "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details of the small number of customary conditions precedent)). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan from alternative resources in the event that the Insurance Proceeds are not sufficient to satisfy the amount of the 2014 Commitment or otherwise not received in time to satisfy the PRA's required timing to satisfy the 2014 Commitment. For further details, see the risk factor titled "*The commitment by Banking Group to contribute £333 million of Common Equity Tier 1 Capital during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Grou*p" in Section 2 (*Risk Factors*).

The Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities are together referred to in this Prospectus as the **Recapitalisation Plan**.

Structure of the 2014 Commitment

The 2014 Commitment has been structured as follows:

(a) The 54,058,442 New Ordinary Shares to be issued to Banking Group against the Undertaking to Pay will be issued immediately following the implementation of the Scheme in accordance with its terms (including the subscription of Additional New Ordinary Shares to Holders of Dated Notes in accordance with the Scheme). The New Ordinary Shares issued in consideration for the Undertaking to Pay will be fully paid up for the purposes of the Companies Act and will be freely transferable (subject to the lock-up restrictions imposed under the 2014 Commitment Agreement, which are to be superseded by the lock-up restrictions imposed in the Relationship Agreement between Banking Group, Co-operative Group and the Bank once this comes into force (as described in paragraph 20.3 "*Relationship Agreement*" in Section 20 (*Additional Information*)) and fungible with all other Ordinary Shares. The New Ordinary Shares issued against the Undertaking to Pay, which will be issued in the same exchange ratio as the New Ordinary Shares to be issued to Holders of the Dated Notes pursuant to the Liability Management Exercise, will represent 21.6 per cent. of the Ordinary Shares in issue at completion of the Liability Management Exercise.

(b) The Undertaking to Pay does not generate Common Equity Tier 1 Capital of the Bank until such time as the cash proceeds of the undertaking are received by the Bank.

(c) The 2014 Commitment requires Banking Group to deliver the cash proceeds to discharge the relevant proportion of the Undertaking to Pay by such dates as to satisfy the PRA's timing requirements. The PRA has stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

See the paragraph 20.4 titled "*2014 Commitment Agreement*" in Section 20 (*Additional Information*) for more details of the 2014 Commitment.

(d) The Intra-group Loan allows Banking Group to draw down sufficient amounts to satisfy the Undertaking to Pay taking into account Banking Group's existing cash resources and is intended to be unconditional before 2014 (and is only subject to a small number of customary conditions precedent – see the paragraph 20.6 titled "*Intra-group Loan*" in Section 20 (*Additional Information*) for further details). Banking Group, under the terms of the Intra-group Loan is obliged to pay any amounts drawn down under that loan to the Bank in satisfaction of the Undertaking to Pay.

Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in RWAs, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

The uncertainty around the implementation of the Recapitalisation Plan constitutes a material uncertainty which casts significant doubt on the Bank's ability to continue as a going concern. The Interim Financial Information, therefore, includes an "emphasis of matter" as to the Bank's ability to continue as a going concern (see note 3 to the Interim Financial Information for further details of the going concern position of the Bank). Failure to implement the Recapitalisation Plan would likely result in the Bank ceasing to be able to continue as a going concern. Please see risk factor titled "*The implementation of the Liability Management Exercise is subject to a number of significant risks. Should the Liability Management Exercise not be implemented, the Bank is likely to be the subject of a resolution procedure under the Banking Act 2009*" in Section 2 (*Risk Factors*). In such circumstances, holders of existing securities could potentially lose some, substantially all, or the entire amount of their investment in the Existing Securities.

Deleveraging the Non-core Business asset portfolio

The Non-core Business consists of those asset classes which are not consistent with the Bank's Core Business strategy and which are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit. As at 30 June 2013 the Non-core Business had total segment assets of £14.2 billion constituting 32.1 per cent. of the Bank's total segment assets. The Bank intends to reduce Non-core Business net loans to less than £11.5 billion by 31 December 2014, and to continue deleveraging the Non-core Business thereafter at a slower pace. The Bank will also target the deleveraging of the Non-core Business in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital that is released from the reduction in RWAs, with the overall intention of achieving Non-core Business deleveraging that does not materially reduce the Common Equity Tier 1 Capital ratio of the Bank as a whole.

Approximately 50 per cent. of the Non-core Business relates to Optimum (as at 30 June 2013, £7.3 billion), a closed book of predominately interest-only intermediary and acquired mortgage book assets. The Optimum portfolio, in line with the life of the book, will be run down over the longer term due to the nature of the assets. Optimum, being a portfolio of predominantly interest-only residential mortgages, is particularly sensitive to changes in interest rates.

The management of arrears and defaults, the running-down of the Non-core Assets and the use of funding will each impact on the Bank's capital position, its cash resources and liquidity, the Core Business and the Bank's operating results and financial position. In support of this business strategy, the Bank is also putting in place an operational and governance structure in respect of the Non-core Business which the Directors believe will allow for future cost reductions in line with the Non-core Asset run-down.

Cost management and operating efficiencies

The Bank has a high cost-income ratio relative to other financial institutions. For the six month period ended 30 June 2013, its cost-to-income ratio was 85.2 per cent. The high cost base and operational inefficiencies continue to impact on the Bank's profitability, and reducing the Bank's cost base is and will continue to be a priority for the business following a successful completion of the Liability Management Exercise.

In particular, the Bank plans to secure substantial long-term cost savings and to target a cost-to-income ratio of less than 60 per cent. in the longer term through a significant cost savings programme. These cost-savings are intended to be delivered through (i) the simplification of the Bank's product offering, allowing for efficiency gains in the Bank's operations and IT functions; (ii) greater levels of self-service through the reorientation of the Bank's distribution model towards digital and other self-service channels; (iii) business process re-engineering (both IT and non-IT enabled) which will remove middle and back office costs; (iv) delayering of management and (v) full integration of Britannia within the Bank.

Investment

The Bank will be required to make significant levels of investment to execute its turnaround plan. A high percentage of these investments will be IT related to make its platform fit-for-purpose and provide the minimum levels of functionality required by the strategy. These investments are expected to contribute to cost savings and revenue uplift.

These investments can be classified into three categories according to level of criticality:

- Mandatory: investments critical for the on-going business. This includes investments in regulatory compliance, risk remediation, resilience activities and management information. Of the three categories, this requires the largest amount of investment;
- Enablement of the strategy: investments critical to allow the Bank to be able to deliver its strategic plan. This includes investments in digital catch-up, improving product pricing and credit decisioning, branch closure and non-IT related process optimisation; and
- Delivery of the strategy: investments required in executing the strategic plan. This includes investments in systems rationalisation, channel optimisation and integration, enabling customer self-service and automating processes and workflow.

The execution of the Bank's turnaround plan will result in significant costs being incurred over the next three years, and the Bank has currently budgeted in the region of £500 million in connection to the re-engineering of the Bank's IT platform to support the Core Business strategy of the Bank, its cost saving programme, and the reorientation of the Bank's distribution channels. Within this amount, total investment spend on transformation, including IT remediation, digital catch-up and other IT initiatives in the next three years of approximately £400 to £450 million is currently budgeted, of which approximately 40 to 45 per cent. is currently expected to be capitalised.

Impairment losses on loans and advances to customers

The Bank's impairment charge on loans and advances for the six months ended 30 June 2013 was £496.0 million, up from £94.6 million for the six months ended 30 June 2012. This impairment charge is made up of £165.5 million in the core business (principally retail banking (£24.8 million) and CABB (£140.0 million)) and £330.5 million in the Non-core Business (non-core corporate £294.3 million and Optimum £36.2 million). These credit impairments are the principal reason for the level of operating loss for the six months ended 30 June 2013.

There are a number of causes of the increase in the overall impairment charge which go to explaining the change in position from the impairment charge recognised at 31 December 2012:

(a) First, the Bank has targeted Non-core Assets for run-down and exit. In the six months to 30 June 2013, the Bank has continued to review its corporate loan book on an asset-by-asset basis and change the work-out approach on a significant number of assets to ensure it complies more closely with industry and regulator standards. This has resulted in a reduction in expected future recoveries in respect of such assets and consequential impairment charges. This reduction in expected future recoveries has contributed approximately half of the overall impairment charge of £496.0 million for the six month period ended 30 June 2013.

(b) Second, there have been further improvements in the Bank's credit risk management approach and improvements in the data upon which impairment assessments are made (constituting approximately 25 per cent. of the overall impairment charge for the six months ended 30 June 2013). In respect of the Bank's retail loans, changes in impairment provisions have resulted from a management review of (i) the probability of possession given default (status level has changed to 180 days past due for non-forborne customers and all customers that are on a forbearance plan from the previous state of possession), (ii) the treatment of forbearance, timing of impairment recognition and length of emergence periods (which have been extended to 12 months) and (iii) the formalisation of a charge-off policy (accounts that are in arrears for over 180 days are now treated as charge-off). The review took into account the continuing impacts of the corporate real estate environment, prolonged real wage deflation and the lower apparent crystallisation of losses whilst the Bank of England base rate continues to be low. The change in the credit risk management approach was the primary driver behind the increase in impairments to the core and non-core retail books in the six months ended 30 June 2013.

(c) Third, impairments continue to be incurred in the ordinary course of business in both the core and non-core businesses due to changes in customer circumstances. New defaults (21 per cent.) and deterioration (4 per cent.) comprise the rest of the overall impairment charge for the six month period ended 30 June 2013.

In light of the significance of the impairment charges recognised in the Interim Financial Information, the Board has also carried out several independent reviews on the Bank's impairment charges, including the impairment charges recognised in the Interim Financial Information, which concluded that it was appropriate for such impairments not to have been recognised in the 2012 Accounts, given the information which was available at the time of such accounts and that the change in methodologies applied in preparing the Interim Financial Statement is considered to be a change in accounting estimate.

The impairment charges at 31 December 2012 and 30 June 2013 were consistent with the credit information available and the prevailing workout and provisioning approach employed by the business at the relevant times.

A number of factors may result in further impairment charges in the future. See paragraphs titled "*Worsening economic and market conditions and/or increasing interest rates and/or a fall in house prices could result in increased residential mortgage and unsecured loan losses which would adversely impact the Bank's financial and operational performance*" and "*Worsening economic and market conditions could result in increased commercial loan losses beyond what the Bank has already provided for, which would adversely impact the Bank's financial and operational performance*" in Section 2 (*Risk Factors*) for further details.

Fair values

The fair value disclosures in the Interim Financial Information and on page 128 of the 2012 Accounts show a decrease in the fair value of the Bank's customer assets from £33.2 billion as at 31 December 2012 to £29.0 billion as at 30 June 2013.

As explained in note 34 of the Interim Financial Statements the Bank has significantly better data now, not least connected with its programme of disposals, and has been able to apply a different and improved methodology to its fair value assessment. The disclosures made in each set of financial statements were consistent with the information available and the methodology employed at the relevant time.

Impairment of the investment made in the replacement banking IT platform

The Bank has previously invested in developing a replacement of its core banking IT platform. Following the change in the Bank's strategy, the directors concluded that the replacement platform being developed was inconsistent with the new strategy, and would no longer be implemented. This resulted in an impairment charge of £136.4 million for the period ended 30 June 2013. In addition, an impairment review has been undertaken of the remaining intangible assets. Following that review, a further impairment of £12.0 million has been made against the assets in use, resulting in a remaining book value as at 30 June 2013 of £24.4 million. The write-off of intangible assets in the six months ended 30 June 2013 is therefore £148.4 million (HY 2012: nil).

Customer redress provisions

The Bank's provision for customer redress is reflected in charges of £166.7 million (£163.0 million significant item charge and £3.7 million relating to interest payments included in the results before significant items) in the six month period ended 30 June 2013, which includes provisions for potential customer compensation claims relating to past sales of payment protection insurance (**PPI**), alleged failings relating to the introduction of third-party sales of card and identity protection products, arrears charges and the processing of first payments on certain mortgages, the mis-selling of interest rate swaps and an additional provision following identification of a technical breach of the CCA.

Impact of general economic conditions in the UK and elsewhere

Since mid-2008, the global economy and the global financial system, and the Eurozone in particular, have experienced a period of significant turbulence and uncertainty. The severe dislocation of the financial markets around the world that began in August 2007 and significantly worsened in mid-2008 triggered widespread problems at many commercial banks, investment banks and other financial and related institutions in the UK and around the world. The dislocation severely impacted general levels of liquidity, the availability of credit and the terms on which credit is available.

Governments and central banks have responded by lowering interest rates and injecting liquidity into the financial system and taking other forms of action relating to financial institutions, including bank recapitalisations and the provision of government guarantees for certain types of funding, aimed at both supporting the sector and providing confidence to the market. Interest levels in the UK have now fallen to their lowest level since the Bank of England was founded. The Bank primarily derives its income from the UK, and therefore is directly and indirectly affected by the general economic conditions in the UK.

These market dislocations were also accompanied by recessionary conditions and trends in the UK and other countries in which the Bank has exposure. This dislocation adversely affected, among other things, consumer confidence, levels of unemployment, salary levels, the state of the housing market, the commercial real estate sector, bond markets, equity markets, counterparty risk, inflation, the availability and cost of credit, transaction volumes in wholesale and retail markets, the liquidity of the global financial markets and market interest rates, which in turn had, and continue to have, a material adverse effect on the Bank's business and operating results.

Although there have been periods where market conditions have generally improved, recent developments, particularly in the Eurozone, have demonstrated that there continues to be significant uncertainty. Discussion on the risks associated with the UK economy can be found in "*The Bank's business and financial* *performance have been and may continue to be affected by general economic conditions in the UK, and adverse developments in the UK or global financial markets could cause the Bank's earnings and profitability to decline*" in Section 2 (*Risk Factors*), respectively.

Among other factors:

- increased unemployment has led to some borrowers being unable to service their loan payments as they become due resulting in increased arrears in the Bank's secured residential mortgage portfolios and in the unsecured consumer loan portfolios, which has resulted in higher impairment charges and doubtful debt provisions in these portfolios;
- house prices have fallen since their peak in 2007, reducing the amount of collateral in the impaired residential mortgage loan portfolio and therefore, in certain cases, increased the actual losses upon loan default. According to the seasonally adjusted Halifax House Price Index, average house prices in the UK peaked in the third quarter of 2007 at almost £200,000 before falling steadily until the end of the first quarter 2008 to £158,000. Average house prices then remained stable before recovering to £167,000 in the three quarters to 30 June 2013;
- commercial property prices fell sharply in late 2008 and early 2009, although they have stabilised since then, reducing the amount of collateral in the commercial real estate loan portfolio and therefore, in certain cases, increased the actual losses upon loan default;
- the low base rate environment and the higher cost of funding arising from increased competition for retail and commercial deposits have resulted in a reduced net interest margin, otherwise known as margin compression, which has resulted in reduced net interest income in retail and corporate banking; and
- the Bank earns non-interest income on its Treasury investment portfolio which is held for liquidity and longer term purposes. This income is sensitive to interest rates and bond yields.

Net interest income

The Bank's net interest margins and, consequentially, earnings are affected by the size and mix of the Bank's lending portfolio, the pricing on its loans, and the costs and sources of its funding, including the repricing and maturity profile of the Bank's interest-earning assets and liabilities, net of any interest rate hedging applied.

The Bank's net interest margins have been squeezed by a number of factors which have negatively impacted on the pricing of its loans and the cost of its funds, including:

- Interest margin as margins achievable on mortgages are typically lower in times of low base rates. The Bank of England base rate has remained at 0.5 per cent. since March 2009, having fallen from 5.75 per cent. in July 2007 through eight consecutive cuts of between 0.25 per cent. and 1.0 per cent. In the 30 years preceding July 2007, the lowest level of the base rate was 3.5 per cent. The very low level of the Bank of England base rate presently has resulted in lower net interest margins as the cost of funding has increased.
- The Funding for Lending Scheme is considered to have lowered the overall cost of funding as retail deposit rates have fallen, due to lower demand, notably for fixed term deposits. Notwithstanding this, competition for the highest quality mortgages remains intense and is likely to continue, putting downward pressure on returns available for the lowest risk-weighted mortgage assets.
- The Bank's high level of surplus liquidity.

So long as interest rates stay relatively low by historic standards, the Directors believe that the cost of funds margin will remain higher than if rates rose.

The credit rating downgrades by Moody's and Fitch, most notably a six notch downgrade by Moody's on 9 May 2013 to Ba3 from A3, taking the Bank below investment grade rating, has had an adverse impact on the Bank's ability to source capital and a consequential impact on the Bank's funding costs. Further detail on funding is included in "*Liquidity and Funding*" below.

Net interest income is the largest component of the Bank's total income representing 94 per cent. of operating income for the six months ended 30 June 2013 (HY 2012: 74 per cent.). Net interest margin for the Bank has fallen to 104 bps as at 30 June 2013 from 111 bps as at 31 December 2012.

Capital adequacy and liquidity requirements

The Bank is subject to capital adequacy and liquidity requirements. Effective management of the Bank's capital and liquidity positions is critical to the implementation of the Recapitalisation Plan and the Bank's ability to operate its businesses and achieve its new strategy. For further details of the UK regulatory requirements, including capital adequacy and liquidity, and proposed changes in legislation see Section 17 (*Supervision and Regulation*).

A number of factors may impact on the Bank's regulatory capital and liquidity positions, and these therefore need to be carefully managed. In particular, the run-off and exit of the Non-core Assets and their impact on the amount and timing of impairment provisions and risk weighted assets, now and going forwards, will have an effect on the Bank's Common Equity Tier 1 Capital and leverage ratios. The Bank's regulatory capital and liquidity may also be impacted by a number of other factors, including (i) reductions in profits and retained earnings as a result of credit losses, write-downs or otherwise, (ii) increases in risk weighted assets (which are pro-cyclical under the existing regime promulgated by the Basel Committee, resulting in risk weighting increasing in economic downturns), (iii) loss of deposits and (iv) the inability to raise finance through wholesale markets as a result of the Bank's situation, market conditions or otherwise.

The introduction of increased capital requirements will constrain the Bank's ability to support risk assets, thereby constraining lending levels. Furthermore, the introduction of new rules on the size of liquidity buffers may affect the Bank by increasing the size of its low-yielding liquid asset portfolio, thereby potentially reducing its non-interest income. The introduction of a leverage ratio could also impact the Bank's performance as it may constrain the growth of its loan portfolios, thereby reducing future profitability.

For risks relating to the Bank's regulatory requirements, see paragraphs titled "*The Bank operates in highly regulated industries and the Bank's business and results may be significantly affected by the laws and regulations applicable to it. In particular, the Bank may face legal and regulatory proceedings*" and "*Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements*" in Section 2 (*Risk Factors*).

CURRENT TRADING

Consistent with the statements made when the Bank's unaudited interim results for the period ended 30 June 2013 were announced on 29 August 2013, the short term outlook for the Bank continues to be challenging.

Monthly revenue and cost trends since 30 June 2013 have remained consistent with those observed in the first half of the year. The average monthly level of impairment charges in July and August has fallen as compared to average monthly levels for the first half of the year. In the period from 30 June 2013 to 30 September 2013, £0.6 billion of Non-core Assets (consisting of Non-core Business loans) were deleveraged, through a combination of asset sales, run-off and managed repayments, net of new drawdowns and the Bank raised £1.5 billion of secured wholesale funding. As at 30 September 2013, the encumbrance ratio was 29.8 per cent.

The Bank's capital position has not materially changed since 30 June 2013 and the Bank remains dependent on the successful completion of the Liability Management Exercise.

LOSS FORECAST

The Bank's unaudited interim results for the six months ended 30 June 2013 contained the following statement:

"Clearly there are lessons to be learned from the last few years but it is vital that the new management team focuses on navigating the short-term issues and building the strategy that is targeted at returning the business to health in the future. We have already taken a number of actions but it is clear that we are in the early stages of turning the bank around. Indeed, we do not expect to be profitable for some years and legacy issues will continue to have an impact on the Bank for some time."

The statement above regarding profitability represents a profit forecast under the Prospectus Rules. The Directors have considered the above statement and continue to believe that it is valid, based on the assumptions below as the Bank will not be profitable in 2013 and 2014 and can give no assurance that the Bank will generate a profit for some years thereafter.

Basis of preparation and principal assumptions

This profit forecast is based on the interim results for the six months ended 30 June 2013, the unaudited management accounts for eight months ended 31 August 2013, management's forecast for the remaining four months ending 31 December 2013 and management's latest available projections for the financial years ending 31 December 2013 and 2014.

The principal assumptions on which the profit forecast is based comprise:

- Assumptions that are within management's control including:
  - Deleveraging of Non-core Business will be underwritten in such a manner that the anticipated future losses from deleveraging do not materially exceed the capital released from the reduction in risk-weighted assets; and
  - There will be no material variation to the assumed level of cost reductions and to the assumption that the cost-to-income ratio for the Core Business, of not less than 60 per cent. is only achieved in the longer term.
- Assumptions that are not within management's control including:
  - There will be no material change in legislation or regulatory capital and liquidity requirements impacting the Bank's operations;
  - There will be no material change in the accounting standards applicable to the Bank;
  - There will not be any material change in interest rates affecting the Bank from those currently applicable to the Bank;
  - There will not be any material improvement in the economic and general trading environment currently prevailing in the UK; and
  - There will be no material change to the competitive environment which impacts on consumer preferences.

The profit forecast has been properly compiled on the basis of the stated assumptions and using accounting policies which are in accordance with IFRS and consistent with those used by the Bank in the six months ended 30 June 2013 and which will be applicable for the financial years ending 31 December 2013 and 2014. Please see Part E: "*Accountants Report on Loss Forecast Report*" in Section 16 (*Financial Information*) for further details.

RESULTS OF OPERATIONS

The table below presents the Bank's results of operations for the six months ended 30 June 2013 and 2012.

	Six months ended 30 June 2013		
	Before significant items	*Significant items*	*After significant items*
		(£ millions)	
Interest receivable and similar income	715.6	(39.0)	676.6
Interest expense and similar charges	(470.8)	–	(470.8)
Net interest income	244.8	(39.0)	205.8
Fee and commission income	116.2	(94.0)	22.2
Fee and commission expense	(36.2)	–	(36.2)
Net fee and commission income	80.0	(94.0)	(14.0)
Net trading income	1.1	–	1.1
Other operating income	26.0	–	26.0
Operating income	351.9	(133.0)	218.9
Operating expenses	(321.7)	(213.0)	(534.7)
Financial Services Compensation Scheme levies	0.1	–	0.1
Impairment losses on loans and advances	(496.0)	–	(496.0)
Impairment gains on investments	–	–	–
Operating (loss)/profit	(465.7)	(346.0)	(811.7)
Share of post-tax profits from joint ventures	0.3	–	0.3
(Loss)/profit before taxation	(465.4)	(346.0)	(811.4)
Income tax	(41.0)	80.4	39.4
(Loss) for the period	(506.4)	(265.6)	(772.0)

	Six months ended 30 June 2012 (unaudited)		
	Before significant items	Significant items (£ millions)	After significant items
Interest receivable and similar income	744.7	–	744.7
Interest expense and similar charges	(473.5)	–	(473.5)
Net interest income	271.2	–	271.2
Fee and commission income	128.0	(40.0)	88.0
Fee and commission expense	(41.2)	–	(41.2)
Net fee and commission income	86.8	(40.0)	46.8
Net trading income	9.3	–	9.3
Other operating income	39.8	–	39.8
Operating income	407.1	(40.0)	367.1
Operating expenses	(294.3)	(39.3)	(333.6)
Financial Services Compensation Scheme levies	(0.8)	–	(0.8)
Impairment losses on loans and advances	(94.6)	–	(94.6)
Impairment gains on investments	2.7	–	2.7
Operating (loss)/profit	20.1	(79.3)	(59.2)
Share of post-tax profits from joint ventures	0.6	–	0.6
(Loss)/profit before taxation	20.7	(79.3)	(58.6)
Income tax	(6.1)	19.4	13.3
(Loss)/profit for the period	14.6	(59.9)	(45.3)

The Bank incurred a loss before taxation (after significant items) of £811.4 million for the six months ended 30 June 2013 compared with a loss before taxation of £58.6 million for the six months ended 30 June 2012.

The increased losses in the six months ended 30 June 2013 as compared with the six months ended 30 June 2012 arose primarily as a result of a substantial increase in the Bank's impairment provisions on loans and advances. The Bank's impairment provision increased from £94.6 million for the six months ended 30 June 2012 to £496.0 million for the six months ended 30 June 2013, representing an increase of £401.4 million. High operating costs continue to be a significant factor impacting the profitability of the Bank. Cost-to-income ratio for the six months ended 30 June 2013 was 85.2 per cent.

In addition, the losses in the six months ended 30 June 2013 were also driven by a number of significant items:

- £148.4 million resulting from a write-down of IT assets previously under development to replace the core banking platform;
- £163.0 million of additional customer redress provisions, including: a £10.0 million provision for potential customer redress relating to past sales of interest rate swaps (HY 2012: nil); a £53.0 million provision for potential customer redress relating to past sales of payment protection insurance, primarily covering increased operating and ombudsman costs (HY 2012: £40.0 million); a £26.0 million provision for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection insurance products (HY 2012: nil); a provision of £30.0 million (HY 2012: £nil) for potential customer redress relating to the processing of first payments on certain mortgages; a provision of £29.0 million (HY 2012: £nil) made for potential

customer redress following identification of a technical breach of the CCA, a provision of £15.0 million (HY 2012: £nil) for potential customer redress relating to arrears charges;

- £10.0 million of costs incurred in connection with the bid for the Lloyds Banking Group branches (HY 2012: £20.0 million);
- £14.7 million of costs incurred on a programme of investment and integration (HY 2012: £19.3 million); and
- £9.9 million impairment in respect of property, plant and equipment (HY 2012: nil).

The table below presents the Bank's net interest income and its components for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June 2013	
	Before significant items (£millions)	*After significant items (£millions)*
Interest receivable and similar income:		
On loans and advances to customers	643.1	614.1
On loans and advances to banks	15.4	15.4
On investment securities	75.3	75.3
Net expenses on financial instruments hedging assets	(59.4)	(69.4)
Net interest income on financial instruments not in a hedging relationship	41.2	41.2
Total interest receivable and similar income	715.6	676.6
Interest expense and similar charges:		
On customer accounts	255.3	255.3
On bank and other deposits	127.5	127.5
On subordinated liabilities	40.1	40.1
On perpetual subordinated debt	20.8	20.8
Net interest expense on financial instruments hedging liabilities	9.5	9.5
Net interest expense on financial instruments not in a hedging relationship	17.6	17.6
Total interest expense and similar charges	470.8	470.8
Net interest income	244.8	205.8

	For the six months ended 30 June 2012 (unaudited) (£millions)
Interest receivable and similar income:	
On loans and advances to customers	693.6
On loans and advances to banks	15.7
On investment securities	77.3
Net expenses on financial instruments hedging assets	(63.1)
Net interest income on financial instruments not in a hedging relationship	21.2
Total interest receivable and similar income	744.7
Interest expense and similar charges:	
On customer accounts	268.2
On bank and other deposits	121.4
On subordinated liabilities	39.6
On perpetual subordinated debt	16.8
Net interest expense on financial instruments hedging liabilities	9.2
Net interest expense on financial instruments not in a hedging relationship	18.3
Total interest expense and similar charges	473.5
Net interest income	271.2

In the six months ended 30 June 2013, net interest income (before significant items) was £244.8 million, a decrease of £26.4 million from net interest income (before significant items) of £271.2 million for the six months ended 30 June 2012.

The main reason for the reduction in net interest income (before significant items) relates to the unwind of fair value adjustments which arose on the merger with Britannia: a £4.2 million charge in the six months to 30 June 2013 compared to income of £22.0 million in the six months to June 2012. £33.6 million of the reduction in the fair value unwind is in respect of customer balances where fair value adjustments are unwinding in the ordinary course of business as these loans are nearing the end of their re-pricing period. This reduction has been partially offset by a £10.2 million increase in fair value unwind relating to investment securities arising in the normal course of business. The significant item for the six months ended 30 June 2013 was a provision for potential customer redress of £39.0 million (HY 2012: £nil) relating to past sales of interest rate swaps and potential redress following identification of a technical breach of the CCA.

The table below presents the Bank's fee and commission income for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June 2013		
	Before significant items	*Significant items*	*After significant items*
		(£millions)	
Fee and commission income:			
On items not at fair value through income or expense	116.0	(94.0)	22.0
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.2	–	0.2
Total fee and commission income	116.2	(94.0)	22.2
Fee and commission expense:			
On items not at fair value through income or expense	34.3	–	34.3
On items at fair value through income or expense	1.9	–	1.9
Total fee and commission expense	36.2	–	36.2
Net fee and commission income	80.0	(94.0)	(14.0)

	For the six months ended 30 June 2012 (unaudited)		
	Before significant items	*Significant items*	*After significant items*
		(£millions)	
Fee and commission income:			
On items not at fair value through income or expense	127.9	(40.0)	87.9
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.1	–	0.1
Total fee and commission income	128.0	(40.0)	88.0
Fee and commission expense:			
On items not at fair value through income or expense	35.0	–	35.0
On items at fair value through income or expense	6.2	–	6.2
Total fee and commission expense	41.2	–	41.2
Net fee and commission income	86.8	(40.0)	46.8

In the six months ended 30 June 2013, net fee and commission income (before significant items) was £80.0 million, a decrease of £6.8 million from net fee and commission income (before significant items) of £86.8 million for the six months ended 30 June 2012.

The Bank's fee and commission income for the six months ended 30 June 2013 was £116.2 million (before significant items), down from £128.0 million for the six months ended 30 June 2012. The primary reason for the reduction in fee and commission income was a reduction in business levels, including as a result of the Bank's decision to stop new lending to larger corporate customers. The significant item for the six months ended 30 June 2013 was provision for potential customer redress of £53.0 million (HY 2012: £40.0 million) relating to past sales of payment protection insurance, £26.0 million (HY 2012: £nil) for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection products, and £15.0 million (HY 2012: £nil) of provisions made for potential customer redress relating to arrears charges.

The table below presents the Bank's operating costs and its components for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June 2013		
	Before significant items	*Significant items*	*After significant items*
		(£millions)	
Staff costs:			
Wages and salaries	93.7	1.2	94.9
Social security costs	7.2	0.4	7.6
Pension costs – defined benefit plans	0.1	–	0.1
Pension costs – defined contribution plans	13.6	0.4	14.0
Other staff costs	16.9	4.3	21.2
Total staff costs	131.5	6.3	137.8
Administrative expenses	158.7	166.8	325.5
Depreciation of property, plant and equipment	6.0	–	6.0
Amortisation of intangible fixed assets	3.0	–	3.0
Impairment of intangible fixed assets	2.0	–	2.0
Profit on sale of property, plant and equipment	–	–	–
Impairment of property, plant and equipment	–	9.9	9.9
Operating lease rentals	15.6	–	15.6
Property provisions for liabilities and charges provided in the period	3.6	–	3.6
Property provisions for liabilities and charges released during the period	(0.4)	–	(0.4)
Other provisions for liabilities and charges provided in the period	–	30.0	30.0
Other provisions for liabilities and charges released during the period	(0.1)	–	(0.1)
Direct expenses from investment properties that generated rental income in the period	1.7	–	1.7
Direct expenses from investment properties that did not generate rental income in the period	0.1	–	0.1
Total operating expenses	321.7	213.0	534.7

	For the six months ended 30 June 2012 (unaudited)		
	Before significant items	Significant items (£millions)	After significant items
Staff costs:			
Wages and salaries	97.3	7.3	104.6
Social security costs	7.5	0.6	8.1
Pension costs – defined benefit plans	0.1	-	0.1
Pension costs – defined contribution plans	18.5	0.7	19.2
Other staff costs	14.7	8.3	23.0
Total staff costs	138.1	16.9	155.0
Administrative expenses	128.9	22.4	151.3
Depreciation of property, plant and equipment	7.8	–	7.8
Amortisation of intangible fixed assets	3.0	–	3.0
Impairment of intangible fixed assets	–	–	–
Profit on sale of property, plant and equipment	(0.4)	–	(0.4)
Impairment of property, plant and equipment	–	–	–
Operating lease rentals	14.7	–	14.7
Property provisions for liabilities and charges provided in the period	1.0	–	1.0
Property provisions for liabilities and charges released during the period	(0.3)	–	(0.3)
Other provisions for liabilities and charges provided in the period	0.1	–	0.1
Other provisions for liabilities and charges released during the period	–	–	–
Direct expenses from investment properties that generated rental income in the period	1.4	–	1.4
Direct expenses from investment properties that did not generate rental income in the period	–	–	–
Total operating expenses	294.3	39.3	333.6

The Bank's relatively high operating costs continue to impact its profitability.

The primary reason for the increase in administrative expenses is increased costs in the running of the Retail segment distribution platform. A significant part of this cost is a one-off provision of £13.9 million relating to a change in ATM rateable values in respect of ATMs situated outside of Co-operative stores. This is an issue which is common across the retail industry.

The significant items for the six months ended 30 June 2013 relate to £14.7 million (HY 2012: £19.3 million) of costs incurred on a programme of investment and integration, £10.0 million (HY 2012: £20.0 million) of costs incurred as a result of the bid for Lloyds' branches, £148.4 million (HY 2012: £nil) of recharged costs relating to impairment of intangible fixed assets, £9.9 million (HY 2012: £nil) of impairment of property, plant and equipment and £30.0 million (HY 2012: £nil) of provisions for potential customer redress relating to the processing of first payments on certain mortgages.

The table below presents the Bank's impairments for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June	
	2013 (audited)	*2012 (unaudited)*
	(£millions)	
Core business:		
Retail banking	24.8	18.2
CABB	140.0	17.5
Treasury/other	0.7	(2.2)
Total core business	165.5	33.5
Non-core business:		
Corporate non-core	293.4	56.9
Other non-core	36.2	1.5
Total non-core business	330.5	58.4
Total impairment losses	496.0	94.6

The Bank's impairment losses for the six months ended 30 June 2013 was £496.0 million up from £94.6 million for the six months ended 30 June 2012. The impairment losses are made up of £165.5 million in the core business (principally retail banking (£24.8 million) and CABB (£140.0 million)) and £330.5 million in the non-core business (non-core corporate £293.4 million and Optimum £36.2 million). These credit impairments are the main driver behind the level of operating loss for the six months ended 30 June 2013.

The impairment losses for the six months ended 30 June 2013 are stated net of a £12.4 million credit fair value unwind. The credit fair value unwind adjustment arose as a result of the merger with Britannia. As at 30 June 2013, the total credit fair value adjustment remaining was £55.2 million.

Segmental analysis

The Bank's business was separated into two business areas: the 'core' business includes the retail, CABB and the Treasury/other segments, while the 'non-core' business comprises the corporate non-core, Optimum (a closed book of predominantly interest-only, intermediary and acquired mortgage book assets) and Illius (the residential property company).

The table below presents the Bank's segmental presentation for the six months ended 30 June 2013 and 2012. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms and internal charges and transfer pricing adjustments have been reflected in each segment.

	For the six months ended 30 June 2013 (audited)							
	Core business				*Non-core business*			
	Retail	*CABB*	*Treasury/ other*	*Total Core*	*Corporate banking*	*Other non-core*	*Total Non-core*	*Total*
				(£ millions)				
Interest margin	203.5	58.4	6.6	268.5	(8.9)	(10.6)	(19.5)	249.0
Non-interest income	65.0	23.8	28.3	117.1	1.0	(11.3)	(10.3)	106.8
Operating income	268.5	82.2	34.9	385.6	(7.9)	(21.9)	(29.8)	355.8
Operating expenses	(242.8)	(43.7)	(16.3)	(302.8)	(2.6)	(12.0)	(14.6)	(317.4)
Impairment losses on loans and advances	(24.8)	(140.0)	(0.7)	(165.5)	(294.3)	(36.2)	(330.5)	(496.0)
Operating profit/(loss)	0.9	(101.5)	17.9	(82.7)	(304.8)	(70.1)	(374.9)	(457.6)

	For the six months ended 30 June 2012 (unaudited)							
	Core business				*Non-core business*			
	Retail	*CABB*	*Treasury/ other*	*Total Core*	*Corporate banking*	*Other non-core*	*Total Non-core*	*Total*
				(£ millions)				
Interest margin	196.6	54.0	7.1	257.7	(11.5)	3.0	(8.5)	249.2
Non-interest income	68.4	32.2	26.0	126.6	1.2	8.1	9.3	135.9
Operating income	265.0	86.2	33.1	384.3	(10.3)	11.1	0.8	385.1
Operating expenses	(214.8)	(38.6)	(13.1)	(266.5)	(2.8)	(12.6)	(15.4)	(281.9)
Impairment losses on loans and advances	(18.2)	(17.5)	(0.5)	(36.2)	(56.9)	(1.5)	(58.4)	(94.6)
Impairment losses on investments	–	–	2.7	2.7	–	–	–	2.7
Operating profit/(loss)	32.0	30.1	22.2	84.3	(70.0)	(3.0)	(73.0)	11.3
Group recharges	(8.2)	(1.1)	(0.3)	(9.6)	(0.1)	(0.4)	(0.5)	(10.1)
Operating profit/(loss) after reallocating group recharges	23.8	29.0	21.9	74.7	(70.1)	(3.4)	(73.5)	1.2

Retail and SME

Retail

The table below presents the retail segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013 (audited)	*2012 (unaudited)*	*Change*
		(£ millions)	
Interest margin	203.5	196.6	6.9
Non-interest income	65.0	68.4	(3.4)
Operating income	268.5	265.0	3.5
Operating expenses	(242.8)	(223.0)	(19.8)
Impairment losses	(24.8)	(18.2)	(6.6)
Operating profit/(loss)	0.9	23.8	(22.9)

The retail operating result for the six months ended 30 June 2013 was a profit of £0.9 million (HY 2012: profit of £23.8 million). Whilst operating income was broadly stable, operating costs have increased by £19.8 million, mainly relating to the running of the distribution platform. A significant part of this cost is one-off in nature, being a provision for additional rates payable on ATMs situated outside stores (£13.9 million), an issue common across the retail banking industry.

There have been further improvements to the credit risk management approach, improving the data on which impairment assessments are made. This is the primary driver behind the increase in retail impairments to £24.8 million for the six-month period ended 30 June 2013 from £18.2 million in the six month period ended 30 June 2012.

Corporate and business banking

The table below presents the Bank's CABB segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013 (audited)	*2012 (unaudited)*	*Change*
		(£ millions)	
Interest margin	58.4	54.0	4.4
Non-interest income	23.8	32.2	(8.4)
Operating income	82.2	86.2	(4.0)
Operating expenses	(43.7)	(39.7)	(4.0)
Impairment losses	(140.0)	(17.5)	(122.5)
Operating profit/(loss)	(101.5)	29.0	(130.5)

The core CABB operation delivered an operating loss of £101.5 million during the six months ended 30 June 2013 (HY 2012: profit of £29 million), reflecting significant impairment of £140.0 million for the six months ended 30 June 2013 (HY 2012: £17.5 million).

Interest margin, at £58.4 million, increased by £4.4 million mainly as a result of improved asset margins partially offset by increased costs of fixed-term deposits. The reduction in non-interest income from £32.2 million for the six months ended 30 June 2012 to £23.8 million for the six months ended 30 June 2013 is due to the decision to stop new lending to larger corporates.

Treasury/other businesses

The table below presents the Bank's treasury operation for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013 (audited)	*2012 (unaudited)*	*Change*
		(£ millions)	
Interest margin	6.6	7.1	(0.5)
Non-interest income	28.3	26.0	2.3
Operating income	34.9	33.1	1.8
Operating expenses	(16.3)	(13.4)	(2.9)
Impairment gains/losses	(0.7)	2.2	(2.9)
Operating profit/(loss)	17.9	21.9	(4.0)

During the six months ended 30 June 2013, significant focus was placed on increasing liquidity whilst at the same time reducing the non-liquidity buffer investment portfolio where strategically appropriate. This resulted in £40.4 million profit from asset sales in the period (HY 2012: £10.7 million). In the six months ended 30 June 2013, the Bank accessed the Bank of England 'Funding for Lending Scheme', drawing £900 million.

Non-core Business

Corporate non-core

The table below presents the corporate non-core segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013 *(audited)*	*2012* *(unaudited)*	*Change*
		(£ millions)	
Interest margin	(8.9)	(11.5)	2.6
Non-interest income	1.0	1.2	(0.2)
Operating income	(7.9)	(10.3)	2.4
Operating expenses	(2.6)	(2.9)	0.3
Impairment losses	(294.3)	(56.9)	(237.4)
Operating profit/(loss)	(304.8)	(70.1)	(234.7)

Corporate non-core operation delivered an operating loss of £304.8 million during the six months ended 30 June 2013 (HY 2012: operating loss of £70.1 million), reflecting significant impairment of £294.3 million for the six months ended 30 June 2013 (HY 2012: £56.9 million).

The table below presents the other non-core segment for the six months ended 30 June 2013 and 2012.

	For the six months ended 30 June		
	2013 *(audited)*	*2012* *(unaudited)*	*Change*
		(£ millions)	
Interest margin	(10.6)	3.0	(13.6)
Non-interest income	(11.3)	8.1	(19.4)
Operating income	(21.9)	11.1	(33.0)
Operating expenses	(12.0)	(13.0)	1.0
Impairment losses	(36.2)	(1.5)	(34.7)
Operating profit/(loss)	(70.1)	(3.4)	(66.7)

Other non-core includes Optimum and Illius. Other non-core delivered an operating loss of £70.1 million during the six months ended 30 June 2013 (HY 2012: operating loss of £3.4 million), reflecting significant impairment of £36.2 million for the six months ended 30 June 2013 (HY 2012: £1.5 million).

The Optimum portfolio delivered a loss of £50.6 million (HY 2012: loss of £2.2 million). This reflected increased provisions for loans both in default and forborne. The loss attributed to the Illius business, a closed residential property portfolio, is £19.6 million (HY 2012: £0.8 million).

Interest margin for other non-core fell from a profit of £3.0 million for the six months ended 30 June 2012 to a loss of £10.6 million for the six months ended 30 June 2013. The main reasons for the fall are payment of 12.5 per cent. interest on cash received through the Calico synthetic securitisation, which payments started in January and totalled £6.3 million in the six months to 30 June 2013), and a provision of £3.6 million which has been raised for potential customer redress. Non-interest income fell from a profit of £8.1 million for the six months ended 30 June 2012 to a loss of £11.3 million for the six months ended 30 June 2013. The primary reason for this is the reduction in the fair value of the Illius portfolio of £18.9 million. The sale profile of these assets has been shortened, and therefore a higher discount factor of 11 per cent. applied to the book, reducing the carrying value.

LIQUIDITY AND FUNDING

Overview

Financial institutions such as the Bank are subject to liquidity risk as an inherent part of their business. Liquidity risk is the risk that an institution may not have sufficient funds at any time to make full payment in respect of liabilities falling due or can only do so at excessive cost.

The Bank raises the majority of its funding through accepting retail and corporate deposits. The Bank also maintains a range of funding programmes (including medium-term note, securitisation and covered bond programmes), targeting wholesale investors. In addition, the Bank maintains a high-quality portfolio of marketable asset pools that it uses for liquidity management within the Treasury operation.

The Bank actively monitors liquidity risk with liquidity risk management, which encompasses survival periods which measure the required liquidity levels of stress scenarios, adherence to regulatory liquidity risk limits and more strategic liquidity risk measures. The strategic measures include:

- Customer loan/deposit ratio, 94 per cent. as at 30 June 2013 (31 December 2012: 92 per cent.) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 29 per cent. as at 30 June 2013 (31 December 2012: 27 per cent.) – the ratio of encumbered assets divided by total assets;
- regulatory limits – Internal Liquidity Guidance and Net Stable Funding Ratio; and
- internal liquidity stress tests – the survival period of the Bank under a range of stressed scenarios.

The Bank monitors its liquidity position on a daily basis and has committees which operate to oversee the operational liquidity management. A range of indicators, details of cash flows and media coverage are monitored to detect early signs of liquidity risk either in the market or specific to the Bank.

From 2009 (following the conclusion of Moody's systemic review of the UK banking sector) until recently the Bank had held a credit rating of A3 from Moody's. On 18 June 2013, Moody's downgraded the Bank's long-term credit rating by four notches to Caa1 from Ba3, reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a six notch downgrade on 9 May 2013 from A3 to Ba3 and the placing of the Bank onto watch for a possible downgrade on 30 July 2012.

In addition, on 20 June 2013, Fitch downgraded the Bank's long-term credit rating by three notches to BB- from BBB-, reflecting concerns regarding the Bank's capital requirements following the announcement of the Recapitalisation Plan. This followed a two notch downgrade on 5 April 2013 from BBB+ to BBB- and a one notch downgrade on 19 July 2012 from A- (which was the long-term rating the Bank had held since 2009) to BBB+.

The following table sets out the Bank's short and long-term credit ratings from Moody's and Fitch.

	Long-Term	*Short-Term*	*Date of last action*
Moody's	Caa1	NP	18 June 2013
Fitch	BB-	B	20 June 2013

The credit rating downgrades have (i) led to sub-investment grade ratings on the Bank's senior debt leading to a significant reduction in the demand for these types of instrument, (ii) negatively impacted the Bank's ability to access short-term unsecured wholesale funding, and (iii) increased the Bank's collateral requirements within some clearing systems.

The credit rating downgrades and, to a lesser extent, the announcement of the Bank's regulatory capital shortfall, its results for the six months ended 30 June 2013, and the continued press attention and speculation to which the Bank is subject have all affected the Bank's funding profile and the cost to it of raising new funding.

Liquidity Portfolio

The Bank monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed and regularly assesses its funding position. This is supported with detailed contingency funding plans and recovery options which are tested and reviewed on a regular basis. The Bank's liquidity management framework is designed in line with the BIPRU regulations and industry guidelines. In the period to 30 June 2013, the Bank has continued to maintain a sufficiently strong liquidity position, with a liquid asset ratio (calculated as liquid asset buffer divided by total assets) of 13.2 per cent. at 30 June 2013 (31 December 2012: 14.6 per cent.). The Bank calculated its total liquidity resources as at 30 June 2013 as £8,971.9 million versus £8,657.7 million as at 31 December 2012. The table below analyses the Bank's liquidity portfolio by product and by liquidity value. Primary liquidity are liquid assets that are eligible under BIPRU 12.7 and secondary liquidity are all other liquid assets (excluding non-buffer assets described below), including self-issued retained securitisations.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Operational balances with Central Banks	5,060.4	5,121.0	(1.2)
Gilts	272.5	664.8	(59.0)
Central government and multilateral development bank bonds	804.7	1,455.1	(44.7)
Total Primary Liquidity	6,137.6	7,240.9	(15.2)
Total Secondary Liquidity	2,834.3	1,416.8	100.0
Total Liquidity	8,971.9	8,657.7	3.6

The Bank uses any combination of these asset pools to manage liquidity, with primary liquidity used predominantly for short term cash flow movements, while secondary liquidity is used for creating longer term or contingent liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools remain sufficiently liquid. The overall quantum of liquidity has remained stable in the first part of 2013, supported by a large reduction in non-buffer assets over the period. The secondary liquidity portfolio has been boosted by an increase in own assets eligible for discounting at central banks.

There has been a substantial reduction in non-buffer assets over the period. This reflects the change in the funding profile as a result of the Bank's rating downgrades. The sale of non-buffer assets has been used to maintain sufficient levels of primary liquidity.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Short term deposits	37.3	38.4	(2.9)
Other public sector securities	3.0	117.5	(97.4)
Floating rate notes	12.2	703.0	(98.3)
Fixed rate bonds	95.7	999.5	(90.4)
Other securities and commodities	40.0	68.8	(41.9)
Total non-buffer assets	188.2	1,927.2	(90.2)

The Bank aims to have sufficient eligible and unencumbered assets available to meet the needs of its secured funding programmes. Details of the Bank's encumbered assets as at 30 June 2013 are shown in note 34d of its Interim Financial Information.

The Bank is also a participant in the Bank of England's sterling monetary framework and, as such and subject to certain eligibility criteria at the Bank of England's discretion (as detailed in Chapter VIII of the

Bank of England's Red Book), the Bank may be granted access to the DWF. The DWF offers liquidity insurance for idiosyncratic as well as system-wide shocks and is a bilateral facility designed to be able to address short-term liquidity shocks without disturbing the Bank of England's incentives for prudent liquidity management. At the Bank of England's discretion, eligible banks may therefore borrow gilts for 30 or 364 days, against a wide range of collateral in return for a fee, which will vary with the collateral used and the size and maturity of the borrowings. The Bank does not currently participate in the DWF scheme.

Retail and commercial funding

The majority of the Bank's funding comes from retail and commercial customer accounts. As at 30 June 2013, the Bank has total customer deposits of £34.9 billion, of which £28.8 billion were retail deposits and £6.1 billion were commercial deposits. The total amount of the Bank's corporate deposits fell by approximately by £1.4 billion in the first half of 2013, which the Bank believes was probably caused by the credit rating downgrade. The retail deposit base has, however, remained broadly stable.

£1.4 billion of outflow in relation to corporate deposits are mainly driven by the credit rating downgrade in the first half of 2013. The run-off of Non-core Assets may allow a reduction in expensive term funding.

The Bank's deposit funding is predominantly denominated in pounds sterling and comprises both fixed and variable rate deposits. As at 30 June 2013, approximately 49 per cent. by principal amount of the Bank's retail deposits were fixed rates of interest and 51 per cent. were variable rates of interest. As at the same date, approximately 37.6 per cent. by principal amount of the Bank's commercial deposits were fixed rates of interest and 62.4 per cent. were variable rates of interest.

The following table sets out the breakdown of the Bank's retail and commercial deposits as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Current accounts:			
Retail	3,450.6	3,276.5	5.3
Corporate	2,410.8	3,066.7	(21.4)
Total current accounts	5,861.4	6,343.2	(7.6)
Instant access savings accounts:			
Retail	7,940.8	8,875.3	(10.5)
Corporate	748.2	877.0	(14.7)
Total instant access savings accounts	8,689.0	9,752.3	(10.9)
Term deposits and bonds:			
Retail	10,310.7	9,900.1	4.1
Corporate	2,959.8	3,615.5	(18.1)
Total term deposits and bonds	13,270.5	13,515.6	(1.8)
Individual savings accounts (ISA):			
Retail – ISA Fixed	3,609.0	3,415.3	5.7
Retail – ISA Demand	2,381.9	2,406.2	(1.0)
Total ISA accounts	5,990.9	5,821.5	2.9
Other deposits	1,110.5	1,339.9	(17.1)
Total customer deposits	34,922.3	36,772.5	(5.0)

The following table sets out the Bank's retail and commercial gross contractual cashflows by residual maturity as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Repayable in less than 1 month	23,463.1	24,172.4	(2.9)
Repayable in less than 3 months	2,295.9	1,924.7	19.3
Repayable between 3 and 12 months	5,014.1	6,648.8	(24.6)
Repayable between 1 and 5 years	5,244.0	4,308.3	21.7
Repayable in more than 5 years	–	–	–
Total	36,017.1	37,054.2	(2.8)

Wholesale funding

The Bank uses wholesale funding 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. The securitisation and covered bond transactions are in the process of being amended due to the downgrades received by the Bank from the rating agencies in the first half of 2013. These proposed amendments relate to the appointment of back up servicing and back up cash management and bank account triggers to accommodate, amongst other things, the latest structured rating agency methodology and changes to the rules relating to direct debits and payment schemes.

The Bank will consider further issuance from these programmes after these modifications are complete and if market conditions permit.

The following table sets out an analysis of the Bank's wholesale funding as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	*As at 31 December 2012*	*Percentage change*
	(£ millions)		*(percentages)*
Preference shares, PSBs and subordinated debt	1,248.1	1,258.6	(0.8)
Secured funding	3,592.3	3,611.0	(0.5)
Repos	3,188.2	2,727.6	16.9
Market borrowing	363.5	1,004.8	(63.8)
MTNs	983.8	982.3	0.2
Total wholesale funding	9,375.9	9,584.3	(2.2)

The credit rating downgrade by the rating agencies in the first half of 2013 has led to sub-investment grade ratings on the Bank's senior debt leading to a significant reduction in the demand for these types of instrument.

Carrying values of debt as at 31 December 2012 and 30 June 2013

The table below provides a breakdown (excluding issue costs, discounts and accrued interest) of the existing tier 1, upper and lower tier 2 securities that will be subject to the Liability Management Exercise, as at 31 December 2012 and 30 June 2013.

	Notional £ thousands	Merger date fair value adjustment £ thousands	Fair value adjustment for hedged risk £ thousands	As at 31 December 2012 £ thousands	Fair value adjustment £ thousands	Currency translation £ thousands	Swap value adjustment £ thousands	As at 30 June 2013 £ thousands
5.56% perpetual subordinated bonds	200,000.0	(64,724.2)	20,973.6	156,249.4	8,410.0	–	(3,785.3)	160,874.1
13% perpetual subordinated bonds	110,000.0	25,877.3	–	135,877.3	(292.0)	–	–	135,585.3
9.25% non-cumulative irredeemable preference shares	60,000.0	–	–	60,000.0	–	–	–	60,000.0
5.875% step up callable subordinated notes 2019	37,775.0	–	–	37,775.0	–	–	–	37,775.0
5.625% fixed rate subordinated notes 2021	8,747.0	–	–	8,747.0	–	–	–	8,747.0
9.25% fixed rate subordinated notes 2021	275,000.0	–	–	275,000.0	–	–	–	275,000.0
5.875% fixed rate subordinated notes 2033	150,000.0	(65,551.7)	40,999.4	125,447.7	862.7	–	(9,271.6)	117,038.8
5.75% fixed rate subordinated notes 2024	200,000.0	(75,089.2)	48,732.0	173,642.8	1,978.0	–	(10,671.4)	164,949.4
7.875% fixed rate subordinated notes 2022	235,402.0	–	–	235,402.0	–	–	–	235,402.0
Floating rate subordinated notes 2016	28,629.4	(6,955.7)	–	21,673.7	880.4	1,348.5	–	23,902.6
Total	**1,305,553.4**	**(186,443.5)**	**110,705.0**	**1,229,814.9**	**11,839.1**	**1,348.5**	**(23,728.3)**	**1,219,274.2**

Notes:

(1) Capitalised amounts of £1.76 million on the 5.875% step up callable subordinated notes 2019 will increase the carrying value of the liability for LME purposes.

(2) Fees paid of £2.4 million relating to the 5.625% fixed rate subordinated notes 2021 will reduce the carrying value of the liability for LME purposes.

(3) The Bank has naturally hedged a proportion of the 28 April 2021 9.25% fixed rate subordinated notes 2021 with liquid bonds which are accounted for as available for sale assets. It is the intention to sell these bonds in the same proportion as the percentage participation of the particular note class in the LME. Most recent market prices indicate a £11 million profit on based on a 100% participation rate in the LME.

(4) The floating rate subordinated notes 2016 issuance is a euro denominated note. The sterling statutory amount is calculated using the spot rate at the end of each presented period.

Notes issued by the Britannia Building Society prior to the 2009 merger were subject to a fair value adjustment at merger date in accordance with IFRS 3 (*Business Combinations*) which continues to unwind on an effective interest rate basis over the expected life of the note at the time of merger. The unamortised amount is shown separately in the table below for each of the notes impacted.

Some liabilities were accounted for as hedge items subject to fair value hedging in accordance with IAS 39 (*Financial instruments: Recognition and measurement*). A fair value adjustment for hedged risk has been added to the pre-hedging carrying value of these liabilities.

The following table sets out the Bank's wholesale funding by maturity as at 30 June 2013 and 31 December 2012.

	As at 30 June 2013	As at 31 December 2012	Percentage change
	(£ millions)		(percentages)
Repayable in less than 1 month	966.8	2,291.0	(57.8)
Repayable in less than 3 months	1,894.1	767.0	146.9
Repayable between 3 and 12 months	300.1	636.1	(52.8)
Repayable between 1 and 5 years	1,427.2	1,071.2	33.2
Repayable in more than 5 years	4,787.7	4,819.1	(0.7)
Total External Funding	9,375.9	9,584.3	(2.2)

Between 30 June 2013 and 30 September 2013, the Bank has raised £1.5 billion of private secured wholesale funding through repurchase transactions and a secured funding facility. As at 30 September 2013, the encumbrance ratio was 29.8 per cent.

See notes 24 and 34 to the Interim Statements for further details of the Bank's wholesale fundings, as at 30 June 2013.

Analysis of cash flow

The following table summarises the Bank's statements of cash flows for each of the six months ended 30 June 2013 and 2012.

	6 months to 30 June 2013	*6 months to 30 June 2012*
	(£ millions)	
Net cash flows from operating activities	(1,978.9)	(1654.5)
Net cash flows from investing activities	1,842.2	(194.2)
Net cash flows from financing activities	(47.2)	(51.2)
Net decrease in cash	(183.9)	(1,899.9)
Cash and cash equivalents at the start of the period	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,130.3	5,988.5

Net cash outflows from operating activities for the six months ended 30 June 2013 were £1,978.9 million compared to a net cash outflow from operating activities for the six months ended 30 June 2012 of £1,654.5 million. The main reason for the net cash outflow is the decrease in customer accounts and capital bonds of £1,850.1 million together with a reduction in net derivative balances of £326.7 million.

Net cash flows from investing activities for the six months ended 30 June 2013 were an inflow of £1,842.2 million, compared to a net cash outflow from investing activities for the six months ended 30 June 2012 of £194.2 million. The net cash flow of £1,842.2 million in investing activities is as a result of the net movement in Treasury investment securities, being approximately £2 billion of new securities purchased and the proceeds of approximately £3.9 billion of securities sold during the period (see "*Liquidity and Funding*" in this Section 12 (*Operating and Financial Review*) for further explanation of underlying trends).

Net cash outflows from financing activities for the six months ended 30 June 2013 were £47.2 million compared to a net cash outflow from financing activities for the six months ended 30 June 2012 of £51.2 million. The main component of the financing net cash flows is the interest paid on other borrowed funds of £44.3 million.

CONTRACTUAL COMMITMENTS

For details of the amounts of certain of the Bank's financial and other contractual liabilities and when payments are due, without taking into account customer deposits and deposits by other financial institutions, see note 30 to the Interim Financial Information.

OFF-BALANCE SHEET ARRANGEMENTS

In the ordinary course of business, the Bank issues guarantees and letters of credit on behalf of customers. These include:

- Cheque guarantees – It is normal in the UK to issue cheque guarantee cards to current account customers holding chequebooks as historically retailers did not generally accept cheques without such form of guarantee. The issuing bank is liable to honour the cheque, if the cheque guarantee card is shown to the retailer, even when the customer does not have sufficient funds in deposit. The Bank's liability is, in theory, the total guarantee on each card multiplied by the number of cheques with retailers not yet presented to the Bank and as such is unquantifiable. Following a decline in the use of cheques– the UK Payments Council agreed to a UK-industry-wide withdrawal from the use of cheques from 30 June 2011, and therefore the Bank has been phasing out the cheque guarantee cards since that date; therefore the quantum of this guarantee has been reducing.

- The Bank issues letters of credit as part of its normal course of business. Letters of credit are common documents used in trade that are issued by the Bank and that guarantee payment to a third party provided certain documents have been presented to the Bank. The letter of credit serves as a guarantee to the seller that it will be paid by the Bank regardless of whether the Bank's customer ultimately fails to pay. The credit risk associated with these guarantees are considered within the Bank's usual credit monitoring and provisioning processes.

Other off-balance sheet exposures include: the undrawn portion of a loan commitment or credit cards; assets pledged as collateral under Treasury repurchase agreements with other banks; and commitments under operating leases. The details of these exposures are shown in note 30 to the Interim Financial Information.

In addition, the Bank has provided guarantees in respect of:

- The Britannia Scheme – Following the merger with Britannia, the Britannia Scheme transferred to CFSMS. Under the terms of this transfer, the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the pension scheme should CFSMS be unable to meet its obligations as they fall due; and
- Intra-group guarantee – The Bank has an indemnification agreement, accounted for as a guarantee, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expenses arising from the agreement.

Save as described above, the Bank did not have any material off-balance sheet transactions during the six months ended 30 June 2013.

RELATED PARTY TRANSACTIONS

For a description of the Bank's related party transactions, see paragraph 22 titled "*Related Party Transactions*" in Section 20 (*Additional Information*).

ACCOUNTING POLICIES, JUDGEMENTS AND CRITICAL ESTIMATES

For details of the accounting policies used by the Bank, see note 1 to the Interim Financial Information.

In preparing the Bank's financial statements, the Bank is required to make certain judgements and estimates. These affect the reported amounts of the Bank's assets and liabilities, including disclosure of contingent assets and liabilities, at the date of the financial statements as well as the reported amounts of its revenues and expenses during the periods presented. The Bank bases its estimates and assumptions on historical experience and other factors that it believes to be reasonable at the time the estimates and assumptions are made and evaluates the estimates and assumptions on an on-going basis. However, future events and their effects cannot be predicted with certainty and the determination of appropriate estimates and assumptions requires the use of judgement. Actual outcomes may differ from any estimates or assumptions made and such differences may be material to the financial statements.

Whilst there have been no changes in accounting policies in the six months to 30 June 2013, certain methods of computation and presentation have been adopted by the Bank in the preparation of its Interim Financial Information which the Bank currently expects to adopt in its 2013 financial statements. In particular IFRS 13, 'Fair value measurement', is effective from 1 January 2013 and additional fair value disclosures have been included but have not had a material impact on the financial statements. Significant additions and changes to underlying methodologies are discussed within the critical judgements and estimates section on pages 305 to 309 of the Interim Financial Information. In addition, the 2012 comparatives have been represented for the cash flow statement and the deferred tax asset/liability presentation. Further detail is provided on the cash flow statement and in note 28 respectively to the Interim Financial Information.

For a discussion of the most significant areas where judgements and estimates are made in the preparation of the Bank's financial statements, see pages 305 to 309 to the Interim Financial Information.

DISCLOSURES ABOUT RISK

For a discussion of the Bank's risk management activities, see Section 14 (*Risk Management*).

13

CAPITAL ADEQUACY

CAPITAL ADEQUACY

1. OVERVIEW OF BANK'S CAPITAL POLICY

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 (see the paragraph titled "*Recapitalisation Plan*" below).

The Bank is required to manage its capital in accordance with prudential rules issued by the PRA, and from 1 January 2008 the Bank has been subject to rules which implement the EU Capital Requirements Directive (which implements **Basel II**).

The FSA (as it was then known) granted approval to the Bank for the use of the IRB approach, effective from 1 January 2008, and as part of the merger with Britannia (see paragraph 4 titled "*History and Development of the Bank*" in Section 8 (*Description of the Bank*) approved the transfer of IRB permissions from Britannia to the Bank.

On 21 June 2013 the European Council approved new capital reforms (the PRR and PRD), which implemented Basel III in Europe. The PRR and the PRD entered into force on 17 July 2013. The objective of the reform package is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress, thus reducing the risk of spill-over from the financial sector into the real economy. The PRR and PRD will apply on a transitional basis from 1 January 2014 and will be phased in over a period of time, to be fully effective by 2019.

The actual impact of the PRR and PRD on capital ratios is also dependent on the related EBA technical standards and the PRA's approach to implementation in those areas for which it is responsible. The PRA published its consultation paper, "*Strengthening Capital Standards: Implementing CRD IV – CP5/13*", on the changes to the PRA's rules to implement the PRD and relevant discretions provided in the PRR, on 2 August 2013. The consultation period ended on 2 October 2013.

The Bank also monitors its capital position under the forthcoming Basel III requirements. Under the above-mentioned PRA consultation, the PRA proposes that the definition of Common Equity Tier 1 (**CET1**) capital will require capital deductions and amendments to prudential filters to apply fully from 1 January 2014, rather than on a transitional basis. However, the disclosures on the Bank's capital resources in this section are produced in line with PRA requirements issued before the consultation on CRD IV and do not include these proposed amendments to the transitional period (see "*The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements*" in Section 2 (*Risk Factors*) and Section 17 (*Supervision and Regulation*).

The Bank's Basel II regulatory capital is analysed in two tiers:

Tier 1 Capital:

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

Tier 2 capital:

Tier 2 Capital includes subordinated debt issues and perpetual subordinated bonds (**PSBs**). The rights of payment to the holders of this debt are subordinated to the claims of depositors and other creditors of the Bank. More information on these can be found in Note 24 to the Interim Financial Information (see "*Part A*" in Section 16 (*Financial Information*)).

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

Regulatory adjustments

Intangible assets are deducted from Core Tier 1 Capital. Under the IRB approach presently provided for in Part 4 of the PRA's Prudential Sourcebook for Banks, Building Societies and Investment Firms (**BIPRU**), which forms part of the Financial Services Handbook, a deduction is made for expected losses in excess of impairment. Of this, 50 per cent. is deducted from Core Tier 1 Capital net of tax and 50 per cent. from tier 2 capital gross of tax. Other Core Tier 1 Capital is adjusted by the remaining 50 per cent. tax on the excess of expected losses over impairment. Further adjustments are explained within the appropriate footnote in "*Table 2: Basel II capital resources*" below.

2. RECAPITALISATION PLAN

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the PRA, it was stated in the June Announcement that the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion, of which at least £1 billion is expected to be contributed pursuant to the Liability Management Exercise in 2013 and, conditional on completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 Capital is to be contributed by Banking Group in 2014 pursuant to the 2014 Commitment of which £170 million must be satisfied at the latest by 30 June 2014 (with £70 million of this contribution to be paid before 31 January 2014), and the remaining £163 million by 31 December 2014).

The Liability Management Exercise is intended to generate at least £1 billion of the £1.5 billion of Common Equity Tier 1 Capital required by the Bank. The Liability Management Exercise will generate Common Equity Tier 1 Capital in two ways:

- first, to the extent that the Bank exchanges Dated Notes for New Ordinary Shares and issues Additional New Ordinary Shares pursuant to the Scheme, the amount of such New Ordinary Shares and Additional New Ordinary Shares issued will constitute Common Equity Tier 1 Capital for the Bank; and
- second, to the extent that Existing Securities are exchanged or issued for New Securities at a discount to the Bank's book value of those Existing Securities (i.e. by imposing a discount on the Existing Securities through the Liability Management Exercise), the amount of that discount will also be recognisable as Common Equity Tier 1 Capital (on the basis that the Bank will reduce a liability for less than the book value of that liability in the Bank's accounts).

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the **Exchange Offers**) and certain proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the **Proposals**). The offer in respect of the Dated Notes is being conducted by way of the Scheme. The Liability Management Exercise will only be successfully completed if the entire principal amount of the Existing Securities are exchanged or sold pursuant to the Liability Management Exercise.

The Scheme will also provide 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription on the terms of the Scheme as described in the Explanatory Statement (the **Additional New Ordinary Shares Offer**).

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this Prospectus as the Liability Management Exercise. In addition, as part of the Liability Management Exercise, a proportion of the New Ordinary Shares issued in exchange for Existing Securities will be delivered to Co-operative Group in exchange for the issue by Cooperative Group to the Holders of certain of the Existing Securities (being Preference Shares and 13% Bonds) of a Final Repayment Notes and/or Instalment Repayment Notes (the Group Notes). Each such Holder will have the opportunity to choose whether it would prefer to receive Final Repayment Notes and/or Instalment Repayment Notes (if the Liability Management Exercise is successfully completed) or a combination of the two, each to be issued by Co-operative Group pursuant to the Group Notes.

In addition, the Bank expects that capital created through interest savings on the Existing Securities surrendered in the Liability Management Exercise net of any coupon payments on the New Securities should contribute an additional amount of Common Equity Tier 1 Capital towards the Recapitalisation Plan, beyond that created as a result of the Liability Management Exercise. The Bank currently estimates that net interest savings should result in allowable Common Equity Tier 1 Capital in the region of £40 million during the course of 2014.

Under the Recapitalisation Plan, Banking Group has agreed to contribute £333 million of Common Equity Tier 1 Capital during 2014 (the **2014 Commitment**). On 4 November 2013 (being the date of the launch of the Recapitalisation Plan), Banking Group entered into a legally binding and irrevocable undertaking to pay (the **Undertaking to Pay**) in favour of the Bank in consideration for the issuance of 54,058,442 New Ordinary Shares immediately following the completion of the Liability Management Exercise (the **2014 Commitment Agreement**). Banking Group's obligations under the 2014 Commitment and the Undertaking to Pay are conditional only upon the successful completion of the Liability Management Exercise.

The Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities are together referred to in this Prospectus as the **Recapitalisation Plan**.

For further details of the 2014 Commitment, see the paragraph titled "*The Recapitalisation Plan*" in Section 12 (*Operating and Financial Review*) above.

Assuming the Liability Management Exercise is completed and therefore at least £1 billion of Common Equity Tier 1 Capital is raised in respect of the Exchange Offers, Proposals and the Scheme, and £125 million is in 2013 raised pursuant to the Additional New Ordinary Shares Offer under the Scheme, the Bank expects to report, for the end of 2013, a Common Equity Tier 1 Capital ratio towards the upper end of previously announced guidance, on 29 August 2013, of "below 9% but above the regulatory minimum requirement". Taking into account the benefit of the additional Common Equity Tier 1 Capital to be provided by Banking Group to satisfy the 2014 Commitment and a reduction in RWAs, partially offset by expected losses in the Bank in 2014, it is currently expected that the Bank's Common Equity Tier 1 Capital ratio will remain broadly stable, improving only modestly from this level in the coming years. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

These components are expected to strengthen the capital position of the Bank, reduce the interest and dividend burden, and reduce costs through business simplification and improvements in operating efficiency, in particular to the Bank's existing IT platform.

On 29 August 2013 the Bank published its interim results for the six months ended 30 June 2013. The interim results showed a loss before taxation of £709.4 million, which was impacted by significant impairment charges of £496.0 million.

Significant credit impairments in 2013 were noted by the Bank in the announcement of the Recapitalisation Plan on 17 June 2013 and were factored into the Recapitalisation Plan. On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion.

3. OVERVIEW OF BANK'S CAPITAL RESOURCES UNDER BASEL II

Table 1 – Basel II capital ratios and risk weighted assets

	30 June 2013	*31 December 2012*
	(£millions, except for percentages)	
Capital ratios		
Core Tier 1 ratio	4.9%	8.8%
Tier 1 ratio	5.4%	9.4%
Total capital ratio	9.5%	14.4%
Risk-weighted assets		
Credit risk	14,758.0	15,974.8
Market and counterparty risk	2.1	492.6
Operational risk	1,255.2	1,441.3
Total risk-weighted assets	16,015.3	17,908.7
Segmental analysis of credit risk risk-weighted assets		
Core		
Retail	2,384.7	2,410.1
CABB core	5,396.0	6,081.9
Treasury/other	1,511.8	1,443.2
	9,292.5	9,935.2
Non-core		
Corporate	1,469.6	1,678.4
Other	3,995.9	4,361.2
	5,465.5	6,039.6
Total credit risk risk-weighted assets	14,758.0	15,974.8

Table 1 provides the risk-weighted assets of the Core Business, subdivided into its various businesses as at 30 June 2013. The measure of the Bank's total risk-weighted assets is used in determining the Bank's capital requirements.

The Bank's Core Tier 1 Capital ratio at 30 June 2013 was 4.9 per cent., a decrease of 3.9 percentage points from 8.8 per cent. as at 31 December 2012. This was due to a 50 per cent. (£779.5 million) decrease in Core Tier 1 Capital after regulatory adjustments offset by an 11 per cent. (£1,893.4 million) decrease in total risk weighted assets.

The reduction in Core Tier 1 Capital was primarily due to the statutory loss of £811.4 million before tax and £772.0 million after tax.

The reduction in risk-weighted assets for the six months ended 30 June 2013 was primarily due to a 12 per cent. (£894.7 million) reduction in total risk weighted assets for CABB core and non-core corporate. Slotting models are used by the Bank to analyse and monitor specialised lending exposures to property, which are assigned to PRA supervisory categories with predefined risk weights. A significant proportion of loans were downgraded with many moving into default. Loans in default have a zero risk weight (but a 50 per cent. expected loss). Movement to default was the primary reason for the reduction in corporate risk weighted assets.

In addition, other non-core risk-weighted assets have decreased by 8 per cent. (£365.3 million). On 28 January 2013, the Bank entered into a transaction to transfer a mezzanine portion of the risk in a portfolio of residential mortgage loans to third party investors, via a special purpose vehicle, Calico Finance Number One Limited. As a result of this transaction, risk-weighted assets reduced by c£1.2 billion. An exercise to review the risk weightings of assets at 30 June 2013 increased risk-weighted assets by c£1.0 billion. In spite of this, Optimum risk-weighted assets have decreased by 5 per cent. (c £200 million) due to on-going reduction in arrears and the continued run-off of the book.

For the six months ended 30 June 2013, market and counterparty risk-weighted assets have also decreased by £490.5 million due to the sale of the Bank's held-for-trading assets.

For the six months ended 30 June 2013, total excess of expected loss over impairment, a deduction from capital resources, decreased by £269.8 million. Credit impairments increased significantly, partially offset by a higher expected loss driven by corporate downgrades.

Table 2 – Basel II capital resources

	30 June 2013	*31 December 2012*
	(£millions, except for percentages)	
Core Tier 1 Capital before regulatory adjustments:		
Permanent share capital	410.0	410.0
Retained earnings	1,304.1	1,813.4
Minority interests(1)	32.8	32.0
Losses for the year/period	(772.0)	(508.1)
Share premium account	8.8	8.8
Total Core Tier 1 Capital before regulatory adjustments	983.7	1,756.1
Regulatory adjustments from Core Tier 1 Capital:		
Intangible assets(2)	(115.6)	(27.9)
50% of excess of expected losses over impairment (net of tax)(3)	(58.8)	(159.7)
50% of securitisation positions(3)	(21.0)	(0.7)
Total Core Tier 1 Capital after regulatory adjustments	788.3	1,567.8
Other Tier 1 Capital:		
Non-cumulative irredeemable preference shares	60.0	60.0
Regulatory adjustments from other Tier 1 Capital:		
50% of tax on excess of expected losses over impairment(3)	17.8	51.8
50% of material holdings	(2.2)	(2.0)
Total Tier 1 Capital after regulatory adjustments	863.9	1,677.6
Tier 2 Capital before regulatory adjustments:		
Revaluation reserves	2.0	2.0
Collective provisions	0.9	0.7
Subordinated notes and perpetual subordinated bonds(4)	1,116.8	1,112.1
Excess on limits for lower Tier 2 Capital(5)	(361.7)	–
Total Tier 2 Capital before regulatory adjustments	758.0	1,114.8
Regulatory adjustments from Tier 2 Capital:		
50% of excess of expected losses over impairment (gross of tax)(3)	(76.6)	(211.5)
50% of securitisation positions(3)	(21.0)	(0.7)
50% of material holdings	(2.2)	(2.0)
Total Tier 2 Capital after regulatory deductions	658.2	900.6
Total capital resources	1,522.1	2,578.2

Notes:

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

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

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

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

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

The Bank contracts with CFSMS to build certain assets, including IT developments. Whilst these intangible assets are on the balance sheet of CFSMS, at 30 June 2013 the share attributable to the Bank has been deducted from the Bank's capital resources. The £115.6 million includes £91.8 million of intangibles included on the CFSMS balance sheet. This is in line with the Bank's regulatory reporting to the PRA.

Approximately £361.7 million of lower Tier 2 Capital was ineligible at 30 June 2013 due to gearing rules, as lower Tier 2 Capital cannot exceed 50 per cent. of Tier 1 Capital after deductions.

Capital allocation

The allocation of capital among specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO.

Table 3 – Basel II capital resources movement between 31 December 2012 and 30 June 2013

	(£millions)
Core Tier 1 Capital after regulatory adjustments as at 31 December 2012	1,567.8
Retained earnings	(1.2)
Minority interests	0.8
Losses for the period	(772.0)
Intangible assets	(87.7)
50% of excess of expected losses over impairment (net of tax)	100.9
50% of securitisation positions	(20.3)
Core Tier 1 Capital after regulatory adjustments as at 30 June 2013	788.3
Other Tier 1 Capital as at 31 December 2012	109.8
50% of tax on excess of expected losses over impairment	(34.0)
50% of material holdings	(0.2)
Other Tier 1 Capital after regulatory adjustments as at 30 June 2013	75.6
Total Tier 1 Capital after regulatory adjustments as at 30 June 2013	863.9
Tier 2 Capital after regulatory adjustments as at 31 December 2012	900.6
Collective provisions	0.2
Subordinated notes and perpetual subordinated bonds	4.7
Excess on limits for lower Tier 2 capital	(361.7)
50% of excess of expected losses over impairment (gross of tax)	134.9
50% of securitisation positions	(20.3)
50% of material holdings	(0.2)
Tier 2 Capital after regulatory adjustments as at 30 June 2013	658.2
Total capital resources as at 30 June 2013	1,522.1

Total capital resources decreased by £1,056.1 million over the period to £1,522.1 million as at 30 June 2013. Core Tier 1 Capital fell by £779.5 million partially due to the statutory loss of £811.4 million before tax and £772.0 million after tax.

Total excess expected loss over impairment provisions deduction (gross of tax) decreased by £269.8 million, primarily driven by an additional £279.2 million of provisions within the period.

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

Approximately £361.7 million of lower Tier 2 Capital was ineligible at 30 June 2013 due to gearing rules, as lower Tier 2 Capital cannot exceed 50 per cent. of Tier 1 Capital after deductions.

4. OVERVIEW OF BANK'S CAPITAL POSITION (CALCULATED IN ACCORDANCE WITH BASEL III)

The Bank also monitors its capital position under forthcoming Basel III requirements. These requirements (under the PRR and PRD) entered into force within the EU on 17 July 2013, but will apply to the Bank from 1 January 2014, with such application being on a transitional basis and in the case of the PRD subject to implementation by the PRA (see paragraph 2.3 titled "*Capital adequacy*" in Section 17 (*Supervision and Regulation*). During the transitional period to full implementation of Basel III, the Bank will have the opportunity to generate additional capital from earnings and to implement management actions in order to mitigate the impact of Basel III and meet target capital ratios.

Table 5 below shows the capital resources of the Bank as at 30 June 2013 and 31 December 2012 using transitional and final Basel III rules. For June 2013, year 1 transitional rules are based on 2014 percentages. For December 2012, year 1 transitional rules are based on 2013 percentages. As a result grandfathering percentages applied to Additional Tier 1 (**AT1**) and Tier 2 (**T2**) capital instruments are 80 per cent. in June 2013 and 90 per cent. in December 2012. In addition transitional percentages applied to regulatory adjustments are 20 per cent. in June 2013 and 0 per cent. in December 2012. Tier 2 capital as at 31 December has been restated such that those instruments which do not have an incentive to redeem remain eligible under Basel III.

Table 5 below is based on the reporting template in Annex VI of the "*EBA Consultation Paper on Draft Implementing Technical Standards on Disclosure for Own Funds by institutions*" (EBA/CP/2012/04), 7 June 2012. It has been completed according to the regulations as stated in the PRR along with the PRA's public statement CRD IV transitional provisions on capital resources. For clarity, only those parts of the table with relevance to the Bank are shown.

Note that the capital instruments included in Table 5 below are subject to the Liability Management Exercise. The Recapitalisation Plan will enable the Bank to improve its capital position and generate additional Common Equity Tier 1 Capital.

The leverage ratio as at 30 June 2013 and 31 December 2012, based on final Basel III rules, is 1.07 per cent. and 2.26 per cent. respectively. The leverage ratio is calculated as Basel III Tier 1 Capital after deductions divided by adjusted balance sheet exposure. Exposure is calculated using instructions for Basel III Quantitative Impact Studies (which are the results of the Basel Committee's Basel III monitory exercise published on 20 September 2012) and related frequently asked questions. Derivative balances are adjusted to reflect the exposure used for capital purposes, off-balance sheet commitments are added and some deductions from Tier 1 are also deducted from the exposure. The Bank expects to achieve a leverage ratio above the regulatory minimum by the end of 2014.

Table 4 – Basel III capital ratios and risk weighted assets

	30 June 2013	*31 December 2012*
	(£millions, except for percentages)	
Capital ratios		
Common Equity Tier 1 ratio	3.0%	6.3%
Tier 1 ratio	3.0%	6.3%
Total capital ratio	7.3%	10.3%
Basel II risk-weighted assets	16,015.3	17,908.7
Securitisations risk-weighted at 1250%	525.8	17.2
Credit valuation adjustment	431.0	397.5
Asset value correlation	379.1	431.5
Deferred tax assets	142.2	77.5
Other	10.7	9.9
Basel III risk-weighted assets	17,504.1	18,842.3

Table 5 – Capital resources of the Bank for the half year ended 30 June 2013 and the year ended 31 December 2012 on a Basel III basis

	Year 1 Basel III transitional rules (30 June 2013)	*Basel III final rules (30 June 2013)*	*Year 1 Basel III transitional rules (31 December 2012)*	*Basel III final rules (31 December 2012)*
		(£millions)		
Common Equity Tier 1 Capital: instruments and reserves				
Permanent share capital and the related share premium account	418.8	418.8	418.8	418.8
Retained earnings	1,304.1	1,304.1	1,813.4	1,813.4
Available for sale and cash flow hedge reserves	30.8	30.8	93.7	93.7
Minority Interests[(1)]	28.7	12.1	32.0	11.5
Common Equity Tier 1 (CET1) capital before regulatory adjustments	1,782.4	1,765.8	2,357.9	2,337.4

	Year 1 Basel III transitional rules (30 June 2013)	Basel III final rules (30 June 2013)	Year 1 Basel III transitional rules (31 December 2012)	Basel III final rules (31 December 2012)
		(£millions)		
Common Equity Tier 1 (CET1) capital: regulatory adjustments				
Prudential valuation in trading book	(5.0)	(5.0)	(7.0)	(7.0)
Intangible assets (net of related tax liability)[2]	(23.1)	(115.6)	–	(27.9)
Deferred tax assets not arising from temporary differences[3]	–	–	(1.4)	(14.1)
Cash flow hedge reserves	(24.9)	(24.9)	(63.7)	(63.7)
Expected loss shortfall[4]	(55.9)	(279.5)	–	(537.4)
Securitisation positions treated as deduction[5]	–	–	–	–
Deferred tax assets arising from temporary difference (exceeding thresholds)	(29.5)	(46.6)	–	–
Losses for the period	(772.0)	(772.0)	(508.1)	(508.1)
Filter for unrealised gains on debt instruments held in the available for sale category[6]	(3.9)	–	(27.9)	–
Unrealised gains or losses on available for sale assets (revaluation reserve)[6]	(2.0)	–	(2.0)	–
Qualifying AT1 deductions that exceed AT1 capital[7]	(155.8)	–	(242.6)	–
Total regulatory adjustments to Common Equity Tier 1 (CET1)	(1,072.1)	(1,243.6)	(852.7)	(1,158.2)
Common Equity Tier 1 (CET1) capital	710.3	522.3	1,505.2	1,179.2
Additional Tier 1 (AT1) capital: instruments				
Perpetual non-cumulative preference shares[8]	48.0	–	54.0	–
Minority interest[1]	0.5	2.6	–	2.5
Additional Tier 1 (AT1) capital before regulatory adjustments	48.5	2.6	54.0	2.5
Additional Tier 1 (AT1) capital: regulatory adjustments				
Intangible assets[2]	(92.5)	–	(27.9)	–
Expected loss shortfall (half)[4]	(111.8)	–	(268.7)	–
Total regulatory adjustments to Additional Tier 1 (AT1) capital	(204.3)	–	(296.6)	–
AT1 adjustments in excess of AT1 capital[7]	155.8	–	242.6	–
Additional Tier 1 (AT1) capital	–	2.6	–	2.5
Tier 1 Capital (T1 = CET1 + AT1)	710.3	524.9	1,505.2	1,181.7

	Year 1 Basel III transitional rules (30 June 2013)	Basel III final rules (30 June 2013)	Year 1 Basel III transitional rules (31 December 2012)	Basel III final rules (31 December 2012)
		(£millions)		
Tier 2 (T2) capital: instruments and provisions				
Capital instruments[9]	1,120.4	747.2	1,119.8	747.3
Minority interests[1]	0.7	3.5	-	3.4
Collective provisions	0.9	0.9	0.7	0.7
Tier 2 (T2) capital before regulatory adjustments	1,122.0	751.6	1,120.5	751.4
Tier 2 (T2) capital: regulatory adjustments				
Expected loss shortfall[4]	(111.8)	-	(268.7)	-
Revaluation reserves[6]	2.0	-	2.0	-
Total regulatory adjustments to Tier 2 (T2) capital	(109.8)	-	(266.7)	-
Tier 2 (T2) capital	1,012.2	751.6	853.8	751.4
Total capital (TC = T1 + T2)	1,722.5	1,276.5	2,359.0	1,933.1

Notes:

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

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

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

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

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

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

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

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

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

5. LEVERAGE RATIO

Under final Basel III rules, the leverage ratio as at 30 June 2013 is 1.07 per cent., based on an adjusted balance sheet exposure of £49,056.7 million and Tier 1 capital of £524.9 million.

14
RISK MANAGEMENT

RISK MANAGEMENT

1. OVERVIEW

The Bank acknowledges that, as a provider of banking and financial services, all of its business activities involve the management of risk. The Bank seeks to appropriately manage the risks that arise from those activities through the Bank's risk management framework (the **Risk Management Framework**). The Risk Management Framework is a hierarchy of strategies, policies and standards which are designed to support the Bank's risk-based decision-making and comprises six components:

- a risk strategy;
- a risk management framework policy (the **Risk Management Framework Policy**);
- a risk appetite statement;
- risk policies in respect of the Bank's Principal Risks, as defined below;
- control standards; and
- business unit operating procedures.

Listed below are the ten principal risks which are the key financial and non-financial risks to which the Bank is exposed and which it seeks to address through specific risk policies (the **Principal Risks**):

- Credit risk;
- People risk;
- Liquidity and funding risk;
- Market risk (including interest rate risk);
- Reputational risk;
- Pension risk;
- Strategic and business risk;
- Regulatory risk;
- Conduct risk; and
- Operational risk (including change risk).

2. THE RISK MANAGEMENT FRAMEWORK

2.1 The Risk Management Strategy

The Bank's overall risk strategy is described in its risk management strategy. The 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 (as summarised above); and
- risk management principles that must be followed across the Bank in order to achieve those strategic goals.

2.2 Risk Management Principles

To achieve the strategic goals, the following principles must be followed across the organisation:

- the Board requires the business to be managed in line with the risk strategy which sets out to realise 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 operating within these limits and an effective risk culture must be in place so these limits are adhered to;
- an independent review and challenge is provided by the CRO who is supported by an appropriate governance structure to ensure effective implementation of the agreed risk management framework;
- The Bank operates a "three lines of defence" governance model to ensure appropriate responsibility and accountability are maintained 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**).
    - the Bank's internal audit function acts as the third line of defence. They are responsible for independently verifying that the principal risk control framework has been implemented as intended across the business, and independently challenge the overall management of the framework to provide assurance to the Audit Committee and senior management on the adequacy of both the first and second lines.
- identified, emerging or current risks should be actively managed in line with the Bank's approach for identification, measurement, management, monitoring and reporting. Identification should be forward-looking to allow management to take a pro-active approach to risk management;
- the business is managed such that it is confident of weathering extreme but plausible stress scenarios and uses stress testing to demonstrate that it is able to withstand these shocks;
- management monitor the aggregated risk profile of the Bank and its regulated entities and review trends which are reported to the Board and externally to regulators to meet external obligations; and
- high quality risk management techniques are adopted across the business and the use of these should be evidenced through documentation and self-certification.

2.3 The Development of the Bank's Risk Management Framework

Until September 2013, Banking Group maintained a common governance, organisational and risk management structure, which had been developed and implemented across the subsidiaries of

Banking Group. As such, historically, the board of directors of Banking Group has been responsible for approving the corporate governance and risk strategy applicable to the Bank.

From September 2013, and as a result of the separation of the Bank from Co-operative Group, the Bank has put in place its own revised, updated and independent risk management framework. The revised and updated risk management framework and policies have been adopted by the Bank, however, these policies will take time to be embedded within individual business units, in particular in relation to awareness of responsibilities. The Bank's new risk management framework reflects the previous system in many respects, but it continues to be refined to meet the Bank's specific requirements. Whilst the revised overall risk management framework (and supporting documented risk policies) adheres to a clear three lines of defence model, there are still occasions where the first and second lines are blurred and improvements are still required to be made to the third line of defence, in particular improving the capability of the internal audit team.

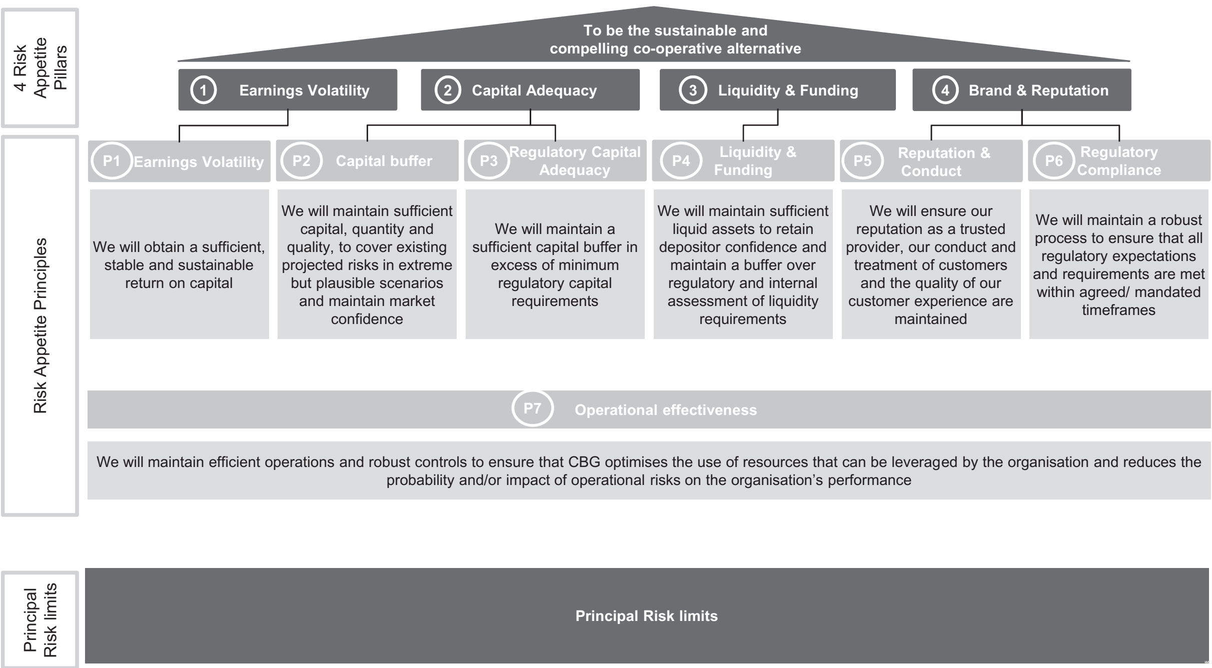
As a result of the new risk management framework, the Bank is now solely responsible for determining its principal risks and the level of acceptable risks as stipulated in the Bank's risk appetite statement, as well as for ensuring that there is an adequate system of risk management and that the levels of capital and liquidity held are consistent with the risk profile of the business.

The "three lines of defence" governance model previously adopted by the board of directors of Banking Group has also been replicated by the Bank to ensure appropriate responsibility and accountability is allocated to the management (see paragraph 2.2 titled "*Risk Management Principles*" above).

2.4 The Risk Appetite Framework

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 Chief Executive Officer (**CEO**). The CEO uses the Executive Committee (**ExCo**) governance structure to assist in consideration, review and setting of these more detailed risk appetite limits and tolerances.

The Bank's seven risk management principles are summarised in the following diagram:



The Bank's risk appetite framework encompasses seven key principles which are earnings volatility, capital buffer, regulatory capital adequacy, liquidity and funding, reputation and conduct, regulatory compliance and operational effectiveness.

Each of the seven risk appetite principles 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 process is aligned to the annual planning cycle and accordingly, the tolerances for each of the risk appetite measures have been recalibrated based on the plan for board approval, including a refresh of some measures. The framework is being developed to incorporate the plans for each of the Core and Non-core Businesses.

3. THE BANK'S PRINCIPAL RISKS

The Principal Risks are the key financial and non-financial risks to which the Bank is exposed and the Principal Risk policies provide the Bank with guidance on how to achieve strategic objectives whilst managing risk within defined risk appetite tolerances.

The ten Principal Risks cover the inherent risks faced by the Bank. Materialisation of any one of the Principal Risks can potentially impact the Bank's reputation, brand and ability to achieve its strategic objectives.

The risk categories outlined in the Risk Management Framework are described below. Each of these apply to the Bank, including its divisions and subsidiaries.

Risk category	*Definition*
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 borrowers failure to perform as agreed.
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).
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.
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.
Reputation risk	The risk associated with an issue which could in some way be damaging to the brand of the Bank or to Co-operative Group, including issues arising as a result of the Bank's strategic decisions or business performance, operational failure, or external perception.
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.
People risk	The risk characterised by individuals being engaged by other members of Co-operative Group, senior management being on

	contracts for services with other members of Co-operative Group, an inability to attract and retain sufficiently qualified employees, unduly high employee turnover, loss of key staff, lack of succession planning and staff development, and indicators of behaviours which are not compliant with the Bank's values.
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.
Conduct risk	The risk that the Bank's behaviour, offerings or interactions will result in unfair outcomes for customers.
Pension risk	The risk to the Bank's capital and company funds from the Bank's exposure to scheme liabilities (to the extent liabilities are not met by scheme assets) and risks inherent in the valuation of scheme liabilities and assets.

The policies in place to manage the Principal Risks (including any subcategories of risk and the associated risk appetite) are reviewed on an annual basis. They are subject to continuous monitoring by the relevant committees.

4. OVERSIGHT

4.1 The Chief Executive Officer (CEO)

In relation to the Risk Management Framework, the CEO is responsible for amongst other responsibilities:

- proposing risk appetite limits to the Board for approval and the implementation of detailed risk appetite limits in the business;
- approving detailed risk appetite, limits and tolerances to be implemented in the business and supported by the other members of the executive, insofar as is within the scope of the CEO's authority as delegated by the Board;
- reviewing and recommending to the BRC for approval, the risk strategy and Risk Management Framework Policy proposed by the CRO;
- leading and managing the business to achieve strategic objectives within the agreed risk appetite as delegated by the Board;
- delegation of responsibility for specific risk management tasks, including management of risk appetite, to appropriately skilled members of the executive team; and
- monitoring business operations within the risk appetite set out for each Principal Risk and reporting on this performance to the Board.

4.2 The Chief Risk Officer (CRO)

In relation to the Risk Management Framework the CRO is responsible for, amongst other responsibilities:

- leading the risk function in pursuit of the risk strategic objectives;
- maintaining the risk strategy, Risk Management Framework Policy and risk appetite statements on behalf of the CEO. The CRO will recommend and make material changes to the risk strategy and the Risk Management Framework Policy; such changes are to be agreed with the BRC and the CEO and approved by the Board;

- ensuring there is a robust operational risk framework and monitoring process in place;
- providing regular reporting to the Board, the BRC and executive management on risk exposures and the effectiveness of the control framework;
- ensuring adequate review and oversight of individual risks at first line committees;
- defining the requirements for the semi-annual risk certification process to confirm the Bank-wide operational implementation of the Risk Management Framework;
- undertaking periodic thematic/conformance reviews to ensure that the business is managing risk within the agreed appetite and in line with the requirements of the Risk Management Framework Policy; and
- agreeing waivers or dispensations to risk policies where applicable within delegated authorities.

4.3 **Risk Framework Owners**

Each of the ten Principal Risks are assigned to a Risk Framework Owner (**RFO**), each of whom is a senior member of management. In relation to the Risk Management Framework each RFO is responsible for, amongst other responsibilities:

- the writing and maintenance of the applicable risk policy and control standard(s);
- developing detailed risk appetite/tolerance thresholds for their risk, ensuring that these are communicated to each business area/function as applicable and recommended to the CEO for approval;
- recommending the risk policy and control standard(s) for approval to the relevant governance committee;
- establishing a semi-annual review cycle to evidence that the risk framework is appropriately established and maintained across the Bank and certify to the Board that it is fit for purpose and supports effective risk management;
- reporting on the overall risk profile for their risk (including but not limited to the key metrics) to the relevant oversight committee;
- ensuring that control failures and breaches of policies within their risk's framework are reviewed and reported by the business (including escalation to the CRO and to the ERC in line with the agreed event escalation process outlined in this document);
- overseeing remediation of control weaknesses, ensuring that these are set up and resourced appropriately by the business and tracked to conclusion.

RFO's responsibilities should be referenced in their role profile and incorporated in their annual performance objectives.

4.4 **Business management**

The Bank's business teams and first line management is responsible for:

- implementing and embedding the requirements of the Principal Risk policies and relevant control standards within their business area/function;
- ensuring that the requirements of the risk management framework are translated into effective operating processes and procedures and controls through an effective implementation plan;
- ensuring the requirements of the risk management framework are communicated to and understood by all staff as appropriate;

- identifying, assessing and understanding where the business area is exposed to risks, including those deriving from the development of new products, processes or other business change;
- managing the risks that reside within their business area/function on a day-to-day basis;
- implementing effective monitoring and control testing processes to ensure that the business' risk profile is understood and maintained within the appetite defined for each risk;
- timely escalation and reporting of control failures and breaches of policy or appetite, in accordance with the timescales/other escalation requirements set out in the control framework;
- establishing and managing remediation action plans to address control weaknesses or instances of risk exposures outside of appetite; and
- producing regular and *ad hoc* risk reports as required by the CRO, Risk Framework Owner, ExCo, Board or Risk Function.

4.5 **Risk Function**

Reporting to the CRO, the Bank's risk function's responsibilities include:

- challenging the Bank's risk appetite to support the setting of Bank operating limits that are appropriate and maintain the success and solvency of the Bank;
- monitoring and challenging risk management information (**MI**) submitted to second line committees and to consider current and emerging risks across the Bank and challenging MI submitted to first line committees;
- overseeing the Risk Management Framework and supporting consistent and effective implementation;
- providing review and challenge to the delegated authorities proposed by the first line;
- overseeing breaches of limits and ensuring appropriate escalation, mitigation actions and reporting to the ERC;
- reviewing the proposed control remediation programmes and action plans designed to bring risk exposure back within risk appetite where it has been exceeded;
- independently monitoring the semi-annual certification process and reporting on the control effectiveness to the ERC and the BRC; and
- the conducting of thematic reviews/conformance testing against areas of risk within the business that are deemed to require additional assurance due to market conditions or internal risk concentrations.

4.6 **Regulatory Risk**

The Regulatory Risk function is led by the regulatory risk director who reports to the CRO. The regulatory risk director's responsibilities include:

- monitoring and reporting on the Bank's compliance with key regulatory requirements, primarily driven by the FCA's and PRA's rules and guidance;
- monitoring regulatory and legislative change and identifying those changes to be escalated to the Bank's senior executive for action;
- monitoring key risk indicators;
- reporting to the Bank's executive on breaches of regulation and/or the approved risk appetite so that timely corrective actions can be taken;

- advising business lines on the regulator's expectations as applicable to the Bank's on-going conduct of business; and
- chairing the Regulatory Risk Committee and attending the Executive Risk Committee to report on regulatory and conduct risks and issues.

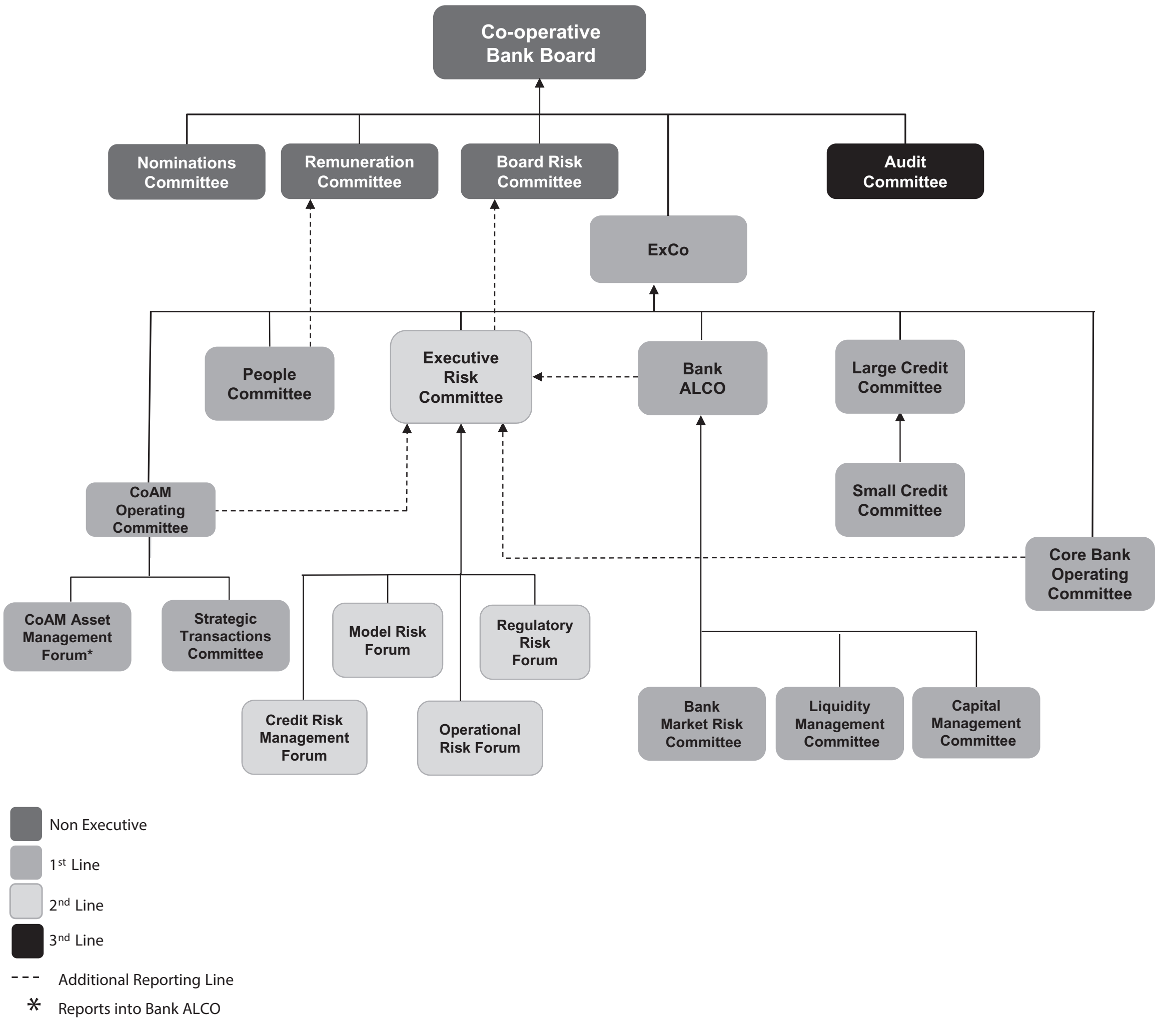
4.7 **Internal Audit**

The Bank's internal audit function (**Internal Audit**) acts as the third line of defence. They independently challenge the overall management of the framework and provide assurance to the Audit Committee and senior management on the adequacy of both the first and second lines.

Internal Audit is responsible for independently verifying that the Risk Management Framework has been implemented as intended across the business and is embedded and functioning effectively. In addition, the Board should receive reports on the design and operating effectiveness of the control requirements of each Principal Risk in line with the audit function's risk-based approach to audit planning.

5. COMMITTEE OVERSIGHT

The diagram below illustrates the Bank's risk management committee 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.

The key executive and non-executive risk management committees are as follows:

The Board

The responsibilities of the Board include:

- setting the overall Bank risk strategy;
- approving the design and implementation of risk management approaches, including the Risk Management Framework and the risk appetite statement and metrics that underpin them;
- delegating authority for oversight of the Risk Management Framework, systems and high-level limits to the BRC;
- delegating authority for cascading the setting and approval of the more granular risk limits and tolerances to the CEO;
- using the output of the semi-annual certification process, to approve the effectiveness of the Risk Management Framework with support from the Bank's internal audit function through their risk-based review programme; and
- reviewing and challenging BRC reports on the effectiveness of the Risk Management Framework and systems.

Remuneration Committee

The Remuneration Committee establishes, implements and maintains remuneration policies, procedures and practices for the Executive Directors and members of the senior executive management team that are appropriate in the context of the Bank's long term business performance and are consistent with effective risk management principles. It also determines and ensures policy on main terms and conditions of employment having regard to applicable good practice on remuneration and corporate governance.

Board Risk Committee *(*BRC*)*

The BRC's responsibilities include:

- providing oversight and advice to the Board on current and potential risks and the overall Risk Management Framework including oversight on risk appetite, risk tolerance and risk management strategies;
- reviewing and challenging the design of the Risk Management Framework, risk appetite limits and tolerances and making recommendations to the Board for approval;
- reviewing and challenging the implementation of the Risk Management Framework through the semi-annual certification process and reviewing the quality and effectiveness of the Risk Management Framework, systems and function;
- reviewing and challenging internal controls and process of risk management including the coverage of the risk taxonomy;
- monitoring the Bank's performance and compliance against high-level risk appetite limits and tolerances;
- in co-operation with the Audit Committee, monitoring identified risk control failings and weaknesses and management actions taken to resolve them; and

- reporting on the effectiveness of the Risk Management Framework and systems to the Board.

Audit Committee

Audit Committee responsibilities include:

- assisting the Board in carrying out its responsibilities relating to internal control, including control breaches and remediation; and
- exercising oversight of identified Risk Management Framework failings and weaknesses as well as management actions taken to resolve them.

Executive Committee (ExCo)

ExCo manages the business in line with the risk appetite statement. It also maintains oversight of risk management processes and management information. Its responsibilities include:

- overseeing the establishment and maintenance of appropriate risk management systems and controls in line with the agreed risk management framework;
- supporting the CEO in developing, reviewing and approving detailed risk appetite limits and tolerances as delegated by the Bank; and
- ensuring the implementation of the risk strategy set by the Bank Board so as to deliver an effective risk management environment.

Large Credit Committee (LCC)

The LCC supports the CEO and has the following main responsibilities:

- 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. The STC ensures that liquidity and funding risk are managed in line with risk appetite, initiating remedial action where necessary.

Any deal sanctioned by the STC must be approved by the CEO and Chief Financial Officer of the Bank or the Treasurer of the Bank and a risk assessment must be carried out by the CRO or Enterprise Risk Director.

Executive Risk Committee (ERC)

The ERC is chaired by the CRO. Its purpose is to provide a mechanism to ensure all the Bank's risks are reviewed, challenged and approved (with escalation to the BRC where required). Its responsibilities include:

- monitoring all significant and emerging risks against risk appetite;
- overseeing the development and implementation of stress testing and risk appetite across the Bank;
- driving the detailed implementation of the Risk Management Framework approved by the Board;

- supporting the CEO in developing the risk strategy, risk management framework, and risk appetite statement with recommendations to the BRC and the Board for approval where required; and
- monitoring the business' risk profile against the agreed limits and parameters and reporting on these to the BRC.

Bank Asset and Liability Committee (ALCO)

ALCO is chaired by the Chief Financial Officer. It is primarily responsible for overseeing the management of capital, market, liquidity and funding risks. Its responsibilities include:

- identifying, managing and controlling the Bank balance sheet risks in executing its chosen business strategy;
- ensuring that the capital and solvency position of the Bank is managed in line with policy and that adequate capital is maintained at all times;
- overseeing and monitoring relevant risk control frameworks; and
- recommending relevant principal risk policies and detailed risk appetite limits to the CEO and the ERC for approval.

To assist in carrying out these responsibilities, ALCO is supported by a Treasury Market Risk Committee, Liquidity Management Committee and Capital Management Committee.

People Committee

The People Committee is chaired by the HR Director. Its purpose is to:

- review all people data within bank, including headcount, contractors, absence, retention;
- review the hiring of senior and critical roles;
- review on at least a quarterly basis all talent data;
- review all performance data on at least a half-year basis;
- understand the employee relations engagement plan;
- ensure the colleague engagement approach is aligned to the strategic direction of the Bank;
- oversee reward strategy, principles and oversight of all remuneration policies and decisions below the Executive level;
- review and amend redundancy terms;
- review absenteeism and monitor disciplinary proceedings;
- monitor compliance with diversity and anti-discrimination legislation; and
- monitor, review and implement appropriate succession plans in respect of senior members of the Bank's management teams.

Core Business Operating Committee

Chaired by the Executive Director of the Core Business, the Core Business Operating Committee is responsible for the delivery of the business plan covering all areas of the Core Business scorecard and provides effective oversight of performance. The Core Business Operating Committee drives first line management of risk across the Core Business, ensuring that a robust and effective control environment exists.

CoAM Operating Committee

Chaired by the Executive Director CoAM, the CoAM Operating Committee is responsible for the delivery of the business plan and provides effective oversight of performance. The CoAM Operating Committee drives first line management of risk across CoAM, ensuring that the correct governance processes are followed and that a robust and effective control environment exists.

CoAM Asset Management Forum

This is a forum for discussing progress on deleveraging, value-decision making including workout, credit and market opportunities, management of market interface, and oversight of project management of structured and enterprise solutions. It is also where portfolio performance is monitored and strategic changes to plans are proposed.

Operational Risk Forum (ORF)

The purpose of the ORF is to support the Operational Risk Director in the execution of his responsibilities including:

- overseeing the design and maintenance of the Bank's operational risk framework;
- overseeing the management of operational risk, providing review and challenge;
- overseeing and monitoring the relevant risk control frameworks;
- recommending to the CEO, CRO and ERC relevant underlying policies and detailed risk appetite limits for approval; and
- ownership and oversight of the anti-money laundering regime.

Regulatory Risk Forum (RRF)

The core purpose of the RRF is to support the Regulatory Risk Director in carrying out his/her responsibilities, including the provision of oversight for:

- maintenance of the appropriate authorisations for the regulated entities within the Bank, including oversight of any variation to permissions;
- review and recommend to the ERC for approval of the regulatory risk policy (the **Regulatory Risk Policy**) and conduct risk policy (the **Conduct Risk Policy**);
- review and approval of the Bank's regulatory risk control standard (**Regulatory Risk Control Standard**);
- review and approval of the conduct risk control standard (**Conduct Risk Control Standard**);
- assessing and monitoring new products against the product approval risk policy and control standard and the Conduct Risk Policy and Conduct Risk Control Standard, as appropriate;
- the Approved Persons regime;
- regulatory reporting requirements;
- conduct of business issues including fair treatment of customers;
- financial promotions;
- the training and competence regime; and
- any on-going regulatory engagement.

Credit Risk Management Forum

The Credit Risk Management Forum advises and supports the Credit Risk Director. Its responsibilities include:

- designing the credit risk control implementation approach and credit control framework and recommending them to the ERC;
- reviewing and recommending to the ERC the Bank's credit risk policy and credit measurement methodologies;
- review and approve the credit risk control standard;
- defining and recommending the credit risk appetite and limits to the ERC; and
- reviewing and challenging the credit risk processes and procedures including the credit risk rating systems.

Bank Market Risk Committee (BMRC)

The role of the BMRC is to review, challenge and monitor the market risk profile for the Bank, in line with applicable policies and within risk appetite.

Liquidity Management Committee (LMC)

The role of the LMC is to enable more detailed discussion on all aspects of the Bank's 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 be taken in order to ensure that the Bank's liquidity position remains within the agreed levels.

Capital Management Committee (CMC)

The role of the CMC is to review, challenge and monitor the Bank's capital adequacy, in line with capital policy and within risk appetite. The CMC is responsible for making recommendations to ALCO as appropriate.

Model Risk Forum

The Model Risk Forum 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.

6. CREDIT RISK

Credit risk is one of the Principal Risks identified in the risk management framework and is an integral part of the Bank's business activities. 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).

All authority to take credit risk derives from the Board. This authority is delegated to the CEO who then sub-delegates to appropriate 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 principal risk 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 fully embedded in the Bank's operations and the business is managed in line with the risk strategy and risk appetite set by the Board. Identified, emerging or current risks are actively managed in line with the Bank's risk management approach of identification, measurement, management, monitoring and reporting. Risk measurement is based on a set of metrics/ratios which are aligned with the risk appetite and support the limits framework.

Timely processes for assessing and reviewing credit risks throughout the credit life cycle are established and documented including completion of risk reports, and credit risk decisions are supported by fully evidenced rationale.

The credit risk control standard has been embedded in each of the business divisions. The Credit Risk Management Forum includes 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 three forums that exist to support the Credit Risk Director in discharging the second line mandate. These include a Reserve Adequacy Forum that was implemented in June 2013 for the first time and exists to ensure that the credit risk impairment and loss recognition policy standard is being implemented effectively and that there is sufficient evidence to support the credit risk impairment stock including, where necessary, support by an appropriate sampling regime. In addition, a Credit Risk Executive Committee Forum will be implemented in the second half of 2013 as a mechanism for approving and reviewing programmes that may impact on the credit risk appetite or profile of the business, including potential departures from the business plan. 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 uses both application and behavioural scoring techniques to rank a customer's risk of default and this is embedded into the front end of the business, in common with other retail banks. In addition, the corporate division includes a number of specialist models to reflect the embedded credit risk of sectors such as PFI and commercial property. The performance of all rating systems is governed by the Credit Risk Model Review Forum with oversight from a new Model Risk Policy Committee that will meet for the first time during the third quarter of 2013.

7. LIQUIDITY RISK

Liquidity risk arising from the structure of the balance sheet (structural liquidity) and stresses occurring from cash withdrawals from customers are managed in line with policies developed by the Liquidity Management Committee (**LMC**), ALCO and the Board. The Bank's liquidity risk management framework is reviewed and approved annually by the BRC and compliance is reviewed by ALCO and the ERC. The Bank's policy is to ensure that sufficient funds are 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 risk appetite is met.

A summary of the Bank's liquidity risk management framework is noted below:

- risk appetite, controls and governance approach are defined in the Bank's Liquidity and Funding Risk Policy and Control Standard;
- articulation of how liquidity risk is identified, measured, monitored and managed in the individual liquidity adequacy assessment and procedures and governance in place to mitigate the risk;
- liquidity risk quantification and mitigation techniques and processes in place;
- management actions linked through to stress testing and liquidity planning models, enabling a method of mitigating the effects of a number of stress scenarios for varying periods of time and to ensure that the Bank operates within its agreed risk appetite parameters in all planning models;
- on-going development and enhancement of the Bank's liquidity risk appetite framework; and
- a process to attribute the cost, benefit and risks of liquidity to specific business lines via the Bank's funds transfer pricing mechanism.

The Bank monitors its liquidity position on a daily basis via liquidity risk metrics and the LMC meets weekly to oversee the operational liquidity management. A range of early warning indicators are monitored which are used to identify the emergence of increased risk or vulnerabilities in the Bank's liquidity position or potential funding needs. Such indicators are used to identify any negative trend. In the event that a negative trend is identified, an assessment and potential response by management would follow in order to mitigate the Bank's exposure to the emerging risk. The LMC, ALCO and the Board discuss the Board's current and projected liquidity position incorporating business plans. More frequent meetings are held if necessary, for instance when the markets have a heightened period of stress or liquidity shortage. The meetings ensure that the business plans are accurate and can be flexed as required. The liquidity position is reported at least monthly to ALCO and the Bank Board. The LMC also monitors the adequacy of its controls to provide assurance that liquidity risk is being appropriately managed and regularly assesses its funding position. This is supported with detailed contingency funding plans and recovery options which are tested and reviewed on a regular basis.

The Bank's liquidity management framework is in line with the requirements of the FCA's BIPRU regulations and industry guidelines.

The Bank uses a liquidity cash flow model in order to perform various stress tests which encompass survival across various timescales and a range of adverse liquidity events, both firm-specific and market-wide, which endeavour to cover all aspects of the liquidity risk to which the Bank is exposed.

8. MARKET RISK

The main source of market risk within the Bank is driven by mismatches between the repricing profiles of asset and liability customer products within the retail and corporate businesses and certain characteristics embedded within these products and basis risk. The Treasury department also creates market risk through its investments within its liquid asset portfolios.

The main market risk faced by the Bank is interest rate risk. Interest rate risk policy statements, approved by the ERC on behalf of the Board, specify the scope of the Bank's wholesale market activity, market risk limits and delegated authorities. The policy is managed by the BMRC and the ALCO. Their prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Bank's assets and liabilities. The Bank seeks to minimise the volatility of future earnings from interest rate changes and all interest rate risk exposure is removed from the Core Business and CoAM divisions and consolidated at the centre of the Bank where it is managed from the core balance sheet within agreed limits.

The Treasury department is responsible for interest rate risk management for the Bank. The principal analytical techniques involve assessing the impact of different interest rate scenarios and changes in balances over various time periods.

The Board receives reports on the management of balance sheet risk and BMRC and ALCO review the balance sheet risk positions and the utilisation of wholesale market risk limits.

Core Business interest rate risk

The Bank uses a gap report and earnings approach for managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year.

The BMRC monitors the non-trading interest rate risk which is split between certain wholesale portfolios, banking and investment books, and the rest of the Bank's balance sheet. The following describes the Bank's non-trading portfolios (excluding wholesale portfolios), managed by the Treasury department.

All interest rate risk is centralised into the Treasury department, using appropriate transfer pricing rates. Gap reports are based on defined time periods. ALCO set guidance limits around the gap, principally that the sum of positions maturing in more than 12 months and non-sensitive balances (includes non-maturity deposits) is no more than a set limit.

Non-maturity deposits which are non-interest bearing are separated into a stable 'core' element, based on a long run average, and a residual balance, which can fluctuate. In the gap report, the residual balance (along with interest bearing non-maturity deposits) is deemed to re-price or mature within one month.

The 'core' non-maturity deposits are within the non-sensitive balance on the gap report, along with non-dated capital and other non-sensitive balances. ALCO sets guidance around the treatment of non-sensitive balances to reinvest in fixed rate assets in periods up to five years to smooth the income based upon the prevailing interest rate environment. Risk limits are formally calculated at each month-end.

Pipeline risk, in particular for fixed rate mortgages, is the risk that the sales profile does not match the associated hedging assumption resulting in a mismatch between asset and liability and the associated hedge. This is managed through weekly balance sheet meetings. The asset and liability management team undertake hedges for interest rate risk using (i) derivative instruments and investment securities (executed via the Treasury markets team to external wholesale markets, and (ii) loans and deposits) which are executed internally with the Treasury markets team. The Bank is also subject to prepayment risk such that the asset or liability (eg a fixed rate mortgage) repays more quickly or slowly, thereby resulting in a mismatch between the asset or liability and the associated hedge position.

Basis risk is the risk that different assets and liabilities reprice with reference to different indices and at different times, and is principally applicable to the Core Business. This exposes the Bank to income volatility if indices do not move at a ratio of one-to-one. Basis risk is monitored by BMRC and ALCO monthly and action is taken as required, which includes pricing, new products or external hedging. The Bank is also exposed to asset swap spread risk, which is another form of basis risk.

Treasury interest rate risk

The Treasury department executes short-term funding and hedging transactions with the wholesale markets on behalf of the Bank and its customers. The two prime measures of risk are the Value at Risk (**VaR**) and PV01 models illustrated below, as supplemented by additional controls such as maturity and stop loss limits.

The VaR model incorporates underlying risk factors based on interest rate and foreign exchange volatilities and correlations. Potential movements in market prices are calculated by reference to daily market data from the last two years, equally weighted. Exposures against limits are reviewed daily by management. Actual outcomes are monitored periodically to test the validity of the assumptions and factors used in the VaR calculation.

The Bank uses VaR and PV01 measures to quantify the level of market risk within the Treasury liquid asset portfolios. PV01 assesses the change in value of the net present value of Treasury assets under a 1 basis point shift in rates. VaR estimates the potential loss that could occur as a result of future movements in market rates over a specified time horizon and to a given level of statistical confidence. In its day-to-day monitoring, the Bank uses a 95 per cent. confidence level over a one day holding period using one year of historical data.

For foreign exchange transactions, the positions are restated to give a sterling equivalent of each long or short position for each currency. The sum of the greater of the total long positions or total short positions may not exceed £20 million intraday or £10 million at the close of each day.

9. PEOPLE RISK

People risk is the risk associated with the recruitment, employment and management of individuals within the Bank.

There are seven sub-categories of people risk, as follows:

- *Inadequate people capability* – the risk that the Bank will fail to attract, select, performance manage, engage and retain appropriate or sufficient resources;
- *Inappropriate behaviour* – the risk that employees will act outside of policies, discretions and accepted codes of behaviour without authorisation;

- *Breach of employment legislation* – the risk that the Bank will fail to comply with relevant employment codes and legislation;
- *Breach of trade union agreements* – the risk that the Bank will fail to comply with relevant agreements and/or will face industrial action, resulting in operational losses and damage to reputation;
- *Ineffective organisation design* – the risk that the organisational design does not support business strategy and/or that individuals are not directly engaged by the Bank, are on short-term contracts or are not fully aware of the scope and accountability of their role;
- *Inadequate colleague engagement* – the risk that colleagues are not adequately engaged in the course of their work and particularly throughout periods of change, resulting in fraudulent or unauthorised activities or poor customer service; and
- *Failure to deliver a compliant and timely payroll function* – the risk that the Bank will not meet its obligations in respect of its employees and/or any external requirements in respect of payroll provision.

10. 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. A key component of the Bank's vision to deliver sustainable financial services for members and society is that its customers can trust the Bank to treat them fairly. Demonstrating compliance with all applicable regulatory requirements helps the Bank to maintain this trust and ensures fair treatment of customers.

Management of regulatory risk entails on-going 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 Regulatory Risk Policy and Regulatory Risk Control Standard aim to ensure that that regulatory risk is managed in a way that is effective, robust and consistent with the Bank's overall risk appetite and aligned to its vision, purpose and values, by clearly defining the requirements of the regulatory risk management process.

The Bank's inherent regulatory risk exposure is determined by the scope of its permitted activities. The Bank continues to experience, along with the rest of the banking industry, increased levels of government and regulatory intervention in the banking sector through changes to laws and regulations from national and supranational regulators in relation to both conduct and prudential regulation. A strong regulatory risk framework is fundamental to the Bank's business objectives and to maintaining stakeholder confidence.

Regulatory risks are reported to, and overseen by, the RRF which is chaired by the Bank's Regulatory Risk Director. Any regulatory risks outside the Bank's appetite are escalated to the ERC and BRC.

11. OPERATIONAL RISK

The Bank adopts the Basel-standardised approach to the management of operational risk. This is designed to assist the Bank to safely operate within a Board-approved risk appetite, particularly with regards to protecting the volatility of earnings, reducing capital requirements, maintaining the Bank's reputation as a trusted provider of financial services and meeting regulatory expectations. The framework continues to be reviewed and enhanced in line with best practice and regulatory guidance.

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. Operational risks and key controls are formally reviewed on a regular basis. Significant operational risks and the associated capital requirements are reported to the ERC and the BRC. These meet regularly to monitor the suitability of the risk management framework and the management of significant risks within the Bank.

The Bank defines operational risk in line with the Basel Accord as "the risk of loss resulting from inadequate or failed internal processes, people and systems or external events." The Bank further categorises operational risk into a number of distinct themes for internal management, monitoring and reporting. These are as follows:

Operational risk theme	**Description**
Financial crime risk	The risk of losses resulting from criminal activity relating to fraud or dishonesty; misconduct in, or misuse of information relating to, a financial market.
Anti-money laundering risk	The risk that the Bank may be used to facilitate the laundering of the proceeds of crime or the financing of terrorist activity.
Legal risk	The risk of a failure to comply with the laws and regulations, including primary and secondary legislation, of the jurisdictions in which the Bank operates.
People risk	The risk characterised by individuals being engaged by other members of Co-operative Group, senior management being on contracts for services with other members of Co-operative Group, an inability to attract and retain sufficiently qualified employees, unduly high employee turnover, loss of key staff, lack of succession planning and staff development, and indicators of behaviours which are not compliant with the Bank's values.
Physical assets and security risk	The risk associated with internal and external threats, either deliberate or accidental, against physical assets, employees and customers that could cause financial and/or non-financial losses and/or damage to or non-availability of Bank assets.
Business continuity planning risk	The risk that the Bank is unable to continue to deliver products or services at acceptable pre-defined levels following a disruptive incident.
Third party suppliers risk	The risk of financial and non-financial loss associated with all third parties relied upon to provide services to functions that support the performance of the Bank.
New product approval risk	The risk in launching new products or modifying existing ones.
Technology risk	The risk of financial and non-financial consequences resulting from the lack of effective IT systems.
Information risk	The risk associated with the theft, loss, corruption, misuse and inadequate quality of business, customer and employee data across the Bank.
Financial reporting risk	The risk of reputational damage, loss of investor confidence and/or financial loss caused by incorrect financial reporting.
Change risk	The risk of change not being implemented successfully and/or that the change adversely impacts the Bank's risk profile.

The Bank also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach that is held by Banking Group.

12. REPUTATIONAL RISK

As part of the assessment and control of reputational risk, the business performance and risk profile across all risk themes are closely monitored and reviewed. The business proactively monitors and manages media, public and customer opinion and works closely with external rating agencies to ensure fair and balanced representation.

This approach helps maintain member, customer and market confidence.

13. STRATEGIC AND BUSINESS RISK

Strategic and business risk arises from changes to the Bank's business and the environment in which it operates, specifically the risk of not being able to carry out the Bank's business plan and desired strategy.

The Bank's strategy is to grow the business in order to achieve the Bank's vision of becoming the compelling, co-operative alternative in the markets in which we compete.

The Bank Board and senior executive management team set and monitor the strategic plan in the light of this strategy having considered the stresses that extreme, but plausible, scenarios could have upon it.

14. CONDUCT RISK

Conduct risk is a category of risk that relates to regulatory risk and is specifically focused on the risks to which the Bank's customers are exposed. 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 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 and, importantly, the primary focus in managing conduct risk within the Bank will be ensuring fair outcomes for all its customers.

The Bank's aim is to avoid the conduct of its business resulting in unfair outcomes for its customers and therefore the Bank will manage its conduct risk within its stated risk appetite. Further, the Bank aims to minimise the probability of any such outcomes occurring and ultimately to remedy any material consequences where a risk crystallises.

15. PENSION RISK

Risks are identified at Co-operative Group level, with the impact of any potential changes to contribution assessed under the Bank's risk management framework.

The Bank is exposed to pension risk through two schemes, namely, Pace and the Britannia pension scheme, as further detailed in Section 20 (*Additional Information*) and the paragraph titled "*The contributions that the Bank is required to make to its pension schemes may change over time. The Bank may be obliged to make large one-off payments to the pension schemes if certain events occur*" in Section 2 (*Risk Factors*).

The trustee of Pace is responsible for the risk management arrangements for Pace, agreeing suitable contribution rates with the principal employer, investment strategy and taking professional advice as appropriate.

The trustee of the Britannia Scheme is responsible for the risk management arrangements for the Britannia Scheme, agreeing suitable contribution rates with the principal employer, investment strategy and for taking professional advice as appropriate.

The Bank is therefore exposed to potential future increases in required contributions and capital set aside for pension risk.

Co-operative Group and the Bank have agreed to limit certain risks to the Bank relating to Pace and the Britannia Scheme as further detailed in paragraph 20.10 "*Pensions Undertaking*" in Section 20 (*Additional Information*).

16. RECOVERY AND RESOLUTION PLANNING (RRP)

RRP is a Bank of England/PRA requirement, which has two distinct elements:

- the recovery plan details the Bank's options for addressing a range of financial stresses caused by idiosyncratic problems, market-wide stresses, or both; and
- resolution planning is the provision of information and analysis to the authorities, in order to help them prepare a resolution plan for the Bank.

There are six separate modules for RRP, all of which have gone through formal governance approval.

Since June 2012 when the recovery plan (module two) was put into place, a series of management information triggers and early warning signals are reported each month to the ERC, so that the ERC can determine whether to recommend the invocation of the recovery plan.

15
SEGMENTAL FINANCIAL AND OTHER INFORMATION

SEGMENTAL FINANCIAL AND OTHER INFORMATION

This segmental and other information represents the current division between the Bank's core and non-core businesses. It is consistent with the approach used in Section 8 (*Description of the Bank*), but distinct from the pre-existing division deployed in Section 12 (*Operating and Financial Review*). Prior to the 2012 financial year, the Bank reported its operating segments as 'Retail', 'Corporate and Business Banking' and 'Treasury/Unity Trust Bank', based on differences in products and services. In 2012, the Bank redefined these operating segments into core and non-core business segments. In 2013, the two distinct business areas were further redefined into new core and non-core businesses as: (i) the Retail, BACB and Treasury/other divisions (the **Core Business**); and (ii) the non-core division (the **Non-core Business**), which comprises the Co-operative Asset Management business (**CoAM**). For further information, refer to paragraph 5A titled "*The Core Business and the Non-core Business*" in Section 8 (*Description of the Bank*).

The table below sets out the segmental information reconciliation to the statutory income statement for the six months ended 30 June 2013.

	For the six months ended 30 June 2013 (unaudited)					
	Core Business					
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*	*Non-core Business*	*Total for the Bank*
	(£millions)					
Net interest income	203.5	34.4	6.6	244.5	4.5	249.0
Non-interest income	65.0	7.7	28.3	101.0	5.8	106.8
Operating income	268.5	42.1	34.9	345.5	10.3	355.8
Operating expenses	(242.8)	(27.8)	(16.3)	(286.9)	(30.5)	(317.4)
Impairment losses on loans and advances	(24.8)	(1.4)	–	(26.2)	(469.1)	(495.3)
Impairment losses on investments	–	–	(0.7)	(0.7)	–	(0.7)
Operating result	0.9	12.9	17.9	31.7	(489.3)	(457.6)
Significant items						(346.0)
Share of post-tax profits from joint ventures						0.3
Financial Services Compensation Scheme levies						0.1
Fair value amortisation						(8.2)
Loss before taxation						(811.4)
Income tax						39.4
Loss after taxation						(772.0)

The table below sets out the segmental information reconciliation to the statutory balance sheet statement as at 30 June 2013:

	As at 30 June 2013 (unaudited)					
	Core Business					
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*	*Non-core Business*	*Total*
Segment assets	17,797.1	979.5	11,245.2	30,021.8	14,164.4	44,186.2
Unallocated assets						1,633.9
Total assets for reportable segments						45,820.1
Statutory reclassifications						812.2
Consolidated total assets						46,632.3
Segment liabilities	27,969.4	4,655.3	9,791.5	42,416.2	1,485.6	43,901.8
Unallocated liabilities						724.6
Total liabilities for reportable segments						44,626.4
Statutory reclassifications						991.2
Consolidated total liabilities						45,617.6

The table below sets out a breakdown of the operating costs of the Bank by directorate for the six months ended 30 June 2013:

	For the six months ended 30 June 2013 (unaudited)		
	Core Business	*Non-core Business*	*Total*
Branch Network	46.2	0.2	46.4
Retail	74.1	3.2	77.3
Customer Operations	39.9	4.0	43.9
BACB	8.6	–	8.6
Treasury	4.6	0.2	4.8
Non-core Business	–	10.4	10.4
Head office/support	97.1	9.6	106.7
Other	1.1	0.4	1.5
	271.6	28.0	299.6
Strategic initiatives	11.8	2.5	14.3
Unity Trust Bank	3.5	–	3.5
	286.9	30.5	317.4

A. **Core Business**

1. PROFIT AND LOSS ACCOUNTS & BALANCE SHEETS

The following table illustrates the financial performance of the Core Business by setting out the operating results for the Core Business and subdividing the results between the Retail Banking Business, the BACB and the Treasury/other, for the six months ended 30 June 2013.

	For the six months ended 30 June 2013 (unaudited)			
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*
	(£millions)			
Net interest income	203.5	34.4	6.6	244.5
Non-interest income	65.0	7.7	28.3	101.0
Total income	268.5	42.1	34.9	345.5
Operating costs				
Steady state	(235.0)	(25.3)	(14.8)	(275.1)
Strategic initiatives	(7.8)	(2.5)	(1.5)	(11.8)
	25.7	14.3	18.6	58.6
Impairment losses	(24.8)	(1.4)	(0.7)	(26.9)
Operating result	0.9	12.9	17.9	31.7

The following table sets out the assets, liabilities and risk-weighted assets of the Core Business and its three business areas as at 30 June 2013.

	As at 30 June 2013 (unaudited)			
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*
	(£millions)			
Gross loans and advances to customers	17,760.5	1,093.7	–	18,854.2
Net loans and advances to customers	17,583.9	1,083.2	–	18,667.1
Segment assets	17,797.1	979.5	11,245.2	30,021.8
Customer deposits	28,132.8	4,655.3	–	32,788.1
Segment liabilities	27,969.4	4,655.3	9,791.5	42,416.2
Risk-weighted assets (B2.5)	2,384.7	1,192.4	1,398.9	4,976.0
Risk-weighted assets (B3 final rules)	2,384.7	1,192.4	2,636.8	6,213.9

The following table sets out a breakdown between the business of the Core Business:

Average net interest margin and spread for the Core Business	*For the six months ended 30 June 2013 (unaudited)*
Net average interest-earning assets	£18,616.1 million
Net average interest-bearing liabilities	£32,835.9 million
Net interest income	£237.9 million
Average yield on average interest-earning assets	2.77%
Average rate on average interest-bearing liabilities	0.91%
Net interest spread	1.86%
Net interest margin	2.56%

2. KEY PERFORMANCE INDICATORS

The following table provides the key performance indicators in relation to the Core Business, and its three business areas as at and for the six months to 30 June 2013.

	As at the six months to 30 June 2013 (unaudited)			
	Retail Banking	*BACB*	*Treasury/ other*	*Total Core Business*
Net interest margin bps(1)	230	685	11	158
Non-interest income/Total income	24.2%	18.3%	81.1%	29.2%
Cost-to-income ratio(2)	87.5%	60.1%	42.4%	79.6%
Non-performing loans ratio(3)	2.2%	2.3%	0.0%	2.2%
Non-performing loans coverage(4)	54.7%	38.2%	0.0%	53.9%
Loan to deposit ratio	63.1%	23.5%	0.0%	57.5%
Cost of risk(5) bps	28	24	–	29

Notes:

(1) The net interest margin is calculated by dividing annualised net interest income by average segment assets.

(2) The cost-to-income ratio is calculated by dividing the steady state costs by total income.

(3) The non-performing loans ratio is calculated by dividing impaired customer balances by gross customer balances.

(4) The non-performing loans coverage ratio is calculated by dividing total credit protection by impaired customer balances.

(5) The cost of risk is calculated by dividing the annualised impairment charge by average assets.

3. LOAN PORTFOLIOS AND DEPOSITS

As at 30 June 2013, the total gross loans and advances of the Core Business to customers were £18.9 billion.

Approximately 42 per cent. of curent lending is made up of customers who have no broader relations with the Bank.

(a) *Loan Portfolio of the Core Business*

The table below sets out the outstanding loan portfolio (on a gross basis) of the Core Business by business segment as at 30 June 2013.

	As at 30 June 2013 (unaudited)	
	(£millions)	*(percentages)*
BACB balances:		
Business Banking	28.5	0.2
Relationship-managed Banking	804.1	4.3
Larger charities	61.3	0.3
Larger co-operatives	195.1	1.0
Total BACB balances	1,089.0	5.8

	As at 30 June 2013 (unaudited)	
	(£millions)	*(percentages)*
Retail Banking unsecured balances:		
Credit cards	584.5	3.1
Other unsecured	795.1	4.2
Total Retail Banking unsecured balances	1,379.6	7.3
Total Retail Banking secured balances	16,305.2	86.9
Total Core Business gross customer balances	18,773.8	100.0

The following table illustrates the breakdown of impaired loans in the Core Business by setting out the non-performing loans ratio as at 30 June 2013.

	As at 30 June 2013 (unaudited)	
Core Business	*Non-performing loans (percentages)*	*Non-performing loans coverage ratio*
Retail unsecured	16.7	87.1
Retail secured	0.9	5.9
BACB	2.3	38.2
Total Core Business	2.0	53.9

(b) ***Deposits of the Core Business***

The table below sets out the customer deposits of the Core Business, broken down by the Retail Banking and BACB business areas.

	As at 30 June 2013 (unaudited)	
Core Business	*(£millions)*	*(percentages)*
Retail Banking	28,132.8	85.8
BACB	4,655.3	14.2
Total Core Business	32,788.1	100.0

(c) ***Retail Banking unsecured lending***

The following table provides a breakdown of the Retail Banking unsecured lending portfolio, by impairment charge, the net charge rate and the level of credit protection as a percentage of the impaired balances as at 30 June 2013.

	As at 30 June 2013 (unaudited)		
Product type	*Impairment charge[1] (£millions)*	*Net charge rate[2] (percentages)*	*Credit protection as a percentage of impaired balances[3] (percentages)*
Credit cards	1.8	0.7	81.1
Overdrafts	3.6	12.0	101.0
Personal loans	15.0	4.4	103.1
Total	20.4	3.3	90.6

Notes:

(1) The impairment charge is the cost to the profit and loss account of the period-to-period movement in total impairment provision stock, plus write-offs less recoveries. Total impairment provision stock includes impairment raised against up-to-date, delinquent, forborne and charged-off balances.

(2) The net charge rate is the annualised impairment charge divided by gross customer balances.

(3) Credit protection is the total impairment provisions divided by impaired customer balances, which is commonly referred to as the non-performing loans coverage ratio.

(d) ***BACB loan portfolio***

The table below sets out a breakdown of the BACB loan portfolio by industry sector (on a gross basis, including credit commitments) by industry sector as at 30 June 2013.

	As at 30 June 2013 (unaudited)	
Industry	*(£millions)*	*(percentages)*
Accommodation, food and licensed services	87.3	5.9
Business banking	55.0	3.7
Care	71.0	4.8
Education	50.1	3.4
Financial services	64.2	4.3
Football clubs	0.8	0.1
Housing associations	53.4	3.6
Manufacturing	39.9	2.7
Motor trade and garages	33.3	2.2
PFI	–	–
Professional services	62.1	4.2
Property and construction	461.0	30.9
Public sector entities	–	–
Renewable energy	8.1	0.5
Retail and wholesale trade	323.5	21.7
Services	154.0	10.3
Transport, storage and communication	14.9	1.0
Utilities	4.9	0.3
Other	6.2	0.4
Total	1,489.7	100.0

4. LOAN RISK ANALYSIS

The following table shows the distribution of the BACB gross customer balances (including commitments, but excluding Unity Trust Bank) by sector and risk grade as at 30 June 2013.

				As at 30 June 2013 (unaudited) Standard is:			
BACB	*Standardised*	*Strong*	*Good*	*Satisfactory*	*Weak*	*Default*	*Total*
				(£millions)			
Accommodation, food and licensed services	44.6	13.3	29.4	–	–	–	87.3
Business banking	1.1	42.0	7.9	3.0	0.5	0.5	55.0
Care	39.6	17.0	14.4	–	–	–	71.0
Education	38.7	8.4	2.9	0.1	–	–	50.1
Financial services	15.6	25.5	23.1	–	–	–	64.2
Football clubs	–	–	–-	–	–	0.8	0.8
Housing associations	2.2	50.3	0.9	–	–	–	53.4
Manufacturing	9.8	13.5	16.2	0.3	–	0.1	39.9
Motor trade and garages	1.6	12.4	19.3	–	–	–	33.3
PFI	–	–	–	–	–	–	–
Professional services	35.6	14.7	9.5	2.3	–	–	62.1
Property and construction:							
Commercial investment	6.8	16.5	277.1	–	–	–	300.4
Residential investment	4.1	0.6	77.1	–	–	–	81.8
Commercial development	1.2	2.3	44.6	–	–	–	48.1
Residential development	4.9	1.9	20.8	3.1	–	–	30.7
Total property and construction	17.0	21.3	419.6	3.1	–	–	461.0
Public sector entities	–	–	–	–	–	–	–
Renewable energy	8.1	–	–	–	–	–	8.1
Retail and wholesale trade	3.5	308.6	11.4	–	–	–	323.5
Services	116.5	20.2	16.7	0.6	–	–	154.0
Transport, storage and communication	4.0	6.8	3.4	0.3	0.4	–	14.9
Utilities	3.1	1.2	0.6	–	–	–	4.9
Other	3.6	1.7	0.9	–	–	–	6.2
	344.6	556.9	576.2	9.7	0.9	1.4	1,489.7

The following table analyses the exposures of the Core Business subject to forbearance, as at 30 June 2013. Impairment provisions are made for accounts subject to forbearance that are in default or on the watchlist. In cases where the customer benefits from a concession to repayment, the Bank retains the forbearance status until the concession lapses. Where the concession is a one-off, the Bank removes the forbearance status a year after the occurrence of the concession.

		As at 30 June 2013 (unaudited)	
Core Business	*Forbearance*	*Non-forbearance*	*Total*
		(£millions)	
Default	113.8	113.4	227.2
Watchlist	18.8	126.7	145.5
Neither default nor watchlist	525.9	17,875.2	18,401.1

The following table breaks down the gross balances by impairment classification for the BACB and Retail Banking (secured and unsecured) by setting out the credit commitments, impairment provisions, fair value adjustments and a reconciliation to gross customer balances as at 30 June 2013.

	As at 30 June 2013 (unaudited)		
	Retail Banking		
	Secured	*Unsecured*	*BACB*
	(£millions)		
Gross balance	16,358.4	1,402.1	1,093.7
Less: allowance for losses	(4.6)	(172.0)	(10.5)
	16,353.8	1,230.1	1,083.2
Analysis of credit risk exposure:			
Not impaired	16,209.7	1,204.4	1,068.3
Impaired	153.2	197.7	25.4
Credit commitments	486.5	2,303.5	620.6
Gross credit exposure	16,849.4	3,705.6	1,714.3
Fair value adjustments	(4.5)	–	–
Allowances for losses	(4.6)	(172.0)	(10.5)
Net credit risk exposure	16,840.3	3,533.6	1,703.8
Reconciliation of accounting to customer balances:			
Gross balance	16,358.4	1,402.1	1,093.7
Fair value adjustments	4.5	–	–
Other accounting adjustments	(57.7)	(22.5)	(4.7)
Gross customer balances	16,305.2	1,379.6	1,089.0

Details on the impaired loans of the Bank's Core Business, BACB segment as at 30 June 2013

	As at 30 June 2013 (unaudited)			
BACB	*Impaired loan ratio*	*Expected performance*	*Loans with collateral*	*Provision*
	(percentages)			
Business Banking	1.6	52.3	0.0	47.7
Commercial Banking	0.1	0.0	0.9	99.1
Total	0.1	19.6	0.6	79.8

B. Non-core Business

1. LENDING AND LOAN PORTFOLIOS

As at 30 June 2013, the CoAM business total gross loans and advances to customers were £14.9 billion.

2. IMPAIRMENT AND NON-PERFORMING LOANS

The following table sets out the loans within the CoAM portfolio which are on the Bank's watchlist or in default, and the percentage of those which are expected to perform and which have been impaired, covered by collateral or fair value provisions, as at 30 June 2013.

CoAM	*As at 30 June 2013 (unaudited) (millions)*
Loans on the watchlist	1,084.7
Loans in default	2,714.0
Total watchlist/default loans	3,798.7
Loans that are expected to perform	–
Impaired loans, loans with collateral or FV loans	3,798.7

The following table provides a breakdown of the non-performing loans ratio in the CoAM portfolio by asset class. The table also illustrates the percentage of impaired loans that are expected to perform, the percentage against which the Bank holds collateral, and the percentage which the Bank has made a provision for, as at 30 June 2013.

	As at 30 June 2013 (unaudited)			
CoAM	*Non-performing loans ratio*[1]	*Expected performance*[2]	*Loans with collateral*[3]	*Provision*[4]
	(percentages)			
Optimum	16.5	–	100.0	–
Corporates	32.9	23.2	35.2	41.6
CRE	57.1	3.1	63.6	33.3
PFI	2.3	80.2	0.0	19.8
Housing/Associations	0.0	0.0	0.0	0.0
Local authorities	0.0	0.0	0.0	0.0
REAF	1.8	12.6	0.0	87.4
Total Non-core Business	25.1			

Notes

(1) Non-performing loans ratio is calculated by dividing the impaired loan balances by the gross customer balances.

(2) Expected performance is the amount expected to be received as against loans.

(3) Loans with collateral is the percentage of loans covered by collateral.

(4) Provision is the percentage of loans covered by provisions.

The following table provides the gross and net impairment charges for the CoAM portfolio as at 30 June 2013.

CoAM	*As at 30 June 2013 (unaudited) (£millions)*
Net impairment charge	838.6
Fair value unwind	198.6
Gross impairment charge	1,037.2

3. LOAN RISK ANALYSIS

The following table sets out the distribution of the CoAM gross customer balances (including commitments) by sector and risk grade as at 30 June 2013.

	As at 30 June 2013 (unaudited) Standard is:						
CoAM	*Standardised*	*Strong*	*Good*	*Satisfactory*	*Weak*	*Default*	*Total*
				(£millions)			
Accommodation, food and licensed services	169.9	122.8	134.0	20.2	21.7	300.1	768.7
Business banking	–	–	–-	–	–	–	–
Care	142.5	1.6	58.6	23.2	3.7	16.8	246.4
Education	48.6	26.1	–	0.9	–	–	75.6
Financial services	50.3	52.1	5.3	4.4	–	4.5	116.6
Football clubs	–	33.1	–	0.4	0.1	15.1	48.7
Housing associations	5.6	1,032.5	45.9	–	–	–	1,084.0
Manufacturing	35.6	11.7	8.0	16.3	12.2	8.6	92.4
Motor trade and garages	22.5	43.0	5.1	3.5	0.7	1.7	76.5
PFI	–	32.0	1,179.0	13.3	20.9	4.8	1,250.0
Professional services	37.4	0.7	12.1	11.9	0.7	3.7	66.5
Property and construction:							
Commercial investment	33.8	87.5	977.1	241.2	54.9	1,502.6	2,897.1
Residential investment	4.1	–	111.4	44.9	63.7	139.3	363.4
Commercial development	0.5	0.2	132.4	72.8	2.4	60.4	268.7
Residential development	1.0	–	41.5	11.7	2.9	11.1	68.2
Total property and construction	39.4	87.7	1,262.4	370.6	123.9	1,713.4	3,597.4
Public sector entities	172.9	0.3	–	–	–	–	173.2
Renewable energy	631.0	–	–	–	–	9.3	640.3
Retail and wholesale trade	66.2	93.8	16.4	11.9	1.1	19.3	208.7
Services	282.0	107.5	19.4	29.7	0.6	33.8	473.0
Transport, storage and communication	20.8	8.8	0.5	6.3	0.9	28.7	66.0
Utilities	39.8	-	0.8	0.9	–	0.6	42.1
Other	3.2	0.6	0.5	2.2	–	2.1	8.6
	1,767.7	1,654.3	2,748.0	515.7	186.5	2,162.5	9,034.7

The following table sets out the fair value of the property collateral held against assets in the CoAM CRE portfolio (on a gross basis) as at 30 June 2013.

CoAM CRE portfolio	*Exposure*	*As at 30 June 2013 (unaudited) Impairment Collateral (£millions)*	*Provision*
Non-defaulting loans with <= 1 year & all defaulted exposures regardless of term			
Less than 50 per cent.	36.5	34.8	1.7
50 per cent. to 60 per cent.	69.6	68.2	1.4
60 per cent. to 70 per cent.	159.8	153.6	6.1
70 per cent. to 80 per cent.	124.3	119.2	5.1
80 per cent. to 90 per cent.	102.7	95.1	7.6
90 per cent. to 100 per cent.	81.2	70.7	10.5
Greater than 100 per cent.	1,378.1	877.4	462.2
Unsecured	245.8	–	161.2
Total non-defaulting loans with <= 1 year & all defaulted exposures regardless of term	2,198.0	1,419.0	655.8
Non-defaulting loans with > 1 year			–
Less than 50 per cent.	106.8	106.8	–
50 per cent. to 60 per cent.	237.4	237.4	–
60 per cent. to 70 per cent.	445.4	445.4	–
70 per cent. to 80 per cent.	320.4	320.4	–
80 per cent. to 90 per cent.	74.0	74.0	–
90 per cent. to 100 per cent.	63.3	63.3	–
Greater than 100 per cent.	67.9	42.4	–
Unsecured	84.2	–	–
Total non-defaulting loans with > 1 year	1,399.4	1,289.7	–

The following table sets out the CoAM portfolio exposures subject to forbearance, as at 30 June 2013. Impairment provisions are made for accounts subject to forbearance (on a gross basis) which are in default or on the watchlist. In cases where the customer benefits from a concession to repayment, the Bank retains the forbearance status until the concession lapses. Where the concession is a one-off, the Bank removes the forbearance status a year after the occurrence of the concession.

CoAM (excluding Optimum)	*Forbearance*	*As at 30 June 2013 (unaudited) Non-forbearance (£millions)*	*Total*
Default	1,390.4	772.1	2,162.5
Watchlist	246.0	192.4	438.4
Neither default nor watchlist	88.7	6,345.1	6,433.8

The following table breaks down the gross balances by impairment classification for CoAM, by setting out the credit commitments, impairment provisions, fair value adjustments and reconciliation to gross customer balances, as at 30 June 2013.

CoAM (excluding Optimum)	*As at 30 June 2013 (unaudited) (£millions)*
Gross balance	7,772.1
Less: allowance for losses	(838.6)
	6,933.5
Analysis of credit risk exposure:	
Not impaired	5,361.0
Impaired	2,609.7
Credit commitments	1,113.4
Gross credit exposure	9,084.1
Fair value adjustments	(198.6)
Allowances for losses	(838.6)
Net credit risk exposure	8,046.9
Reconciliation of accounting to customer balances:	
Gross balance	7,772.1
Fair value adjustments	198.6
Other accounting adjustments	(49.7)
Gross customer balances	7,921.0

16
FINANCIAL INFORMATION

PART A: AUDITED FINANCIAL INFORMATION FOR THE SIX MONTHS ENDED 30 JUNE 2013

The Co-operative Bank plc

Financial information for six months ended 30 June 2013

Part of The **co-operative** banking group

Contents

Reference is made to the Bank, the consolidated Co-operative Banking Group and the wider Co-operative Group throughout this financial information. Information in relation to the Bank and its subsidiary undertakings is referred to as 'the Bank', information relating to the consolidated Co-operative Banking Group is referred to as 'the Banking Group' and information relating to the wider Co-operative Group is referred to as 'the Group'.

In setting out the Bank's main risks and uncertainties, and likely future developments, this document contains statements which, by their nature, cannot be considered indications of likelihood or certainty. The statements are based on the knowledge and information available at the date of preparation of the report and accounts and are believed to be reasonable judgments. These statements should not be construed as a profit forecast.

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

		Period to 30 June 2013			*Period to 30 June 2012*		
	Notes	*Before significant items*	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Interest receivable and similar income	2	715.6	(39.0)	676.6	744.7	–	744.7
Interest expense and similar charges	2	(470.8)	–	(470.8)	(473.5)	–	(473.5)
Net interest income		244.8	(39.0)	205.8	271.2	–	271.2
Fee and commission income	3	116.2	(94.0)	22.2	128.0	(40.0)	88.0
Fee and commission expense	3	(36.2)	–	(36.2)	(41.2)	–	(41.2)
Net fee and commission income		80.0	(94.0)	(14.0)	86.8	(40.0)	46.8
Net trading income	4	1.1	–	1.1	9.3	–	9.3
Other operating income	5	26.0	–	26.0	39.8	–	39.8
Operating income		351.9	(133.0)	218.9	407.1	(40.0)	367.1
Operating expenses	6	(321.7)	(213.0)	(534.7)	(294.3)	(39.3)	(333.6)
Financial Services Compensation Scheme levies	27	0.1	–	0.1	(0.8)	–	(0.8)
Impairment losses on loans and advances	11	(496.0)	–	(496.0)	(94.6)	–	(94.6)
Impairment gains on investments	12	–	–	–	2.7	–	2.7
Operating (loss)/profit		(465.7)	(346.0)	(811.7)	20.1	(79.3)	(59.2)
Share of post tax profits from joint ventures	31	0.3	–	0.3	0.6	–	0.6
(Loss)/profit before taxation		(465.4)	(346.0)	(811.4)	20.7	(79.3)	(58.6)
Income tax	7	(41.0)	80.4	39.4	(6.1)	19.4	13.3
(Loss)/profit for the period		(506.4)	(265.6)	(772.0)	14.6	(59.9)	(45.3)
Attributable to:							
Equity shareholders	8	(506.7)	(265.6)	(772.3)	13.8	(59.9)	(46.1)
Minority interests		0.3	–	0.3	0.8	–	0.8
		(506.4)	(265.6)	(772.0)	14.6	(59.9)	(45.3)
(Losses)/earnings per share	8	(6.18)p	(3.24)p	(9.42)p	0.17p	(0.73)p	(0.56)p

The significant items in 2013 relate to:

- £10.0m (2012: £nil) of provisions made for potential customer redress relating to past sales of interest rate swaps (notes 2 and 27);
- £53.0m (2012: £40.0m) of provisions made for potential customer redress relating to past sales of payment protection insurance (notes 3 and 27);
- £30.0m (2012: £nil) of provisions made for potential customer redress relating to the processing of first payments on certain mortgages (notes 6 and 27). A further £3.7 million of redress costs relating to interest payments are included in the results before significant items;
- £26.0m (2012: £nil) of provisions made for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection products (notes 3 and 27);
- £15.0m (2012: £nil) of provisions made for potential customer redress relating to arrears charges (notes 3 and 27);
- £29.0m (2012: £nil) of provisions made for potential customer redress following identification of a technical breach of the Consumer Credit Act (notes 2 and 27);
- £10.0m (2012: £20.0m) of costs incurred as a result of the bid for the Lloyds Bank branches (note 6);
- £14.7m (2012: £19.3m) of costs incurred on a programme of investment and integration (note 6);
- £9.9m (2012: £nil) of impairment of property, plant and equipment (note 6); and
- £148.4m (2012: £nil) of recharged costs relating to intangible asset impairment regarding the development of new banking systems (note 6).

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated statement of comprehensive income

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2013			*Period to 30 June 2012*		
	Equity shareholders	*Minority interests*	*Total*	*Equity shareholders*	*Minority interests*	*Total*
(Loss)/profit for the period	(772.3)	0.3	(772.0)	(46.1)	0.8	(45.3)
Other comprehensive (expense)/ income that may be recycled to profit or loss:						
Changes in cashflow hedges						
Net changes in fair value recognised directly in equity	(39.9)	(0.5)	(40.4)	32.4	(0.3)	32.1
Income tax	9.2	0.1	9.3	(3.9)	0.1	(3.8)
Transfers from equity to income or expense	(10.6)	–	(10.6)	(23.1)	(0.1)	(23.2)
Income tax	2.4	–	2.4	2.5	–	2.5
Changes in available for sale assets						
Net changes in fair value recognised directly in equity	(44.4)	–	(44.4)	159.3	–	159.3
Income tax	10.0	–	10.0	(40.7)	–	(40.7)
Transfers from equity to income or expense	13.4	–	13.4	(89.3)	–	(89.3)
Income tax	(3.1)	–	(3.1)	23.7	–	23.7
Other comprehensive (expense)/ income for the period, net of income tax	(63.0)	(0.4)	(63.4)	60.9	(0.3)	60.6
Total comprehensive (expense)/ income for the period	(835.3)	(0.1)	(835.4)	14.8	0.5	15.3

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated balance sheet
At 30 June 2013
All amounts are stated in £m unless otherwise indicated

	Notes	*30 June 2013*	*30 June 2012*
Assets			
Cash and balances at central banks	9	5,402.1	4,316.6
Loans and advances to banks	10	1,737.5	2,359.7
Loans and advances to customers	11	32,715.9	34,008.4
Fair value adjustments for hedged risk	11	217.0	368.2
Investment securities – loans and receivables	12	30.6	483.0
Investment securities – available for sale	12	3,429.7	3,217.6
Investment securities – fair value through income or expense	12	1,622.3	817.4
Investment securities – held for trading	12	–	439.0
Derivative financial instruments	13	804.3	910.8
Equity shares	14	5.7	5.7
Investments in joint ventures	31	4.3	3.4
Goodwill	15	–	0.6
Intangible fixed assets	16	29.9	37.9
Investment properties	17	153.0	172.2
Property, plant and equipment	18	48.4	72.2
Amounts owed by other Co-operative Group undertakings	32	0.5	288.9
Other assets	19	44.4	51.7
Prepayments and accrued income	20	16.9	17.6
Current tax assets		266.3	37.3
Deferred tax assets	28	103.5	109.9(1)
Total assets		46,632.3	47,718.1
Liabilities			
Deposits by banks	21	3,517.8	4,416.0
Customer accounts		34,166.3	33,054.7
Customer accounts – capital bonds	22	756.0	1,141.7
Debt securities in issue	23	4,610.0	4,146.8
Derivative financial instruments	13	662.7	983.1
Other borrowed funds	24	1,248.1	1,257.1
Amounts owed to other Co-operative Group undertakings	32	123.9	97.7
Other liabilities	25	88.5	90.6
Accruals and deferred income	26	33.9	26.4
Provisions for liabilities and charges	27	293.0	104.4
Deferred tax liabilities	28	117.4	111.5(1)
Total liabilities		45,617.6	45,430.0
Capital and reserves attributable to the Bank's equity holders			
Ordinary share capital	33	410.0	410.0
Share premium account	33	8.8	8.8
Retained earnings		532.0	1,687.7
Available for sale reserve		5.9	72.5
Cashflow hedging reserve		24.8	75.5
		981.5	2,254.5
Minority interests		33.2	33.6
Total equity		1,014.7	2,288.1
Total liabilities and equity		46,632.3	47,718.1

(1) The 2012 balance sheet comparatives have been re-presented to reflect that certain deferred tax liabilities cannot be offset against the deferred tax assets.

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated statement of cash flows
For the period ended 30 June 2013
All amounts are stated in £m unless otherwise indicated

	Period to 30 June 2013	*Period to 30 June 2012*
Cash flows from operating activities		
Loss before taxation	(811.4)	(58.6)
Adjustments for:		
Increase in prepayments and accrued income	(7.7)	(0.2)
Increase/(decrease) in accruals and deferred income	23.9	(18.9)
Interest payable in respect of other borrowed funds	45.3	36.3
Effect of exchange rate movements	(12.8)	8.6
Fair value movement on investment properties	18.9	(0.1)
Impairment losses on loans and advances	495.8	95.8
Movements on investment impairments	(19.0)	(2.7)
Depreciation and amortisation	4.8	8.4
Impairment of intangible fixed assets	2.0	–
Interest amortisation	(0.2)	(4.7)
Fair value movements and amortisation of investment securities	44.0	(55.6)
Impairment of property, plant and equipment	9.9	–
Profit on disposal of property, plant and equipment	–	(0.4)
Unwind of fair value adjustments arising on transfer of engagements	8.2	(19.7)
Preference dividend	2.8	2.8
	(195.5)	(9.0)
(Decrease)/increase in deposits by banks	(94.2)	1,113.3
Decrease in customer accounts and capital bonds	(1,850.1)	(2,223.7)
Decrease in debt securities in issue	(148.4)	(59.7)
(Increase)/decrease in loans and advances to banks	(41.4)	76.9
Decrease/(increase) in loans and advances to customers	291.2	(278.5)
Decrease/(increase) in amounts owed by other Co-operative Group undertakings	255.9	(109.7)
Increase/(decrease) in amounts owed to other Co-operative Group undertakings	11.9	(34.6)
Net movement of other assets and other liabilities	(224.7)	(128.8)
Income tax received/(paid)	16.4	(0.7)
Net cash flows from operating activities	(1,978.9)	(1,654.5)
Cash flows from investing activities		
Purchase of tangible and intangible fixed assets	(0.5)	(0.5)
Proceeds from sale of fixed assets	–	0.8
Proceeds from sale of investment property	1.3	0.7
Purchase of investment securities	(2,033.8)	(2,176.7)
Proceeds from sale and maturity of investment securities	3,875.2	1,981.5
Net cash flows from investing activities	1,842.2	(194.2)

	Period to 30 June 2013	Period to 30 June 2012
Cash flows from financing activities		
Interest paid on other borrowed funds	(44.3)	(48.1)
Dividends paid to minority interests	(0.1)	(0.3)
Preference share dividends paid	(2.8)	(2.8)
Net cash flows from financing activities	(47.2)	(51.2)
Decrease in cash and cash equivalents	(183.9)	(1,899.9)
Cash and cash equivalents at the beginning of the period	6,314.2	7,888.4
Cash and cash equivalents at the end of the period	6,130.3	5,988.5
Cash and balances with central banks (note 9)	5,331.7	4,278.3
Loans and advances to banks (note 10)	673.6	1,450.2
Short term investments (note 12)	125.0	260.0
	6,130.3	5,988.5

The cash flows cannot be directly reconciled to the balance sheet movements as these movements include the non-cash unwinds of the fair value adjustments arising on the transfer of engagements of Britannia Building Society.

The 2012 comparatives have been re-presented to reflect a correction of the analysis of loans and advances to banks between the cash and cash equivalent analysis and the increase/decrease in loans and advances to banks line.

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Consolidated statement of changes in equity

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

	Attributable to equity holders of the Bank							
	Share capital	*Share premium*	*Available for sale reserve*	*Cashflow hedging reserve*	*Retained earnings*	*Total*	*Minority interest*	*Total equity*
Period from 1 January 2013 to 30 June 2013								
At the beginning of the period	410.0	8.8	30.0	63.7	1,304.3	1,816.8	33.4	1,850.2
Total comprehensive income for the period	–	–	(24.1)	(38.9)	(772.3)	(835.3)	(0.1)	(835.4)
Transactions with owners recorded directly in equity:								
Dividend	–	–	–	–	–	–	(0.1)	(0.1)
At the end of the period	410.0	8.8	5.9	24.8	532.0	981.5	33.2	1,014.7
Period from 1 January 2012 to 30 June 2012								
At the beginning of the period	410.0	8.8	19.5	67.6	1,733.8	2,239.7	33.4	2,273.1
Total comprehensive income for the period	–	–	53.0	7.9	(46.1)	14.8	0.5	15.3
Transactions with owners recorded directly in equity:								
Dividend	–	–	–	–	–	–	(0.3)	(0.3)
At the end of the period	410.0	8.8	72.5	75.5	1,687.7	2,254.5	33.6	2,288.1

The accounting policies and notes on pages 287 to 389 form part of this financial information.

Basis of preparation and significant accounting policies
For the period ended 30 June 2013

1. Basis of preparation

The Bank's financial information has been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and IFRS Interpretations Committee (IFRIC) guidance as adopted by the European Union (EU).

Standards and interpretations issued and effective

In preparing this consolidated financial information, the Bank has adopted the following pronouncements during the year that are new or revised:

- *IFRS 13 (Fair Value Measurement (2011))*

  This new standard defines fair value and also acts as its single authority, dealing primarily with both its measurement and disclosure. It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The adoption of this new standard resulted in additional disclosures set out in note 34.

- *Amended IAS 1 (Presentation of Items of Other Comprehensive Income)*

  This amendment's objective is to split the presentation of other comprehensive income into two sections. The different sections will distinguish between items which may or may not be recycled into any future income or expense. The amendment to IAS 1 has no material impact on the financial information of the Bank.

- *Revised IAS 19 (Employee Benefits (2011))*

  This revision covers the standard's recognition, measurement and presentation criteria with regard to a pension scheme's expense contained within IAS 19's 'defined benefit' scope. Actuarial gains or losses will now be fully recognised within income or expense, thus removing the previous partial recognition of 'corridor and spreading'.

  Furthermore, the revision eliminates the 'expected return on assets' from the measurement of a pension's expense and directs entities to instead charge a cost of finance against its net unfunded liability position.

  When determining a discount rate, that calculates a pension obligation's present value, reference should be made to market yields. These yields should be matched to high quality corporate bonds, in terms of both the obligation's currency and maturity, ahead of any previously assumed government bond yield reference point.

  The adoption of this revised standard resulted in additional disclosure (see note 29). The impact to income statement was immaterial to 30 June 2013 as the rate of future contributions remains unchanged. Contributions are reviewed triennially as part of the Pace scheme's valuation.

- *Amendments to IFRS 7 (Disclosures Offsetting Financial Assets and Liabilities)*

  This amendment requires disclosures to include information that will enable users of an entity's financial information to evaluate the effect of netting arrangements, on the entity's financial position. The amendment to IFRS 7 has no material impact on the financial information of the Bank.

Standards and interpretations issued but not yet effective

- *IFRS 9 (Financial Instruments: Classification and Measurement (2010))*

  This new standard replaces IAS 39 (Financial Instruments: Recognition and Measurement (2009)). Phase one requires financial assets to be classified as at amortised cost or at fair value. Further phases of IFRS 9 are scheduled to cover impairment and hedge accounting.

  It becomes effective for accounting periods beginning on or after 1 January 2015. Early adoption is permitted, once endorsed by the EU. The impact of IFRS 9 is likely to be material to the Bank, due to the value of financial instruments held on the Bank's balance sheet. The standard is currently being drafted and so a detailed assessment of its impact is not currently possible.

- *IFRS 10 (Consolidated Financial Statements (2011))*

  This new standard establishes principles for the presentation and preparation of consolidated financial information when an entity controls one or more other entities. It supersedes both IAS 27 (Consolidated and Separate Financial Statements (2008)) except where IAS 27 still applies as noted below, and Amended SIC 12 (Consolidation: Special Purpose Entities (2004)). It aims to provide transparency in identifying off balance sheet, parent subsidiary relationships, using a consistent basis for determining the existence and thus consolidation of those underlying entities being controlled by the reporting entity.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Bank of IFRS 10 is likely to be immaterial.

- *IFRS 11 (Joint Arrangements (2011))*

  This new standard establishes principles for financial reporting by parties to a joint arrangement. It supersedes both IAS 31 (Interests in Joint Ventures (2010)) and Amended SIC 13 (Jointly Controlled Entities: Non-Monetary Contributions by Venturers (2007)). Recognition criteria now distinguish between joint operations and joint ventures on their relative 'rights and obligations' scope. A joint operation interest is accounted for between assets, liabilities, revenue and expense, whilst a joint venture is restricted to equity accounting.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Bank of IFRS 11 is likely to be immaterial.

- *IFRS 12 (Disclosure of Interests in Other Entities (2011))*

  This new standard applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It aims to provide disclosure transparency on the reporting entity's risks associated with its interests in other entities, in conjunction with IFRS 10's application which determines the existence of such entities.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact to the Bank of the additional disclosure requirements is likely to be immaterial.

- *Amended IAS 27 (Consolidated and Separate Financial Statements (2011))*

  This amendment occurs as a direct consequence of IFRS 10's issuance, which now acts as the new single authority on consolidation requirements. IAS 27's scope has therefore reduced and focuses more specifically on separate financial information accounting bases. An entity shall therefore prepare its separate financial information using one of two bases; either at cost or in accordance with IFRS 9.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 27 is likely to be immaterial to the Bank.

- *Amended IAS 28 (Investments in Associates and Joint Ventures (2011))*

  This amendment occurs as a direct consequence of IFRS 11's issuance, which now acts as the new single authority on joint arrangements. IAS 28 changes in order to consistently apply equity accounting methods for both joint ventures and associates. An entity shall therefore use IAS 28's equity accounting method, when accounting for any of IFRS 11's joint arrangements.

  It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 28 is likely to be immaterial to the Bank.

- *Amendments to IAS 32 (Offsetting Financial Assets and Financial Liabilities)*

  The current offsetting model in IAS 32 requires an entity to offset a financial asset and financial liability only when the entity currently has a legally enforceable right of set-off and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously. This amendment clarifies the position when offsetting financial assets and financial liabilities. The legal right of set-off must be available today and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The amended disclosures will require more extensive disclosures than are currently required. The disclosures focus on quantitative information about recognised financial instruments that are offset in the statement of financial position, as well as those recognised financial instruments that are subject to master netting or similar arrangements irrespective of whether they are offset.

  It becomes effective for accounting periods beginning on or after 1 January 2014. It has been adopted for use within the EU for accounting periods beginning on or after 1 January 2014. The impact of the amendment to IAS 32 is likely to be immaterial to the Bank.

  Other standards and interpretations have been issued but these are not considered to be relevant to the Bank's operations.

2. Going concern

a. Introduction

This financial information is prepared on a going concern basis. The directors have a reasonable expectation that the Bank will have the resources to continue in business for the foreseeable future, subject to the comments below.

The assessment of the going concern basis of preparation has been subject to a thorough process involving analysis and discussion by management, Executive and Board committees and the Board, in line with our governance processes and discussion with the PRA. This analysis covered forecast information for the Bank's planning period, 2013-2018, with a particular focus on the period up to and including 2015, as well as the management actions agreed as part of the Recapitalisation Plan (as defined and detailed below). The forecasts covering the planning period included stressed scenarios, which the Board considered to be reasonable and appropriate.

Since the publication of its unaudited interim financial report for the six month period ended 30 June 2013, on 29 August 2013, the Bank has continued to work on its plan and has continued its engagement with the PRA in relation to this plan. The successful execution of the Recapitalisation Plan, is intended to significantly strengthen the Bank's capital base through the generation of an additional £1.5bn of common equity tier 1("CET1") capital, and to reshape the business as a core relationship bank. This is intended to enable the Bank to meet the requirement to hold CET1 resources of at least 7% of risk weighted assets. Despite this, the Bank is currently below the Individual Capital Guidance for total capital set by the PRA, and is forecast to remain so for most of the duration of the planning period. The PRA has reviewed and accepted this plan.

Nevertheless, at present, there is material uncertainty around the implementation of the Recapitalisation Plan, a cornerstone of which is the Exchange Offer, as outlined below.

b. **Recapitalisation Plan**

Continuing losses in the first half of 2013 have reduced capital to a point where if the Exchange Offer, discussed below, does not take place, the Bank would not remain a going concern. Successful execution of the Recapitalisation Plan is necessary in order for the Bank to remain a going concern. Total Basel II capital resources as at 30 June 2013 are £1.5bn (30 June 2012: £3.1bn) with core tier 1 capital after regulatory deductions of £0.8bn (30 June 2012: £2.0bn). As at 30 June 2013, the Bank's CET1 ratio stands at 3.0% on a Basel III end point basis, representing a shortfall to the PRA's direction that, based on Basel III end point rules, major UK banks should hold CET1 capital resources of at least 7% of their risk weighted assets by December 2013.

In the Bank's 17 June 2013 announcement, updated on 4 November, the directors acknowledged a £1.5bn CET1 capital shortfall. To address this, the current plan (the Recapitalisation Plan) announced on 4 November comprises the following:

i. **Exchange Offer**

The Exchange Offer, is forecast to generate approximately £1.14bn of CET1 capital towards the end of 2013 and comprises the following components:

a) £1.019bn to be generated, net of £43m of expenses, via an Exchange Offer to holders of the Bank's subordinated capital securities including the issue of £129m Co-operative Group bonds and £206m of new Bank Tier 2 bonds; and

b) Lower Tier 2 investors injecting £125m of new equity capital, fully underwritten by a group of Lower Tier 2 bondholders.

ii. **Further contribution in 2014**

A further cash contribution to the Bank in 2014 of £333m, committed by The Co-operative Banking Group, is expected to be sourced primarily from the sale proceeds of the Insurance businesses. This contribution is contingent on a successful Exchange Offer. The Co-operative Banking Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of this further contribution in the event that the proceeds for the sale of Insurance businesses are not sufficient to satisfy The Co-operative Banking Group's contribution of £333m or otherwise not received in time to satisfy the PRA's required timing for the satisfaction of this commitment. Based on the information provided by The Co-operative Banking Group and on investigations made by and on behalf of the Bank, the Bank believes that the incorporation of this contribution into its plans is appropriate. In addition, retiring the subordinated capital securities is expected to generate interest savings of approximately £40m in 2014.

iii. **Refocus on core relationship banking proposition**

The Co-operative Bank remains a strong brand and continues to maintain a loyal customer base. Moving forward, the strategy is to reshape the business as a core relationship bank providing business banking and standard retail banking services including but not limited to current accounts, loans, credit cards, residential mortgages and savings products to individuals and small businesses and restructuring the business, including head office costs, to drive a significant reduction of the cost base.

A key underpin of the reshaping of the business is the reduction in the non-core banking business and assets, which carry the majority of the impairment risk for the Bank currently. This will reduce the risk weighted assets of the Bank, thereby improving its Basel III CET1 and leverage ratios.

Risks and uncertainties

Risks associated with successful execution of the Recapitalisation Plan include:

i. Successful execution and completion of the Exchange Offer within the required timeframe;

ii. Continued ability of The Co-operative Banking Group to enhance the capital of the Bank through the 2014 contribution;

iii. The ability of the Bank to implement the plan and to achieve the results set out in the plan. In this respect particular challenges include (but are not limited to): ability to achieve the targeted cost savings; ability to retain customers and deposits; the timing and quantum of impacts to capital from the asset reduction exercise; meeting its planned improvements in net interest margin; a possible further deterioration in the quality of the Bank's asset portfolio; unplanned costs from (for example) conduct risk matters and ability to maintain the Bank's access at an appropriate cost to liquidity and funding;

iv. The ability of the Bank to raise further tier 2 capital which is assumed in its forecasts covering the planning period; and

v. The Bank needs the continuing support of the PRA in accepting and moving forward with its plan and to the extent this is not forthcoming or to the extent that the Bank doesn't perform in line with its plan, additional capital over and above that included in the plan may be required. This could also be the case if there are increases in regulatory capital requirements as a result of changes to international regulations (e.g. Basel III) or other changes to legislation or other market wide regulatory requirements.

The Recapitalisation Plan is forecast to increase CET1 capital by approximately £1.14bn in 2013 and an additional £333m generated in 2014 from The Co-operative Banking Group's contribution and £40m of interest savings on retired bonds. The Bank's Basel III end point CET1 ratio is forecast to move above 7% following the successful completion of the Exchange Offer. These strengthened capital ratios will put the Bank in a better position to withstand future market wide or idiosyncratic stresses.

c. **Liquidity**

The Bank has continued to maintain an acceptable liquidity position through the period to 30 June 2013, with a liquid asset ratio of 13.2% (30 June 2012: 12.4%). In addition, during the first half of 2013, the Bank proactively managed its liquidity position, maintaining a regulatory liquidity buffer, and has continued to restructure existing exposures to improve the funding profile.

Retail deposits have remained broadly stable in the period to 30 June 2013, however the Bank recognises that liquidity risk is particularly elevated until the short term objectives under the Recapitalisation Plan have been achieved.

d. **Conclusion**

The directors have concluded that risks set out above in connection with the Recapitalisation Plan, a cornerstone of which is the Exchange Offer, and their potential consequential effects, represent a material uncertainty which may cast significant doubt upon the Bank's ability to continue as a going concern. The Bank may, therefore, be unable to continue realising its assets and discharging its liabilities in the normal course of business. Nevertheless, after making enquiries and considering the current forecasts, in particular those for the period up to and including 2015, and taking into account the material uncertainty described above, the directors have a reasonable expectation that the Bank will have adequate resources to continue in business over this period. For these reasons, they continue to adopt the going concern basis in preparing this financial information. This set of financial information does not include the adjustments that would result if the Bank was unable to continue as a going concern.

Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in this financial information.

1. Business combinations

On 1 August 2009, The Co-operative Bank p.l.c merged with Britannia Building Society, with Britannia transferring their engagements to the Bank.

This business combination has been accounted for applying the requirements of IFRS 3 (Business Combinations (2004)).

The consideration transferred was valued by reference to the members' interests acquired. Financial assets and liabilities which, following the Bank's accounting policies, would be carried at amortised cost, were brought onto the balance sheet at their fair value at acquisition and were subsequently carried at amortised cost using the effective interest rate method. The income statement includes the results of the engagements transferred from Britannia since the date of acquisition.

2. Basis of consolidation

a. **Subsidiaries**

Subsidiaries are entities controlled by the Bank. Control exists whenever the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial information of subsidiaries is included in the consolidated financial information from the date that control commences until the date that control ceases. The financial information has been prepared using uniform accounting policies and is based on the same accounting period as the Bank.

Intra-group balances and transactions, and any unrealised gains and losses arising from intra-group transactions, are eliminated in preparing the consolidated financial information.

b. **Special purpose entities**

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well defined objective; for the Bank this includes:

- various securitisation transactions in which mortgages were sold to SPEs. The equity of these SPEs is not owned by the Bank; and
- Covered Bond Limited Liability Partnerships created in order to act as a guarantor for the issue of covered bonds (refer to note 34d for further information).

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Bank and the SPE's risks and rewards, the Bank concludes that it controls the SPE.

The following circumstances may indicate a relationship in which, in substance, the Bank controls and consequently consolidates an SPE:

- the activities of the SPE are being conducted on behalf of the Bank according to its specific business needs so that the Bank obtains benefits from the SPE's operation;
- the Bank has the decision making powers to obtain the majority of the benefits of the activities of the SPE;
- the Bank has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to the risks incidental to the activities of the SPE; or
- the Bank retains the majority of the residual or ownership risks related to the SPE or its assets in order to obtain benefits from its activities.

The above circumstances apply to all of the SPEs. Consequently the Bank consolidates each SPE.

The assessment of whether the Bank has control over an SPE is carried out at inception. No further assessment of control is carried out unless changes in the structure or terms of the SPE or additional transactions between the Bank and the SPE occur.

c. **Interests in joint ventures**

The Bank's interests in joint ventures are accounted for using the equity method. The consolidated financial information includes the Bank's share of the income and expenses and equity movements of equity accounted investees, after adjustments to align the accounting policies with those of the Bank.

3. Revenue recognition

a. **Interest income and expense**

Interest income and expense is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs and fees including arrangement and broker fees, valuation and solicitor costs, discounts and premiums where appropriate and early redemption fees.

The EIR basis spreads the interest income and expense over the expected life of each instrument. The EIR is the rate that, at the inception of the instrument, exactly discounts expected future cash payments and receipts through the expected life of the instrument back to the initial carrying amount. When calculating the EIR, the Bank estimates cash flows considering all contractual terms of the instrument (for example, prepayment options) but does not consider assets' future credit losses except for assets acquired at a deep discount.

For assets acquired at a value significantly below the carrying value in the acquiree's financial information because they have incurred loss, expectations of future loss are higher than at origination, and interest spreads have widened because of deteriorating market conditions, the calculation of EIR is the same as shown above with the exception that the estimates of future cash flows include credit losses.

b. **Fees and commissions**

Fee and commission income is predominantly made up of arrangement and other fees relating to loans and advances to customers that are included in the effective interest calculation. Commitment fees received are deferred and included in the EIR calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

Fees and commissions payable to introducers in respect of obtaining lending business, where these are direct and incremental costs related to the issue of a financial instrument, are included in interest income as part of the effective interest rate.

All other fee and commission income, such as loan closure fees or arrears fees, not included in the effective interest calculation, is recognised on an accruals basis as the service is provided.

4. Significant items

Items which are material by both size and nature (ie outside of the normal operating activities of the Bank) are treated as significant items and disclosed separately on the face of the income statement.

The separate reporting of significant items helps to provide an indication of the Bank's underlying business performance. Events which may give rise to the classification of items as significant include individually significant programmes of restructuring, investment, integration and provisions for material non-recurring items.

5. Financial instruments (excluding derivatives)

a. **Recognition**

The Bank initially recognises loans and advances, deposits, debt securities issued and other borrowed funds on the date at which they are originated.

Regular way purchases and sales of financial assets are recognised on the trade date at which the Bank commits to purchase or sell the asset. All other financial assets and liabilities are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

b. **Derecognition**

Financial assets are derecognised when all the rights to receive contractual cash flows have ceased, or they are qualifying transfers where:

- the rights to receive contractual cash flows from the assets have ceased; and
- the Bank has transferred substantially all the risks and rewards of ownership of the assets.

When a financial asset is derecognised in its entirety, the difference between the carrying amount and the sum of the consideration received (including any new asset obtained less any new liability assumed), and any cumulative gain or loss that had been recognised in other comprehensive income, is recognised in the income statement.

When available for sale financial assets are derecognised, the cumulative gain or loss, including that previously recognised in reserves, is recognised in the income statement.

A financial liability is derecognised when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability derecognised and the consideration paid is recognised through the income statement.

c. **Financial assets**

i. **Overview**

The Bank classifies its financial assets (excluding derivatives) as either:

- loans and receivables;
- available for sale; or
- financial assets at fair value through income or expense.

ii. **Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and the Bank does not intend to sell immediately or in the near term. These are initially measured at fair value plus transaction costs that are directly attributable to the financial asset. Subsequently, these are measured at amortised cost using the effective interest method. The amortised cost is the amount advanced less principal repayments, plus or minus the cumulative amortisation using the EIR method of any difference between the amount advanced and the maturity amount less impairment provisions for incurred losses.

Loans and receivables mainly comprise loans and advances to banks and customers (except where the Bank has elected to carry the loans and advances to customers at fair value through income or expense as described in accounting policy (5c. iv. below) and assets reclassified from available for sale (see below)).

iii. **Available for sale**

Available for sale financial assets are debt securities and equity shares that are not held for trading and are intended to be held for an indefinite period of time. These are measured at fair value based on current bid prices where quoted in an active market. Where the debt securities and equity shares are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Movements in fair value are recorded in equity as they occur. On disposal, gains and losses recognised previously in equity are transferred to the income statement. In exceptional circumstances, for instance where the market in the securities has become inactive, the Bank has reclassified such assets as loans and receivables.

Any transfer back from loans and receivables, upon reclassification, would be measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the debt securities or equity shares are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques.

iv. **Financial assets at fair value through income or expense**

These are:

- financial assets designated at fair value through income or expense

  Financial assets designated at fair value are assets which have been designated to eliminate or significantly reduce a measurement and recognition inconsistency or where management specifically manages an asset or liability on that basis eg capital bonds.

  These assets are measured at fair value based on current bid prices where quoted in an active market. Where there is no active market or the securities are unlisted the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques. Gains and losses arising from changes in the fair value are brought into the income statement within trading income as they arise.

- financial assets held for trading

  Financial assets held for trading are assets which have been principally acquired for the purpose of selling or repurchasing in the near term, or they form part of a portfolio of identified financial instruments that are managed together for which there is evidence of a recent pattern of short term profit taking. These financial assets are recognised on the date of trade, when the Bank enters into contractual arrangements with counterparties to purchase or sell financial instruments, and are normally derecognised when sold. Measurement is initially at fair value, with transaction costs taken to the income statement. Subsequently their fair values are remeasured, and gains and losses from changes therein are recognised in the income statement within trading income.

d. **Financial liabilities**

i. **Overview**

Financial liabilities are contractual obligations to deliver cash or another financial asset. Financial liabilities are recognised initially at fair value, net of directly attributable transaction costs.

Financial liabilities, other than derivatives and capital bonds, are subsequently measured at amortised cost.

Capital bonds within customer accounts have been designated at fair value through income or expense upon initial recognition in the balance sheet. Changes in fair value are recognised through the income statement.

The capital bonds are economically matched using equity linked derivatives, which do not meet the requirements for hedge accounting. Recording changes in fair value of both the derivatives and the related liabilities through the income statement most closely reflects the economic reality of the transactions. In doing so this accounting treatment eliminates a measurement inconsistency that would otherwise arise from valuing the capital bonds at amortised cost and the derivatives at fair value.

ii. **Borrowed funds**

Borrowings are recognised initially at fair value, which equates to issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

The Bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. The Bank's preference shares are classified as financial liabilities as they carry the right to a fixed non-cumulative preferential dividend (further information is provided in note 24) and are subsequently presented in other borrowed funds. The dividends on these preference shares are recognised in the income statement as interest expense on an amortised cost basis using the EIR method.

iii. **Perpetual subordinated bonds**

Perpetual subordinated bonds are carried at their nominal value plus any premium and a fair value adjustment for hedged risk where items are designated as part of a fair value hedge relationship.

Interest payable on perpetual subordinated bonds is recognised in the income statement using the EIR method.

6. Impairment provisions

a. **Assessment**

i. **Objective evidence**

At the balance sheet date, the Bank assesses its financial assets, not at fair value through income or expense, for objective evidence that an impairment loss has been incurred.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower, a breach of contract, such as default or delinquency in interest or principal payments, the granting by the Bank to the borrower, for economic and legal reasons relating to the borrower's financial difficulty, a concession that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy or other financial reorganisation, or the disappearance of an active market for a security.

The Bank considers evidence for impairment for loans and advances at both a specific asset and collective level.

ii. **Forbearance**

The Bank operates a policy of forbearance which mitigates against borrower default. All such cases are included within its provisioning methodology.

- Residential secured mortgages

  If a loan is identified as being subject to forbearance, it is assessed for impairment. Once classified as impaired, mortgages subject to forbearance are treated in the same way as all other impaired mortgages in the impairment provisions calculations.

- Unsecured retail business

  Loans are treated as impaired where the Bank has granted forbearance concessions. The amount of the impairment provision will vary with the type of concession granted.

- Corporate business

  Impairment provisions are made for accounts subject to forbearance which are in default or on a watchlist.

  Corporate customers are placed on a watchlist when they show signs of unsatisfactory performance and require close control, but are currently expected to continue trading and where no provision for bad debt is required. Forbearance is a strong indicator that a customer should be placed on the watchlist.

For further information on the Bank's approach to forbearance, its management and execution, see the risk management section on pages 310 to 338.

b. **Scope**

i. **Individual accounts**

All secured loans and advances are assessed for impairment using a range of criteria graded for levels of risk. Accounts at risk of impairment are monitored and impaired where they display clear indicators of underperformance.

Loans and advances that do not meet the criteria for individual impairment are collectively assessed for impairment by grouping together loans and advances of similar risk characteristics.

ii. **Collective accounts**

a. **Retail**

When assessing collective impairment for secured retail loans, the Bank estimates incurred losses on mortgages based on the borrower's external credit score or where the loan is identified as being subject to forbearance.

When assessing collective impairment for unsecured retail loans, the Bank estimates losses on loans with delinquency greater than a pre-determined trigger point. In addition the Bank makes provision on all loans arising from fraud and loans transferred to debt collection agencies. In respect of unsecured loans, the Bank uses statistical modelling of historical trends of probability of default, timing of recoveries and the amount of loss incurred.

The model's results are adjusted for management's judgment as to whether current economic and credit conditions are such that actual losses are likely to differ from those suggested by historical modelling. Once impaired, accounts are subjected to higher levels of impairment according to both their relevant stage of delinquency, ie the number of days in arrears, and their consequent likelihood of ultimately being charged off. Default rates, loss rates and future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

b. **Corporate**

Collective risk cover provides further balance sheet protection for impairment losses. The amount of collective risk cover is reviewed regularly by the Bank. The Bank reviews all loans and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation). Trigger events may include a deteriorating balance sheet, material losses, trading difficulties (eg loss of material contracts or suppliers), breach of financial covenants, poor account conduct, arrears and material reduction in value of security. A collective impairment provision is raised against these loans based on the total estimated loss that may arise and the propensity for the borrower to fail.

c. **Measurement**

The amount of the loss is the difference between:

- the asset's carrying amount; and
- the present value of estimated future cash flows (discounted at the asset's original or variable EIR for amortised cost assets and at the current market rate for available for sale assets).

Where the debt is secured, the assessment reflects the expected cash flows from the realisation of the security, net of cost to realise, whether or not foreclosure or realisation of the collateral is probable.

d. **Impairment of financial assets carried at amortised cost**

The amount of the impairment loss on assets carried at amortised cost is recognised immediately through the income statement and a corresponding reduction in the value of the financial asset is recognised through the use of an allowance account.

A write off is made when all or part of a claim is deemed uncollectable or forgiven after all the possible collection procedures have been completed and the amount of loss has been determined. Write offs are charged against previously established provisions for impairment or directly to the income statement.

Any additional recoveries from borrowers, counterparties or other third parties made in future periods are offset against the write off charge in the income statement once they are received.

Provisions are released at the point when it is deemed that following a subsequent event the risk of loss has reduced to the extent that a provision is no longer required.

e. **Impairment of financial assets classified as available for sale**

Available for sale assets are assessed at each balance sheet date to see whether there is objective evidence of impairment. In such cases, any impairment losses are recognised by transferring the cumulative loss that has been recognised directly in equity to income or expense.

When a subsequent event causes the amount of impaired loss on available for sale investment securities to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement.

However any further recovery in fair value of an impaired available for sale equity security is recognised directly in equity.

7. Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to do so and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

8. Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) are reclassified on the balance sheet as pledged assets when the transferee has the right by contract or custom to sell or repledge the assets. The liability to the transferee is also included on the balance sheet, in deposits by banks. The difference between sale and repurchase price is accrued over the life of the agreements using the EIR method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

9. Derivative financial instruments and hedge accounting

a. **Derivatives used for asset and liability management purposes**

Derivatives are used to hedge interest and exchange rate exposures related to non-trading positions. Instruments used for hedging purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. The Bank also uses equity derivatives to hedge the equity risks within its capital bonds.

Derivative financial instruments are stated at fair value based on quoted market prices in active markets and, where these are not available, using valuation techniques such as discounted cashflow models. Further information is provided on note 34. All derivatives are carried as assets when the fair value is positive and liabilities when the fair value is negative. The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cashflow hedge accounting.

On initial designation of derivatives and qualifying hedged items as a hedge, the Bank formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objective and strategy in undertaking the hedge transaction together with the method used to assess effectiveness of the hedging relationship.

The Bank makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instruments are expected to be 'highly effective' on offsetting the changes in fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80% to 125%.

i. **Cash flow hedges**

Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the portion of the fair value gain or loss on the derivative that is determined to be an effective hedge is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement immediately.

The accumulated gains and losses recognised in equity are reclassified to the income statement in the periods in which the hedged item will affect income or expense. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss recognised at that time remains in equity until the forecast transaction is eventually recognised in the income statement.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in equity is immediately reclassified to the income statement.

ii. **Fair value hedges**

Where a derivative is designated as the hedging instrument to hedge the change in fair value of a recognised asset or liability or a firm commitment that could affect income or expense, changes in the value of the derivative are recognised immediately in the income statement together with changes in the fair value of the hedged item that are attributable to the hedged risk.

Fair values are based on quoted market prices in active markets or, where these are not available, using valuation techniques such as discounted cashflow models.

If the derivative expires or is sold, terminated, or exercised, or no longer meets the criteria for fair value hedge accounting, or the designation is revoked, then hedge accounting is prospectively discontinued. Any adjustment up to that point, to a hedged item for which the EIR method is used, is amortised to income or expense as part of the recalculated EIR of the item over its remaining life.

iii. **Fair value hedge accounting for a portfolio hedge of interest rate risk**

As part of its risk management process the Bank identifies portfolios whose interest rate risk it wishes to hedge. The portfolios may comprise only assets, only liabilities or both assets and liabilities. The Bank analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Bank decides the amount it wishes to hedge and designates as the hedged item an amount of assets or liabilities from each portfolio equal to this.

The Bank measures monthly the change in fair value of the portfolio relating to the risk that is being hedged. Provided that the hedge has been highly effective, the Bank recognises the change in fair value of each hedged item in the income statement with the cumulative movement in its value being shown on the balance sheet as a separate item, fair value adjustment for hedged risk, either within assets or liabilities as appropriate. If the hedge no longer meets the criteria for hedge accounting, this amount is amortised to the income statement over the remaining average useful life of the hedge relationship.

The Bank measures the fair value of each hedging instrument monthly. The value is included in derivative financial instruments in either assets or liabilities as appropriate, with the change in value recorded in the income statement.

Any hedge ineffectiveness is recognised in the income statement as the difference between the change in fair value of the hedged item and the change in fair value of the hedging instrument.

b. **Embedded derivatives**

A derivative may be embedded in another instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract (and the host contract is not carried at fair value through income or expense), the embedded derivative is separated from the host and held on balance sheet at fair value.

Movements in fair value are posted to the income statement, whilst the host contract is accounted for according to the relevant accounting policy for that particular asset or liability.

c. **Derivatives used for trading purposes**

Derivatives entered into for trading purposes include swaps, forward rate agreements, futures, options and combinations of these instruments. Derivatives used for trading purposes are measured at fair value and any gains or losses are included in the income statement. The use of derivatives and their sale to customers as risk management products is an integral part of the Bank's trading activities.

10. Financial guarantee contracts

Other financial guarantees, in respect of intra-group funding and the pension deficit in respect of the Britannia Pension Scheme, between the Bank and its subsidiaries are treated as insurance contracts in accordance with IFRS 4 (Insurance Contracts (2004)). In accordance with the standard, the recognised insurance liability is assessed based on the current estimate of forecast future cash flows. If this highlights that the liability is inadequate, the liability is increased and the corresponding charge taken through the income statement.

11. Property, plant and equipment

Items of property, plant and equipment are stated at cost less any accumulated depreciation and impairment losses. Depreciation is provided on a straight line basis at the following rates, which are estimated to write down the assets to realisable values at the end of their useful lives.

Freehold and long leasehold land and buildings	40–50 years
Freehold and leasehold improvements	10–40 years
Short leasehold buildings	life of lease
Equipment:	
Computer	3–7 years
Furniture and equipment	3–10 years

All items of property, plant and equipment are reviewed for indications of impairment on a regular basis and at each balance sheet date. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset.

If the carrying value of the asset is less than the recoverable amount, an impairment charge is recognised in the income statement.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised net within operating expenses in the income statement.

12. Intangible assets

a. **Computer software**

Computer software is stated at cost less cumulative amortisation and impairment and comprises computer software together with the costs of development of the software.

Acquired computer software licences are capitalised on the basis of cost incurred to acquire and bring the software to use.

Costs that are directly associated with the internal production of software products that will generate future economic benefit are capitalised. Only costs which meet the definition of development costs under IAS 38 (Intangible Assets) are capitalised, with costs being capitalised only if the asset can be reliably measured, will generate future economic benefits and there is an ability to use the asset. Expenditure that is not directly attributable to the development of such assets is recognised in the income statement in the period to which it relates.

The expenditure capitalised includes direct employee costs and an appropriate portion of relevant direct overheads. Amortisation is charged to the income statement on a straight line basis to allocate the cost over the estimated useful life up to a maximum of seven years.

b. **Other intangible assets**

Other intangible assets are stated at cost less cumulative amortisation and impairment. Amortisation is charged over the useful life of the asset. For core systems, a review of the asset's useful life is carried out and a maximum useful life of up to ten years is applied.

c. **Impairment**

Intangible assets are assessed for indications of impairment at least annually. If impairment is indicated, the asset's recoverable amount (being the greater of fair value less cost to sell and value in use) is estimated. Value in use is calculated by discounting the future cash flows generated from the continuing use of the asset. If the carrying value of the asset is less than the greater of the value in use and the fair value less costs to sell, an impairment charge is recognised to this value in the income statement. Irrespective of whether there is any indication of impairment, intangible assets in the course of construction are tested for impairment at least annually.

13. Goodwill

All business combinations are accounted for by applying the purchase method. Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures and represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

If a business combination is achieved without transfer of consideration, the amount of goodwill is calculated by reference to the fair value of the Bank's interest in the acquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting using a rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is not amortised but is tested for impairment on an annual basis. Where impairment is required, the amount is recognised in the income statement and cannot be subsequently reversed.

14. Leases

a. Overview

The Bank enters into leases for land and buildings and operating leases for vehicles and equipment.

Leases for land and buildings are split between leases for the land and leases for the buildings for accounting purposes only. The leases are separately assessed as to whether they are finance or operating leases.

The Bank policy is to provide for the minimum future lease payments on buildings that it does not currently use, net of expected rental income from sub-leases.

b. Assets leased to customers

All leases of assets to customers are finance leases. Income from assets leased to customers is credited to the income statement based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

c. Assets leased from third parties

i. Finance leases

Finance lease assets are initially recorded at the lower of fair value and the present value of the minimum lease payments, and subsequently in accordance with the relevant policy for the underlying asset. An equal liability is recorded in other liabilities. Interest is allocated to the lease payments so as to record a constant periodic rate of charge on the outstanding liability.

ii. Operating leases

Operating lease payments are charged to the income statement on a straight line basis over the term of the lease and the asset is not recognised on the balance sheet.

15. Investment property

Property held for long term rental yields that is not occupied by the Bank, or property held for capital appreciation, is classified as investment property.

Investment property comprises freehold land and buildings. It is carried at fair value. Fair value is based on discounted expected future cashflows, subject to periodic review via external third parties, reflecting market conditions. No depreciation is provided on these properties. Any gain or loss arising from a change in fair value is recognised in the income statement.

If the Bank takes occupancy of an investment property, it is reclassified as property, plant and equipment and its fair value at the date of reclassification becomes its cost for subsequent accounting purposes. Similarly, transfers to the investment property portfolio are made when occupancy by the Bank ceases and the property meets the criteria of an investment property under IAS 40. Prior to such a transfer the property is measured at fair value with any gain or loss recognised in the income statement.

16. Cash and cash equivalents

Cash and cash equivalents comprises cash balances and balances with a maturity of three months or less from the acquisition date, which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Overdrafts that are repayable on demand and form an integral part of the Bank's cash management are included as a component of cash and cash equivalents for the purpose of the cashflow statement.

17. Income tax

a. Overview

Tax on the income statement for the year comprises current and deferred tax, which is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in the statement of comprehensive income.

b. **Current tax**

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

c. **Deferred tax**

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided for is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

18. Pension costs

a. **Defined contribution basis**

The Bank, along with other businesses within the Co-operative Group, participates in the Co-operative Pension Scheme (Pace), the assets of which are held in a separate fund administered by trustees. Pace is a non-segregated hybrid scheme, consisting of a defined benefit and a defined contribution section.

As a Co-operative Group wide pension scheme, the Pace defined benefit section exposes the participating businesses to actuarial risks associated with the current and former employees of other Co-operative Group companies, with the result that there is no consistent and reliable basis for allocating Pace's liabilities, assets and costs to individual companies participating in the scheme.

Therefore pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred.

b. **Britannia Pension Scheme**

The Britannia Pension Scheme is a hybrid scheme, consisting of a defined benefit and a defined contribution section. Following the transfer of engagements of Britannia Building Society, ownership of the Britannia Pension Scheme transferred to CFSMS, a fellow subsidiary undertaking of The Co-operative Banking Group. The pension costs in respect of this scheme are accounted for, by the Bank, on a defined contribution basis and recognised as an expense in the income statement as incurred.

19. Foreign currency

The functional and presentational currency for the Bank is sterling. Transactions in foreign currencies are translated at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to sterling at the foreign exchange rate ruling at that date. Foreign currency differences arising on translation are recognised in the income statement, except for foreign currency differences arising on translation of available for sale equity instruments or a qualifying cashflow hedge, which are recognised directly in the statement of comprehensive income. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair values are translated to sterling at the exchange rates prevailing at the dates the values were determined.

20. Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Bank has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

21. Profit based payments to members of The Co-operative Group

Members of The Co-operative Group receive a dividend based on their transactions with The Co-operative Group and its subsidiaries including the Bank. Once these profit based payments are approved by The Co-operative Group Limited, the Bank is recharged an amount which reflects its eligible products' contribution to the overall Co-operative Group member dividend.

Critical judgments and estimates

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

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

The judgments and assumptions that are considered to be the most important to the portrayal of the Bank's financial condition are those relating to loan impairment provisions, conduct risk issues, intangible and tangible asset impairment and deferred tax.

a. **Loan impairment provisions**

i. **Overview**

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

The calculation of impairment loss includes expectations of levels of future cash flows, and is based on both the likelihood of a loan or advance being written off and the estimated loss on such a write off.

The changes in impairment provisions for Corporate, Optimum and Retail result from a management review of assumptions, with respect to the determination and operational alignment of the; probability of possession given default (PPD), treatment of forbearance, length of loss emergence periods, timing of impairment recognition and the formalising of charge off policy. Where required, management also periodically overlays collective provisions for additional risk parameters upon existing individual and collective impairment models.

Further explanation of the treatment of forborne balances is included in the Bank's risk management disclosures in sections 1.4.1.3, 1.4.1.4 and 1.4.1.5 on pages 314 to 327.

ii. **Collective provisions**

a. **Unsecured and secured residential**

The Bank's collective provision for retail personal advances has increased to £217.0m (30 June 2012: £167.3m). Loans are identified as impaired by taking account of the age of the debt's delinquency, the product type and the regularity of payments made whilst in arrears. The provision is calculated by applying a percentage rate to different categories and ages of impairment debt. The provision rates reflect the likelihood that the debt in that category/age will be written off or charged off at some point in the future. The rates are based on historical experience and current trends, which incorporate the effects of discounting at the customer interest rate and are subject to regular review. The provision is the product of the rate and the balance for the relevant arrears segment.

During 2013 the Bank has amended its unsecured provisioning methodology to treat accounts that are in arrears for over 180 days as charge off. These accounts will be operationally charged off during the second half of 2013. The Bank has also used improved management information which has resulted in a better understanding of the probability of possession given default on its exposure to residential mortgage assets. The status level for PPD has changed to 180 days past due for non-forborne customers and all customers that are on a forbearance plan from the previous state of possession. The material impact of this change was a PPD charge of £53.5m for Optimum. Consequently, the prevailing collective Optimum management overlay covering additional risks now stands at £25.7m (30 June 2012: £48.6m). Loss emergence periods have been extended to 12 months.

Further explanation of collective residential loan impairment method is included in the Bank's risk management disclosures in sections 1.4.1.3, 1.4.1.4 and 1.4.1.5 on pages 314 to 327.

The majority of provisions are made against unsecured loans. A key estimate within this provisioning model is the percentage provision rate applied to regular visa payers. A 5% change would change the collective provision by £2.5m.

b. **Corporate**

The Bank's corporate collective provision has increased to £100.1m (30 June 2012: £17.7m).

The methodology's key components comprise risk parameters defined by the Bank. The collective provision is calculated using factors such as observed default rates and loss given default. An assessment is made of the likelihood of the assets becoming recognised as impaired in the loss emergence period. It is a broad based approach, covering all live accounts not individually reviewed and where a trigger event could have occurred but has not yet been observed.

During 2013, the Bank has amended its methodology by reclassifying out of collective, into individual, those accounts which are being observed on a watchlist. These accounts may not carry any actual impairment, but display performance characteristics which indicate the emergence of such cases. No management overlay has been applied. Loss emergence period has changed from six to nine months. The definition of exposure within the calculation of impairment has been changed to exposure at default in order to exclude an element of balances which have not yet been drawn.

The formula underpinning this methodology applied to the unimpaired portfolio is:

Exposure at Default x Probability of Default x Loss Given Default x Loss emergence period of nine months. Both the Probability of Default and Loss Given Default are based on observed default rates in this portfolio.

A key estimate within the corporate collective model is the loss emergence period. A movement of one month in this estimate would change the provision by £14m.

iii. **Individual provisions**

a. **Secured residential**

The Bank's provision for credit protection on secured residential has increased. It is split between Retail £9.1m (30 June 2012: £9.4m) and Optimum £148.1m (30 June 2012: £129.6m) mortgages. Mortgage accounts are identified as impaired and provided for on an individual basis by taking account of the age of the debt's delinquency on a case by case basis.

Due to continuing difficulties and uncertainties currently being experienced in this sector, the Bank classifies all accounts with arrears outstanding for one monthly instalment or more as individually impaired.

The Bank has also used improved management information which has resulted in a better understanding of the probability of possession given default on its exposure to residential mortgage assets. The status level for PPD has changed to 180 days past due for non-forborne customers and all customers that are on a forbearance plan from the previous state of possession. The key management overlay for individual provisions covering such additional risks crystallising currently stands within Optimum at £25.7m (30 June 2012: £48.6m) and is being made on a collective basis. Loss emergence periods have been extended from three months to 12 months.

A key assumption in the judgment of estimated future credit losses is our estimate of future HPI movements, the material element of which sits in Optimum. If Optimum's future HPI movements were to differ from expectations by 5%, the impact on the estimate would be £22.1m.

b. **Corporate**

The Bank's corporate individual provision has increased to £749.1m (30 June 2012: £147.1m). It reflects the change in Bank strategy which is now focused on accelerating the reduction of its non-core assets. Impairments are further exacerbated because the Bank has exhausted its associated fair value adjustment for credit risk in 2012, alongside a deterioration of expected future recoveries against impaired loans which are now being managed for exit.

The methodology's key components comprise risk parameters defined by the Bank. It incorporates normal course of business default cases, improving management information to support decisions, improved credit processes where there have been changes to accounting estimates and progression of the Bank's stated intent to reduce the assets held.

Given the persistent weakness in economic recovery and the increasing levels of risk associated with refinancing and interest payment cover currently being experienced in this sector, a significantly higher number of cases meet the definition of corporate loans identified as being individually impaired.

The increase in cases arises from a change in methodology which allocates any account previously held on a watchlist to one which is individually assessed for impairment, irrespective of whether any actual impairment has been made.

Each corporate account is assessed and allocated a 'risk grade' to enable the Bank to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and loss provisions may be required, are centrally monitored with specific management actions taken at each stage within laid down procedures and specific provisioning criteria. Provisions represent the likely net loss after realisation of any security.

A key estimate within the corporate individual impairment model is collateral valuation. A 10% movement in this estimate would change the provision by £140.8m.

For further information on credit risk and impairment, see section 1 of the risk management disclosures.

b. **Conduct risk and legal provisions**

The Bank has identified a number of conduct risk and legal issues against which it has raised provisions, based on management's best estimate of the potential costs to the Bank. The calculation of these provisions requires significant judgment by management in determining appropriate assumptions, which include basis of redress, operating costs of resolving redress, the level of complaints, uphold rates, proactive contact and response rates and Financial Ombudsman Service referral and uphold rates.

In respect of potential customer compensation claims relating to past sales of payment protection insurance (PPI) the Bank has recognised an additional provision of £53.0m (30 June 2012: £40.0m) in the period, in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £297.0m (30 June 2012: £134.3m). The two key sensitivities are complaint uphold rate and response rate. A 5% change in these assumptions would lead to a £4.3m and £4.2m additional liability respectively.

Other provisions in the period include £33.7m (2012: £nil) for potential customer redress relating to processing of certain mortgage 'first payments' in a manner other than that shown in the customers' illustrations, £26.0m (2012: £nil) for alleged failings in the introduction of third party sales of card and identity protection products, £15.0m (2012: £nil) for potential customer redress in relation to arrears charges and £10.0m (2012: £nil) for potential interest rate swap mis-selling. The main area of judgment on the first payments issue regarded the presumed response rate of 40% for customers post 2002 and 15% pre 2002. Both judgments are based upon response rates from PPI and also the published experience of other financial institutions. An increase in post 2002 response rates by 10% would lead to an additional liability of £2.1m. A 5% increase in pre 2002 response rates would lead to an additional liability of £0.5m. Operating costs provided to facilitate the redress are based upon our experience providing redress on PPI.

In addition, provisions of £29.0m (2012: £nil) for potential customer redress following identification of a technical breach of the Consumer Credit Act have been recognised. Legal advice has been sought to identify the customer accounts which are affected by this issue. Once the population was confirmed, the provision has been calculated using assumptions of terms of loan. The assumptions were based on average terms over the last seven years. An increase in the average term by 10% would lead to an increased liability of £2.6m.

Also, given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain other aspects of the Bank's current or historic business, including, inter alia, mortgages and relationship banking, may be determined by the Financial Conduct Authority (FCA) and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion.

c. **Intangible and tangible asset impairment**

The Bank had a strategic programme of investment around the replacement of the core banking system. This intangible asset, along with other assets bought or developed for the Bank and other Banking Group entities, is held on the balance sheet of CFSMS, a sister company of the Bank. These assets undergo a regular impairment review, where the present values of projected future benefits are assessed against the carrying value of the asset plus estimated costs to complete.

The Banking Group has reviewed its IT strategy and has decided not to complete or implement the majority of the replacement of the core banking platform. £136.4m has therefore been written off and recharged to the Bank.

£36.4m of the total balance remains in use and this has been assessed for impairment in light of the current strategic direction and business plans of the Bank. Following that review, the asset has been impaired by £12.0m making the total write down £148.4m.

The carrying value of the asset at 30 June 2013 is £24.4m and is no longer subject to any specific key sensitivity.

The Bank was also recharged £4.0m for the impairment of other intangible assets.

d. **Deferred tax**

The Bank has reconsidered the deferred tax position in light of the Bank's five year plans approved by the Board as part of the Exchange Offer and the preparation of a debt prospectus.

Recognition of deferred tax assets is only possible to the extent it is probable that future taxable profits will be available against which the unused tax losses and other deductible temporary differences can be utilised. Any deferred tax asset representing tax losses carried forward can only be offset against future taxable profits in the Bank. After approving the plans, the directors are satisfied that there will be sufficient profits in the foreseeable future to absorb a proportion of the Bank's deductible temporary differences, and deferred tax has been recognised on a proportion of the tax losses carried forward.

The Bank has recognised a deferred tax asset of £103.5m (30 June 2012: £109.9m) and a deferred tax liability of £117.4m (30 June 2012: £111.5m), making a net deferred tax liability of £13.9m (30 June 2012: £1.6m). These balances represent the net of reversing taxable temporary differences and recognised deductible temporary differences.

Risk management

For the period ended 30 June 2013

All amounts are stated in £m unless otherwise indicated

Risk management structure

The governance and organisation structure for the period to 30 June 2013 is consistent with that described in the Bank's risk management section of the 2012 financial statements on pages 54 to 79.

Significant risks

The following are considered to be significant risks facing the Bank:

	Risk type	*Definition*	*Page*
1.	**Credit risk**	Credit risk is 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.	310
2.	**Liquidity and funding risk**	Liquidity and funding risk is 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).	331
3.	**Market risk**	Market risk is 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.	335

1. Credit risk

1.1 **Overview**

Credit risk is one of the principal risks identified in the risk management framework and is an integral part of our business activities. It is inherent in both traditional banking products (revolving credit lines, loans, mortgages, 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).

All authority to take credit risk derives from the Bank's Board. This authority is delegated to the CEO and then on to other 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.

1.2 **Credit risk policy**

The principal risk policy for credit risk is approved annually by the Executive Risk Committee (ERC) and defines appropriate standards and principles for the effective management of credit risk throughout the Bank.

The key principles of the policy are:

- credit risk management is fully embedded in Bank operations and the business is managed in line with the risk strategy and risk appetite set by the Board;
- identified, emerging or current risks are actively managed in line with the Bank's overall risk management approach of identification, measurement, management, monitoring and reporting;
- risk measurement is based on a set of metrics/ratios which are aligned with the risk appetite and support the limits framework;

- timely processes for assessing and reviewing credit risks throughout the credit life cycle are established and documented including completion of risk reports; and
- credit risk decisions are supported by fully evidenced rationale.

1.3 Credit exposure

1.3.1 *Definitions*

Impaired and not impaired in the tables below are defined in the following sections on retail and corporate credit risk and investment securities.

During the period to 30 June 2013, the only amendment to impairment definitions is to corporate loans. Watchlist cases are now included within impaired.

Fair value adjustments represent credit losses on assets acquired on the merger of the Bank with Britannia Building Society on 1 August 2009 and are reviewed on a regular basis to ensure appropriate allocation and utilisation.

1.3.2 *Analyses of credit exposure*

The following analysis of credit exposure shows:

- carrying amounts by class of asset in the balance sheet;
- the gross credit exposure by class of asset (excluding fair value adjustments and allowance for losses but including credit commitments); and
- the net credit exposure by class of asset (including fair value adjustments, allowance for losses and credit commitments).

Cash and balances at central banks are credit exposures with the Bank of England and have been excluded from the analysis.

	Loans and advances to banks	*Loans and advances to customers*	*Investment securities*	*Derivative financial instruments*	*Total*
30 June 2013					
Analysis of balance in note	10	11	12	13	
Gross balance	1,737.5	33,785.5	5,102.6	804.3	41,429.9
Less: allowance for losses	–	(1,069.6)	(20.0)	–	(1,089.6)
	1,737.5	32,715.9	5,082.6	804.3	40,340.3
Analysis of credit risk exposure					
Not impaired	1,737.5	29,954.0	5,082.6	797.4	37,571.5
Impaired	–	4,138.8	20.0	6.9	4,165.7
	1,737.5	34,092.8	5,102.6	804.3	41,737.2
Credit commitments	48.0	4,524.0	–	–	4,572.0
Gross credit risk exposure	1,785.5	38,616.8	5,102.6	804.3	46,309.2
Less:					
Fair value adjustments	–	(307.3)	–	–	(307.3)
Allowance for losses	–	(1,069.6)	(20.0)	–	(1,089.6)
Net credit risk exposure	1,785.5	37,239.9	5,082.6	804.3	44,912.3

	Loans and advances to banks	*Loans and advances to customers*	*Investment securities*	*Derivative financial instruments*	*Total*
30 June 2012					
Analysis of balance in note	10	11	12	13	
Gross balance	2,359.7	34,349.5	4,999.3	910.8	42,619.3
Less: allowance for losses	–	(341.1)	(42.3)	–	(383.4)
	2,359.7	34,008.4	4,957.0	910.8	42,235.9
Analysis of credit risk exposure					
Not impaired	2,359.7	31,761.6	4,957.0	910.8	39,989.1
Impaired	–	2,965.7	42.3	–	3,008.0
	2,359.7	34,727.3	4,999.3	910.8	42,997.1
Credit commitments	93.0	5,345.1	–	–	5,438.1
Gross credit risk exposure	2,452.7	40,072.4	4,999.3	910.8	48,435.2
Less:					
Fair value adjustments	–	(377.8)	–	–	(377.8)
Allowance for losses	–	(341.1)	(42.3)	–	(383.4)
Net credit risk exposure	2,452.7	39,353.5	4,957.0	910.8	47,674.0

The comparative table has been updated to include the changes made to impairment criteria in both the December 2012 financial statements and the current period.

1.4 Analysis of impaired assets and associated collateral

The following sections provide further analysis and disclosure of the Bank's credit risk associated with:

- loans and advances to customers;
- investment securities; and
- loans and advances to banks.

1.4.1 *Loans and advances to customers*

1.4.1.1 *How we oversee and control credit risk*

The credit risk team is part of the Risk Directorate, with an independent reporting line from business management, and provides second line risk oversight. Accountability for the origination of credit risk sits with business management subject to compliance with key credit criteria, policy and risk appetite. Where business management recommend the sanction of a facility that is outside of their discretion then the recommendation is made to the Credit Approvals Committee.

On pages 314 to 327 the management of credit risk by portfolio is described covering:

- acquisition and account management;
- collateral;
- impairment assessment; and
- forbearance.

1.4.1.2 *Assessment for impairment*

The loan portfolios are periodically reviewed to assess impairment. A loan is deemed to be impaired when there is objective evidence that a loss event has occurred at 30 June 2013.

Once a loan is defined as impaired, the impairment provision is calculated as the difference between the current carrying value of the asset (including fair value adjustments) and the expected future recovery, discounted at the loan's effective interest rate, taking into account the expected charge off rate and any supporting collateral.

Full details are contained in the significant accounting policies on page 296 and in the following credit risk sections.

The tables below analyse the gross balance by impairment classification for the Retail and Corporate and Business Banking (CABB) business segments. They include credit commitments, impairment provisions, fair value adjustments and a reconciliation to gross customer balances as this is the basis on which the business manages risk.

There has been an increase in impairment provisions in the period to 30 June 2013 driven primarily by the decision to reduce non-core assets, revised collateral values for the corporate business and updated experience in support of our credit risk impairment policy.

	Retail		*CABB*			
	Secured	*Unsecured*	*Corporate*		*Optimum*	
			Core	*Non-core*		*Total*
30 June 2013						
Analysis of balance in note 11						
Gross balance	16,358.4	1,402.1	5,870.9	2,994.9	7,159.2	33,785.5
Less: allowance for losses	(4.6)	(172.0)	(272.7)	(576.4)	(43.9)	(1,069.6)
	16,353.8	1,230.1	5,598.2	2,418.5	7,115.3	32,715.9
Analysis of credit risk exposure						
Not impaired	16,209.7	1,204.4	5,134.3	1,337.0	6,068.6	29,954.0
Impaired	153.2	197.7	736.6	1,856.5	1,194.8	4,138.8
	16,362.9	1,402.1	5,870.9	3,193.5	7,263.4	34,092.8
Credit commitments	486.5	2,303.5	1,694.3	39.7	–	4,524.0
Gross credit risk exposure	16,849.4	3,705.6	7,565.2	3,233.2	7,263.4	38,616.8
Less:						
Fair value adjustments	(4.5)	–	–	(198.6)	(104.2)	(307.3)
Allowance for losses	(4.6)	(172.0)	(272.7)	(576.4)	(43.9)	(1,069.6)
Net credit risk exposure	16,840.3	3,533.6	7,292.5	2,458.2	7,115.3	37,239.9
Reconciliation of accounting to customer balances						
Gross balance	16,358.4	1,402.1	5,870.9	2,994.9	7,159.2	33,785.5
Fair value adjustments	4.5	–	–	198.6	104.2	307.3
Other accounting adjustments	(57.7)	(22.5)	(58.3)	3.9	18.0	(116.6)
Gross customer balances	16,305.2	1,379.6	5,812.6	3,197.4	7,281.4	33,976.2

	Retail		CABB			
	Secured	Unsecured	Corporate		Optimum	
			Core	Non-core		Total
30 June 2012						
Analysis of balance in note 11						
Gross balance	16,226.8	1,531.8	5,639.7	3,375.3	7,575.9	34,349.5
Less: allowance for losses	(3.4)	(164.9)	(83.4)	(81.4)	(8.0)	(341.1)
	16,223.4	1,366.9	5,556.3	3,293.9	7,567.9	34,008.4
Analysis of credit risk exposure						
Not impaired	16,080.9	1,309.6	5,412.3	2,697.8	6,261.0	31,761.6
Impaired	151.9	222.2	227.4	927.7	1,436.5	2,965.7
	16,232.8	1,531.8	5,639.7	3,625.5	7,697.5	34,727.3
Credit commitments	556.5	2,340.1	2,328.7	119.7	0.1	5,345.1
Gross credit risk exposure	16,789.3	3,871.9	7,968.4	3,745.2	7,697.6	40,072.4
Less:						
Fair value adjustments	(6.0)	–	–	(250.2)	(121.6)	(377.8)
Allowance for losses	(3.4)	(164.9)	(83.4)	(81.4)	(8.0)	(341.1)
Net credit risk exposure	16,779.9	3,707.0	7,885.0	3,413.6	7,568.0	39,353.5
Reconciliation of accounting to customer balances						
Gross balance	16,226.8	1,531.8	5,639.7	3,375.3	7,575.9	34,349.5
Fair value adjustments	6.0	–	–	250.2	121.6	377.8
Other accounting adjustments	(10.3)	(24.9)	209.8	(142.1)	25.5	58.0
Gross customer balances	16,222.5	1,506.9	5,849.5	3,483.4	7,723.0	34,785.3

Corporate impaired balances have been restated to show all watchlist cases as impaired, in line with revised 2013 treatment. The comparative table has also been updated to include the changes made to impairment criteria in the December 2012 financial statements.

Other accounting adjustments include accrued interest, interest fair value adjustments and effective interest rate adjustments.

The disclosures in sections 1.4.1.3 Secured residential credit risk, 1.4.1.4 Unsecured retail credit risk and 1.4.1.5 Corporate credit risk are all based on the gross customer balances in the above tables.

1.4.1.3 *Secured residential credit risk*

Acquisition and account management

Mortgages are loans to customers secured by a first charge over a residential property. Mortgages are originated directly to customers via branches, telephone and the internet under the Britannia and Co-operative Bank brands, and via intermediaries under the Platform brand. In the period to 30 June 2013, 70% (30 June 2012: 66%) of mortgages were originated directly and 30% (30 June 2012: 34%) through intermediaries.

The Britannia and Co-operative Bank brands only originate prime residential mortgages, while Platform primarily originates a combination of prime residential and buy-to-let loans.

Historically, loans may have been advanced on a capital and interest payment basis, where the loan is repaid over the term of the loan, or interest only, where the capital element of the loan is repayable at the end of the term. All new advances are on a capital repayment basis, with the exception of buy-to-let lending and existing interest only customers moving home.

The table below shows residential mortgage completions in the period, analysed by loan-to-value (LTV) and repayment method:

	Period to 30 June 2013			*Period to 30 June 2012*		
	Amount advanced	*Average LTV %*	*Interest only %*	*Amount advanced*	*Average LTV %*	*Interest only %*
Retail prime	1,076.9	63.5	1.3	972.9	57.8	10.6
Platform prime	404.2	68.5	–	180.3	58.6	25.0
Total prime	1,481.1	65.0	0.9	1,153.2	57.9	12.2
Buy-to-let	57.0	65.8	84.9	306.6	62.8	84.5
Almost prime	1.6	54.8	–	3.4	56.1	2.8
Total completions	1,539.7	65.0	4.2	1,463.2	59.0	25.6

The risk in the portfolio is recalculated monthly, using internally developed behavioural models, to assess the likelihood of default. A regional house price index is used to reflect any changes in the value of collateral (see below). This process is also used to determine the amount of capital required to be held for individual loans.

Mortgages originated prior to 2009 by Platform or acquired by Britannia, are managed as part of a closed portfolio, Optimum. These loans include a range of asset types, including prime residential (both income verified and self-certified), buy-to-let, and non-conforming mortgages.

The table below shows gross customer balances for residential mortgages analysed by current LTV banding:

	30 June 2013			*30 June 2012*		
	Retail secured	*Optimum*	*Total*	*Retail secured*	*Optimum*	*Total*
Less than 50%	5,613.4	471.5	6,084.9	5,654.8	459.4	6,114.2
50% to 60%	2,389.1	380.3	2,769.4	2,217.0	355.5	2,572.5
60% to 70%	2,802.5	708.5	3,511.0	2,613.6	641.9	3,255.5
70% to 80%	2,704.4	1,122.8	3,827.2	2,792.7	1,010.5	3,803.2
80% to 90%	2,021.9	1,407.9	3,429.8	1,876.5	1,523.7	3,400.2
90% to 100%	475.0	1,450.5	1,925.5	630.5	1,600.3	2,230.8
Greater than 100%	298.9	1,739.9	2,038.8	437.4	2,131.7	2,569.1
	16,305.2	7,281.4	23,586.6	16,222.5	7,723.0	23,945.5

The table below shows gross customer balances for residential mortgages analysed by asset class, the LTV shown is the current average percentage:

	30 June 2013			*30 June 2012*		
	Gross customer balance	*Average LTV %*	*Interest only %*	*Gross customer balance*	*Average LTV %*	*Interest only %*
Prime residential	15,743.5	44.5	20.2	15,875.7	44.3	24.1
Buy-to-let	3,194.2	73.5	90.6	3,119.1	75.8	90.5
Self-certified	2,031.1	75.8	78.1	2,164.0	77.3	77.5
Almost prime	912.7	88.7	68.0	969.0	91.2	67.4
Non-conforming	1,705.1	76.3	67.2	1,817.7	78.2	66.2
	23,586.6	53.1	40.0	23,945.5	53.5	42.6

Collateral

Mortgages are secured by a first charge over the property being purchased or remortgaged. Valuation of the property is normally assessed by a RICS certified surveyor from the Bank's approved panel. For low LTV remortgages, valuation may be assessed through the use of an automated valuation model (AVM).

It is not normal practice to reassess the valuation of collateral unless further lending is being considered, or the property has been repossessed, but on a quarterly basis the valuation is restated using a regional property price index.

The table below analyses the indexed value of property collateral held against mortgage portfolios:

	30 June 2013			*30 June 2012*		
	Gross customer balance	*Collateral*	*Cover %*	*Gross customer balance*	*Collateral*	*Cover %*
Impaired	1,350.9	1,297.0	96.0	1,594.1	1,523.8	95.6
Not impaired	22,235.7	22,111.9	99.4	22,351.4	22,202.0	99.3
	23,586.6	23,408.9	99.2	23,945.5	23,725.8	99.1

The comparative figures have been updated to include the changes made to impairment criteria in both the December 2012 financial statements and the current period.

In the table, collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank.

Impairment

A loan is identified as impaired when:

- arrears outstanding are equivalent to one monthly instalment or more; or
- the loan is more than 90 days past its term but has not been repaid; or
- the account is in litigation or the property is in possession; or
- the estimated forced sale value of the collateral on a roll up mortgage has reduced below the loan balance outstanding.

Loans meeting any of these criteria are considered impaired even if a loss is not expected in the event of repossession.

Loans that are not identified as impaired are collectively assessed for unidentified impairment (where a loss event has occurred, but objective evidence of impairment has not manifested).

Certain segments are separated into discrete pools for assessment where there are potential indicators of impairment that are not, by themselves, sufficient to identify a loan as impaired. These are:

- the loan is in arrears by less than one monthly instalment; and
- there has been a material deterioration in the borrower's external credit score in the last 12 months.

For each loan assessed for impairment, whether identified or unidentified, a shortfall is calculated based on the difference between the current loan balance and the expected 'forced sale' price of the collateral, discounted at the current interest rate to reflect the anticipated time to sale, and taking into account anticipated fees and costs prior to sale. This shortfall is then reduced on a collective basis to reflect the probability of the loan being taken into possession.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and

- impairment coverage, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	30 June 2013			*30 June 2012*		
	Retail secured	*Optimum*	*Total*	*Retail secured*	*Optimum*	*Total*
Gross customer balances	16,305.2	7,281.4	23,586.6	16,222.5	7,723.0	23,945.5
Impaired customer balances	153.1	1,197.8	1,350.9	152.9	1,441.2	1,594.1
Impaired as a % of gross customer balances	0.9%	16.5%	5.7%	0.9%	18.7%	6.7%
Credit protection						
Impairment provisions	4.6	43.9	48.5	3.4	8.0	11.4
Fair value adjustments	4.5	104.2	108.7	6.0	121.6	127.6
	9.1	148.1	157.2	9.4	129.6	139.0
Credit protection as a % of impaired customer balances	5.9%	12.4%	11.6%	6.1%	9.0%	8.7%

The comparative figures for impaired customer balances have been re-presented to reflect the changes made to impairment criteria in the December 2012 financial statements.

The table below shows the credit quality of loans and advances that are not impaired:

	30 June 2013			*30 June 2012*		
	Retail secured	*Optimum*	*Total*	*Retail secured*	*Optimum*	*Total*
Low to medium risk	15,826.0	4,522.0	20,348.0	15,674.4	4,477.0	20,151.4
Medium to high risk	326.1	1,561.6	1,887.7	395.3	1,804.7	2,200.0
	16,152.1	6,083.6	22,235.7	16,069.7	6,281.7	22,351.4

Low to medium risk is defined as exposures with a probability of default (PD) in the next year of 1% or below using the internal ratings based (IRB) approach under Basel II. Medium to high risk is defined as exposures with a PD in the next year of greater than 1%. 2012 balances have been restated based on the same risk classification used at 30 June 2013.

Forbearance

A number of options are available to borrowers in financial difficulty. Repossession of the property will only be considered when all other avenues have been explored. The precise treatment selected depends on the borrower's individual circumstances, but may include:

- arrangements to repay outstanding arrears over a period of time, by making payments above the contractual amount. The loan is deemed to be impaired, until the arrears have been cleared in full;

- short term concessions, where the borrower is allowed to make reduced repayments (or, in exceptional circumstances, no repayments) on a temporary basis to assist with a short term financial hardship. In these cases the shortfall on the repayments will accrue as arrears and the loan is deemed to be impaired;

- payment holidays are allowed as part of a customer's flexible mortgage contract. Payment holidays are not knowingly allowed for customers experiencing financial hardship. However, in the absence of evidence to the contrary, loans that have had a payment holiday in the last two years are treated as being subject to forbearance;

- temporary conversion of a mortgage to interest only repayments. The capital repayments due in this period are spread over the remaining term on conversion back to capital repayment as part of an instalment recalculation exercise;
- permanent conversion to interest only repayments, is no longer allowed, however where this has been agreed in the past two years, a loan is considered to be subject to forbearance;
- an extension to the mortgage term to reduce the borrower's repayments. All loans that have had a term extension in the last two years are considered to be subject to forbearance, even where these were not agreed as a forbearance treatment;
- capitalisation, where outstanding arrears are added to the capital value of the loan to be repaid over the remaining term. This is only considered by exception with eight cases capitalised during the period to 30 June 2013 (30 June 2012: eight); and
- where applicable we will work with the customer as part of a government support scheme. Unmet loan payments will continue to accrue as arrears until such time as the loan is cleared, or the outstanding payments are brought up to date.

Loans subject to forbearance are only classed as impaired if they meet the impairment definition in this section on page 316.

The underlying basis for the calculation of residential mortgage impairment provisions remains unchanged. Mortgages subject to forbearance, once classified as impaired, are assessed for the appropriate impairment rate to apply.

The table below analyses secured residential mortgage balances by type of forbearance and the associated gross impairment coverage, including credit fair value adjustments:

	Neither past due nor impaired	*Impaired*	*Loans subject to forbearance*	*Impairment coverage*
30 June 2013				
Arrangements	54.5	436.4	490.9	(51.8)
Concessions	1.0	3.4	4.4	(0.1)
Payment holidays	166.4	0.5	166.9	–
Interest only switches	276.1	46.8	322.9	(2.6)
Term extensions	334.8	5.3	340.1	(0.2)
Capitalisations	0.4	–	0.4	–
	833.2	492.4	1,325.6	(54.7)

	Neither past due nor impaired	Impaired	Loans subject to forbearance	Impairment coverage
30 June 2012				
Arrangements	57.6	493.8	551.4	(25.6)
Concessions	1.2	4.0	5.2	(0.1)
Payment holidays	175.8	–	175.8	–
Interest only switches	616.6	–	616.6	(1.4)
Term extensions	240.2	–	240.2	(0.1)
Capitalisations	3.6	–	3.6	–
	1,095.0	497.8	1,592.8	(27.2)

1.4.1.4 *Unsecured retail credit risk*

Acquisition and account management

The Bank offers unsecured lending through fixed repayment loans, credit cards and overdrafts. Customers are assessed using a combination of credit scoring and policy rules. Credit cards and overdrafts are subject to ongoing account management to increase or decrease credit limits and manage over limit authorisations.

The risk in the portfolio is reassessed monthly using internally developed behavioural scorecards to determine the amount of capital required to be held for individual loans.

The following table shows unsecured lending gross customer balances (including undrawn commitments) by product type:

	30 June 2013	*30 June 2012*
Loans	723.2	750.6
Credit cards	2,597.2	2,724.6
Overdrafts	362.7	371.8
	3,683.1	3,847.0

Impairment

Impairment provision is raised for:

- identified impairment – at one penny, one day past due or in excess, based on the probability of default and the discounted cash flow of recoveries from default;
- unidentified impairment – on the performing book, based on the probability of emerging as delinquent, the probability of default and the discounted cash flow of recoveries from default; and
- fraud upon identification.

The table below shows:

- gross customer balances (excluding undrawn commitments);
- impaired customer balances as a percentage of gross customer balances; and
- impairment coverage, ie impairment provisions including those charged off in relation to Debt Collection Agencies (DCA) as a percentage of impaired customer balances.

	30 June 2013	30 June 2012
Gross customer balances	1,379.6	1,506.9
Impaired customer balances	230.8	305.6
Impaired as a % of gross customer balances	16.7%	20.3%
Credit protection		
Impairment provisions	172.0	164.9
DCA balances charged off	29.0	83.4
	201.0	248.3
Credit protection as a % of impaired customer balances	87.1%	81.3%

The comparative figure for impaired customer balances in the table above has been re-presented to reflect the changes made to impairment criteria in the December 2012 financial statements.

The reduction observed in impaired customer balances between June 2012 and June 2013 is reflective of debt sale, made in the period between 1 January 2013 and 30 June 2013.

Forbearance

A number of forbearance options are available to borrowers in financial difficulty. Accounts classified as impaired remain so until the arrears are cleared in full. This will be achieved through making arrangement either with customers directly or through a third party whom they have chosen to represent them.

1.4.1.5 *Corporate credit risk*

Acquisition and account management

The Bank is managed through two distinct classifications. Currently the Core business represents activity consistent with the strategy and risk appetite for the Bank and within corporate comprises corporate banking, business banking and business services. Non-core business lines predominantly include corporate banking business (Optimum and Illius (the residential property company) business which originated from the non-member Britannia prior to merger are reported elsewhere in this report). The non-core business is managed for value and targeted for run down or exit.

The Bank operates to a new lending policy which is subject to meeting criteria as laid down in the corresponding sector strategy guidelines and strict policy with regards single name and sector concentrations. New lending is approved within the centrally based credit underwriting team, independent from income generation. Lending discretions are based on the risk profile of the customer and the amount of exposure. The lending discretions of the Credit Risk Sanctions Committee, Chief Risk Officer, Credit Risk Director, the Chief Executive and the Credit Approvals Committee are operated to sanction the largest credit applications. In the context of the non-core strategy this is limited to annual reviews and renewals and in certain circumstances where additional lending may protect value in the work out of a customer asset. Following the Bank's decision to change business focus a challenge process has been applied by senior management to the pipeline business.

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.

Monitoring of portfolios and impairment provisioning governance is in place across the portfolios. Individual cases which show signs of unsatisfactory performance are managed through a specialist Corporate Business Support team who are engaged with the customers to restore them to good health or wherever this is not possible management actions are taken to effect recovery.

The Credit Risk Management Committee (CRMC) and Executive Risk Committee (ERC) (and by exception Board Risk Committee BRC) receive regular reports on the performance of the portfolio.

The tables below show the distribution of the Corporate and Business Banking gross customer balances (including commitments, but excluding Unity Trust Bank) by sector and risk grade, where PD grades have been mapped to regulatory slotting categories for ease of interpretation in this report.

	Stand-ardised	*Strong*	*Good*	*Satis-factory*	*Weak*	*Default*	*Total*
30 June 2013							
Core							
Accomodation, food and licensed services	214.5	136.2	125.1	20.2	21.7	40.7	558.4
Care	182.0	18.6	73.0	23.3	3.7	16.8	317.4
Education	87.3	34.5	2.9	1.0	–	–	125.7
Financial services	65.9	77.6	28.4	4.4	–	4.5	180.8
Football clubs	–	33.1	–	0.4	0.1	0.8	34.4
Housing associations	7.8	252.6	1.8	–	–	–	262.2
Manufacturing	45.5	25.1	24.2	16.6	12.2	8.6	132.2
Motor trade and garages	24.2	55.5	24.3	3.5	0.7	1.7	109.9
PFI	–	32.0	1,179.0	13.3	20.9	4.8	1,250.0
Professional services	73.0	15.4	21.7	14.2	0.7	3.4	128.4
Property and construction:							
Commercial investment	16.5	80.6	1,039.8	174.8	4.8	158.0	1,474.5
Residential investment	8.1	0.7	111.4	18.5	7.0	7.8	153.5
Commercial development	1.6	2.5	177.0	72.9	2.4	54.0	310.4
Residential development	5.9	1.9	62.3	14.8	2.9	11.1	98.9
Public sector entities	172.9	0.3	–	–	–	–	173.2
Renewable energy	611.0	–	–	–	–	9.3	620.3
Retail and wholesale trade	69.7	402.5	27.8	11.9	1.1	19.3	532.3
Services	398.6	127.5	36.1	30.3	0.6	33.8	626.9
Transport, storage and communication	24.8	15.5	3.9	6.6	1.3	28.7	80.8
Utilities	42.9	1.2	1.3	1.0	–	0.6	47.0
Business banking	1.1	41.8	7.9	3.0	0.5	0.5	54.8
Other	6.9	2.4	1.4	2.2	–	2.1	15.0
	2,060.2	1,357.5	2,949.3	432.9	80.6	406.5	7,287.0
Non-core							
Accomodation, food and licensed services	–	–	38.3	–	–	259.4	297.7
Football clubs	–	–	–	–	–	15.1	15.1
Housing associations	–	830.2	45.0	–	–	–	875.2
Professional services	–	–	–	–	–	0.3	0.3
Property and construction:							
Commercial investment	24.0	23.3	214.2	66.5	50.1	1,344.7	1,722.8
Residential investment	–	–	77.0	26.4	56.7	131.4	291.5
Commercial development	–	–	–	–	–	6.4	6.4
Renewable energy	28.1	–	–	–	–	–	28.1
Transport, storage and communication	–	–	–	–	–	–	–
	52.1	853.5	374.5	92.9	106.8	1,757.3	3,237.1
Total exposure	2,112.3	2,211.0	3,323.8	525.8	187.4	2,163.8	10,524.1

	Standardised	Strong	Good	Satisfactory	Weak	Default	Total
30 June 2012							
Core							
Accomodation, food and licensed services	308.4	114.0	156.0	24.7	17.1	3.7	623.9
Care	180.0	34.1	65.3	30.9	2.8	–	313.1
Education	71.8	46.6	9.1	1.4	–	–	128.9
Financial services	88.9	67.0	24.6	3.8	–	2.3	186.6
Football clubs	–	41.5	–	0.5	0.1	0.1	42.2
Housing associations	279.4	–	0.5	–	–	–	279.9
Manufacturing	70.5	20.8	43.4	17.9	21.2	1.2	175.0
Motor trade and garages	29.4	39.5	23.0	10.0	0.8	3.7	106.4
PFI	0.1	4.0	1,297.5	–	–	14.9	1,316.5
Professional services	68.6	71.0	17.9	9.8	2.5	3.9	173.7
Property and construction:							
Commercial investment	5.7	141.9	1,049.4	187.0	95.8	48.9	1,528.7
Residential investment	10.5	6.3	114.8	10.0	8.1	3.6	153.3
Commercial development	24.4	13.0	140.7	81.4	39.3	11.7	310.5
Residential development	1.5	2.6	79.1	12.7	11.9	4.9	112.7
Public sector entities	197.2	–	–	–	–	–	197.2
Renewable energy	567.7	–	–	–	–	9.4	577.1
Retail and wholesale trade	107.5	374.5	31.0	22.1	–	5.2	540.3
Services	458.2	110.2	62.0	39.2	20.7	18.5	708.8
Transport, storage and communication	136.9	53.0	10.2	8.3	14.1	5.7	228.2
Utilities	86.1	1.5	0.3	11.5	–	0.6	100.0
Business banking	0.7	33.5	7.9	4.5	0.7	0.3	47.6
Other	8.9	1.7	1.4	4.2	–	2.1	18.3
	2,702.4	1,176.7	3,134.1	479.9	235.1	140.7	7,868.9
Non-core							
Accomodation, food and licensed services	47.5	–	–	–	36.0	161.2	244.7
Football clubs	–	–	–	15.0	–	4.2	19.2
Housing associations	910.2	–	–	–	–	–	910.2
Professional services	–	–	–	–	–	–	–
Property and construction:							
Commercial investment	13.9	18.0	323.6	284.4	949.2	476.1	2,065.2
Residential investment	–	39.5	137.9	27.6	44.4	79.2	328.6
Commercial development	–	–	–	–	–	–	–
Renewable energy	28.9	–	–	–	–	–	28.9
Transport, storage and communication	6.3	–	–	–	–	–	6.3
	1,006.8	57.5	461.5	327.0	1,029.6	720.7	3,603.1
Total exposure	3,709.2	1,234.2	3,595.6	806.9	1,264.7	861.4	11,472.0

The Standardised category relates to sectors which for purposes of capital calculations, are not rated with a regulatory approved rating model due to the sector having insufficient numbers of customers and/or low defaults. These typically belong to the public sector entities and renewable energy sectors, and to the following customer types within other sectors: other energy efficiency schemes, leveraged (more highly geared businesses, for example, comprising of Management Buy-Outs or firms that have made business acquisitions to expand their operation) of which we have a relatively small portfolio, newly established companies with an insufficient number of published financial accounts, project finance and charities.

The movement of balances into the Default category in the period remains reflective of the continued challenging commercial property environment and the Bank's focus on the expected outlook for this sector, consequential forbearance strategies and the completion of the Bank's review of its default and credit risk impairment strategy.

Collateral

The Bank uses various forms of collateral including guarantees to mitigate credit risk. Collateral is regularly reviewed to ensure continued effectiveness as part of the credit review process. Property collateral for corporate lending is categorised as security for property development 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 customer, other security is taken in modest proportion to the total portfolio. This includes debentures or floating charges and guarantees (often supported by tangible security, where appropriate, including property, life policies and stocks & 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.

The table below analyses the fair value of the property collateral held against assets in the property and construction sectors. Property valuations are obtained when the facility is first approved and the current lending procedures require collateral to be revalued every two years or more frequently in higher risk situations (typically annually or when a material change has occurred that is likely to affect the value and recoverability of the debt). In certain circumstances, such as syndicates, the Bank may be unable to obtain regular revaluations or may exercise discretion to not seek a revaluation for a longer period of time. However, the Bank has adopted a review and challenge process on valuations to assure itself on current valuations held in the Bank's systems. The values held in the Bank's systems are indexed using the appropriate regional and asset type indexes where available, otherwise the average national index is applied:

	30 June 2013			*30 June 2012*		
	Exposure	*Collateral*	*Impairment provision*	*Exposure*	*Collateral*	*Impairment provision*
Core						
Non-default loans with <= 1 year & all defaulted exposures regardless of term						
Less than 50%	72.1	72.0	0.1	68.7	68.7	–
50% to 60%	53.7	53.7	–	98.8	98.8	–
60% to 70%	132.1	132.1	–	86.5	86.5	–
70% to 80%	112.0	107.3	4.8	98.9	98.9	–
80% to 90%	42.6	37.4	5.2	62.1	59.7	2.4
90% to 100%	50.1	42.9	7.2	20.7	19.8	0.9
Greater than 100%	204.8	126.5	59.4	140.0	95.3	16.4
Unsecured	33.9	–	7.5	16.6	–	6.2
	701.3	571.9	84.2	592.3	527.7	25.9

	30 June 2013			30 June 2012		
	Exposure	*Collateral*	*Impairment provision*	*Exposure*	*Collateral*	*Impairment provision*
Non-default loans with > 1 year						
Less than 50%	206.4	206.4	–	270.6	270.6	–
50% to 60%	297.9	297.9	–	225.5	225.5	–
60% to 70%	424.4	424.4	–	361.4	361.4	–
70% to 80%	264.9	264.9	–	269.3	269.3	–
80% to 90%	32.0	32.0	–	60.7	60.7	–
90% to 100%	16.6	16.6	–	73.1	73.1	–
Greater than 100%	42.7	27.7	–	126.4	100.4	–
Unsecured	51.1	–	–	125.9	–	–
	1,336.0	1,269.9	–	1,512.9	1,361.0	–
	2,037.3	1,841.8	84.2	2,105.2	1,888.7	25.9
Non-core						
Non-default loans with <= 1 year & all defaulted exposures regardless of term						
Less than 50%	2.6	1.0	1.6	6.6	6.1	0.5
50% to 60%	27.0	25.6	1.4	–	–	–
60% to 70%	49.8	43.7	6.1	0.8	0.8	–
70% to 80%	13.3	13.0	0.3	31.5	31.5	–
80% to 90%	62.8	60.4	2.4	0.3	0.3	–
90% to 100%	31.1	27.8	3.3	19.9	19.9	–
Greater than 100%	1,173.1	750.9	402.8	739.1	475.1	168.7
Unsecured	212.4	–	153.7	41.2	–	37.7
	1,572.1	922.4	571.6	839.4	533.7	206.9
Non-default loans with > 1 year						
Less than 50%	39.2	39.2	–	71.3	71.3	–
50% to 60%	37.9	37.9	–	83.9	83.9	–
60% to 70%	111.3	111.3	–	180.4	180.4	–
70% to 80%	74.3	74.3	–	104.9	104.9	–
80% to 90%	63.1	63.1	–	132.9	132.9	–
90% to 100%	47.5	47.5	–	112.3	112.3	–
Greater than 100%	32.4	18.4	–	700.4	603.7	–
Unsecured	42.9	–	–	168.3	–	–
	448.6	391.7	–	1,554.4	1,289.4	–
	2,020.7	1,314.1	571.6	2,393.8	1,823.1	206.9

In the table, collateral is constrained to a maximum of 100% of the exposure to each customer to correctly reflect the maximum protection available to the Bank.

Of the above at 30 June 2013, £46.1m (30 June 2012: £40.0m) is not held as first charge.

Impairment

Corporate customers are placed on a watchlist and treated as impaired when they show signs of unsatisfactory performance and require close control. Strong indicators that a customer should be placed on watchlist include but are not limited to:

- unsatisfactory account operation – both lending facility and current accounts;
- considerable reduction in value of collateral;
- deteriorating balance sheet position and/or material losses/cashflow pressures;
- breach of covenants;

- refinance risk at maturity;
- application of forbearance strategies; and
- business performance is assessed to have deteriorated to the extent that there is a real risk of loss of principal, interest or fees.

After a period of satisfactory performance and dependent on the Bank's satisfaction that the triggers which led to inclusion on the watchlist no longer apply, customers who stop exhibiting higher risk traits are removed from the watchlist.

Removal from the watchlist usually requires the customer's management information to show that trading is achieving the revised plan with objective evidence that this will continue.

The Bank also reviews on a monthly basis all higher risk loans (including those accounts subject to forbearance) and considers the potential loss which might arise were the borrowers to fail (notwithstanding that continued trading remains the expectation).

Objective evidence of impairment will include but is not limited to:

- an instalment on a loan account being overdue, or having been in excess of its limit (or being overdrawn without an agreed limit) for 90 days or more;
- an event likely to result in insolvency which may involve bankruptcy, or the appointment of an administrative receiver, liquidator or administrator; or
- if the Bank considers that at some point (normally taken within the next 12 months) the facility is unlikely to be repaid in full and actions such as an issue of formal demand will be required in order to achieve full repayment.

Credit risk impairment will be required on some or all of the entire shortfall between the security held and the loan balance outstanding and represents an assessment of the likely net loss after realisation of any security.

For credit risk impairment purposes, a property valuation or selling agent's recommendation is discounted to take into account selling and legal costs and also to build in a contingency to cover potential reductions in the selling price based upon the type of security and entity and the existence or otherwise of a contracted sale. In some cases, calculation of the credit risk impairment is based on an up to date assessment (often following an independent business review by a firm of accountants) of likely receivables from the business or a formal estimated outcome statement from an insolvency practitioner where the business has failed.

Provisioning adjustments are also recorded, as appropriate, against loans whose interest terms have changed such that revised future cashflows discounted at the original interest rate are less than the current carrying amount.

The collective unidentified impairment provision (CUIP) provides cover for the performing portfolio using a formulaic approach based on default experience across the portfolio. The unidentified impairment reflects trigger events that have occurred but not yet been captured and cannot, therefore be allocated to individual loans.

The table below shows:

- impaired customer balances as a percentage of gross customer balances; and
- credit protection, ie impairment provisions and fair value adjustments as a percentage of impaired customer balances.

	30 June 2013		*30 June 2012*	
	Core	*Non-core*	*Core*	*Non-core*
Gross customer balances	5,812.6	3,197.4	5,849.5	3,483.4
Impaired customer balances	687.9	1,893.8	525.9	1,897.1
Impaired as a % of gross customer balances	11.8%	59.2%	9.0%	54.5%
Credit protection				
Impairment provisions	272.7	576.4	83.4	81.4
Fair value adjustments	–	198.6	–	250.2
	272.7	775.0	83.4	331.6
Credit protection as a % of impaired customer balances	39.6%	40.9%	15.9%	17.5%

The comparative figures for impaired customer balances in the table above has been re-presented to reflect the changes made to impairment criteria in the December 2012 and June 2013 financial statements.

The level of cover as a percentage of impaired non-core customer balances has increased to 40.9% in June 2013 from 17.5% in June 2012 following a further increase in the level of impairment provisions. The increased impairment provisions for corporate core loans has also increased causing the cover to rise to 39.6% in June 2013 from 15.9% in June 2012.

Forbearance

If the Bank is confident of a customer's ability and commitment to address their financial difficulties, it may agree to grant concessions to the original contractual terms. Such concessions typically include:

- restructuring, waiving or reserving rights in the event of covenant breaches;
- postponement of principal payments;
- restructures of principal payments;
- extension of loan maturities;
- partial or full capitalisation of interest payments; or
- swap restructures.

In addition to the above, other forbearance concessions are considered to be objective evidence of impairment and include:

- a partial write off of debt, following which the account continues to be classified as impaired for at least six months; or
- a material postponement or forgiveness of interest or 'soft' rates or waiver or reduction of normal fees and charges; the accounts must remain impaired while such favourable terms are being applied.

The table below analyses the exposures subject to forbearance:

	30 June 2013			30 June 2012		
	Forborne	*Non-forborne*	*Total*	*Forborne*	*Non-forborne*	*Total*
Core						
Default	244.8	161.8	406.6	49.2	91.4	140.6
On watchlist	138.8	178.2	317.0	285.7	118.5	404.2
Neither default nor on watchlist	77.5	6,485.9	6,563.4	194.4	7,129.7	7,324.1
	461.1	6,825.9	7,287.0	529.3	7,339.6	7,868.9
Non-core						
Default	1,145.5	611.6	1,757.1	344.0	376.7	720.7
On watchlist	107.1	32.0	139.1	941.9	296.0	1,237.9
Neither default nor on watchlist	31.5	1,309.4	1,340.9	89.9	1,554.6	1,644.5
	1,284.1	1,953.0	3,237.1	1,375.8	2,227.3	3,603.1
	1,745.2	8,778.9	10,524.1	1,905.1	9,566.9	11,472.0

Impairment provisions are made for accounts subject to forbearance which are in default and on the watchlist.

For those customers that benefit from ongoing concessions (such as postponement of principal payments), the Bank retains the forbearance status for as long as the concession remains in place. In the event of one off concessions (such as capitalisation of interest payments), the Bank removes the forbearance status 12 months after their occurrence provided that the loan has been kept up to date during that period and all covenants continue to be met.

1.4.2 ***Investment securities***

At the balance sheet date, the Bank has a total investment securities portfolio of £5,102.6m (30 June 2012: £4,999.3m) of which £20.0m (30 June 2012: £42.3m) is considered impaired and against which £20.0m (30 June 2012: £42.3m) of provisions are held.

The following tables analyse the gross balance by impairment classification and type of investment security:

	Loans and receivables	*Available for sale*	*Fair value through income or expense*	*Held for trading*	*Total*
30 June 2013					
Analysis of balance per note 12					
Gross balance	30.6	3,449.7	1,622.3	–	5,102.6
Less: allowance for losses	–	(20.0)	–	–	(20.0)
	30.6	3,429.7	1,622.3	–	5,082.6
Analysis of credit risk exposure					
Not impaired	30.6	3,429.7	1,622.3	–	5,082.6
Impaired	–	20.0	–	–	20.0
Gross credit risk exposure	30.6	3,449.7	1,622.3	–	5,102.6
Less: allowance for losses	–	(20.0)	–	–	(20.0)
Net credit risk exposure	30.6	3,429.7	1,622.3	–	5,082.6

	Loans and receivables	*Available for sale*	*Fair value through income or expense*	*Held for trading*	*Total*
30 June 2012					
Analysis of balance per note 12					
Gross balance	483.0	3,259.9	817.4	439.0	4,999.3
Less: allowance for losses	–	(42.3)	–	–	(42.3)
	483.0	3,217.6	817.4	439.0	4,957.0
Analysis of credit risk exposure					
Not impaired	483.0	3,217.6	817.4	439.0	4,957.0
Impaired	–	42.3	–	–	42.3
Gross credit risk exposure	483.0	3,259.9	817.4	439.0	4,999.3
Less: allowance for losses	–	(42.3)	–	–	(42.3)
Net credit risk exposure	483.0	3,217.6	817.4	439.0	4,957.0

1.4.2.1 *Collateral*

Policies are in place with regard to the management and valuation of collateral. Repos and secured lending positions are revalued daily. Margin calls on collateralised swaps are predominantly made daily, save for several arrangements which permit calls on a weekly basis. Eligible financial collateral for Basel II reporting purposes includes gilts held under reverse repo agreements and cash held under both repo agreements and collaterised swap arrangements. The guarantees relied upon are either parental guarantees held against subsidiary exposures within bank groups or sovereign guarantees.

1.4.2.2 *Impaired assets*

Investment securities are considered past due where the contractual interest or principal payments are in arrears and it is determined that the Bank will be able to collect all principal and interest outstanding according to the contractual terms of the agreements.

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

At the balance sheet date, the Bank assesses its investment securities for objective evidence that an impairment loss has occurred. Particular consideration is given to evidence of any significant difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

1.4.2.3 *Not impaired*

The Bank only invests in treasury assets which comply with the treasury credit risk policy. Within the treasury investment security portfolio 100% (30 June 2012: 98%) of exposures have an external credit rating equivalent to Fitch A or above.

1.4.3 ***Loans and advances to banks***

None of the Bank's exposures to loans and advances to banks are impaired. The Bank considers that its exposures to loans and advances to banks are all of low to medium risk.

1.5 Eurozone risk

The Bank remains a UK focused retail and commercial operation. It has no sovereign exposure to 'peripheral' eurozone countries (Portugal, Ireland, Italy, Greece and Spain). As at 30 June 2013 the Bank had a £306.6m (30 June 2012: £304.9m) gross exposure to the Government of Finland, £91.2m (30 June 2012: £50.1m) to the Swedish Export Credit Corporation, £110.0m (30 June 2012: £nil) to KfW (a development bank owned by the German Federal Government) and £116.5m (30 June 2012: £nil) to FMS Wertmanagement (the German Federal Government's winding up institution for the nationalised Hypo Real Estate Holding AG), repayable in over one year. It held no other material non-UK sovereign debt.

Other than a £25k (30 June 2012: £25k) exposure to the London subsidiary of a Greek bank, the Bank has no direct exposure to Greek financial institutions or any other counterparty types.

1.5.1 *Direct exposures*

The analyses on the following pages set out the Bank's exposures to financial institutions in European countries, both by asset maturity and by asset type.

The Bank has exposures to financial institutions in the following European countries at 30 June 2013:

Country	*Repayable within 30 days*	*Repayable within 1 year but more than 30 days*	*Repayable in over 1 year*	*Total gross exposure*	*Credit risk mitigation*	*Total net exposure*
30 June 2013						
Austria	–	–	–	–	–	–
Belgium	–	–	–	–	–	–
Denmark	6.2	–	–	6.2	–	6.2
Finland	–	–	9.0	9.0	–	9.0
France	212.0	24.8	58.4	295.2	(11.3)	283.9
Germany	25.9	21.0	338.9	385.8	(323.1)	62.7
Ireland	0.1	–	–	0.1	–	0.1
Netherlands	18.1	35.1	259.5	312.7	–	312.7
Norway	–	–	–	–	–	–
Spain	–	–	–	–	–	–
Sweden	1.4	–	–	1.4	–	1.4
Switzerland	45.3	420.0	83.0	548.3	(362.4)	185.9
	309.0	500.9	748.8	1,558.7	(696.8)	861.9

Country	*Repayable within 30 days*	*Repayable within 1 year but more than 30 days*	*Repayable in over 1 year*	*Total gross exposure*	*Credit risk mitigation*	*Total net exposure*
30 June 2012						
Austria	–	4.2	–	4.2	(4.2)	–
Belgium	–	22.8	11.2	34.0	(34.0)	–
Denmark	57.2	–	–	57.2	–	57.2
Finland	–	–	–	–	–	–
France	151.4	70.2	158.2	379.8	(59.3)	320.5
Germany	161.0	32.2	187.5	380.7	(174.0)	206.7
Ireland	0.1	–	–	0.1	–	0.1
Netherlands	0.1	54.4	264.7	319.2	–	319.2
Norway	–	–	70.6	70.6	–	70.6
Spain	–	1.8	71.3	73.1	(23.0)	50.1
Sweden	10.7	10.0	114.9	135.6	–	135.6
Switzerland	93.5	3.1	660.1	756.7	(373.6)	383.1
	474.0	198.7	1,538.5	2,211.2	(668.1)	1,543.1

For the purposes of the above table, exposures to counterparties which comprise subsidiaries of larger banking groups within which Treasury maintains additional counterparty relationships are aggregated at the group level with the associated risk country being that of the ultimate parent entity. As at 30 June 2013 an exposure of £5.7m (30 June 2012: £8.5m) to an Irish subsidiary of a major American bank group was accordingly reported as exposure to the American based parent and is thus excluded from the analysis above. This exposure is fully guaranteed by the group holding company.

Credit risk mitigation takes the form of UK gilt collateral held in relation to reverse repo transactions, cash collateral held in relation to sold repo and derivative transactions, and sovereign/sub-sovereign guarantees in relation to specific debt security holdings.

The table below shows the Bank's exposure to financial institutions in European countries by asset type.

Country	*Bank and money market balances*	*Bonds*	*Derivatives*	*Other*	*Total net exposure*
30 June 2013					
Denmark	0.6	–	–	5.6	6.2
Finland	–	9.0	–	–	9.0
France	–	50.9	21.0	212.0	283.9
Germany	1.4	18.0	18.7	24.6	62.7
Ireland	0.1	–	–	–	0.1
Netherlands	18.1	294.6	–	–	312.7
Norway	–	–	–	–	–
Spain	–	–	–	–	–
Sweden	0.2	–	–	1.2	1.4
Switzerland	0.4	–	55.2	130.3	185.9
	20.8	372.5	94.9	373.7	861.9

Country	*Bank and money market balances*	*Bonds*	*Derivatives*	*Other*	*Total net exposure*
30 June 2012					
Denmark	49.4	–	–	7.8	57.2
Finland	–	–	–	–	–
France	0.1	100.4	19.7	200.3	320.5
Germany	128.0	25.0	20.8	32.9	206.7
Ireland	0.1	–	–	–	0.1
Netherlands	0.1	319.1	–	–	319.2
Norway	–	70.6	–	–	70.6
Spain	–	50.1	–	–	50.1
Sweden	20.2	114.9	0.5	–	135.6
Switzerland	20.6	–	40.8	321.7	383.1
	218.5	680.1	81.8	562.7	1,543.1

The other asset types comprise repo, reverse repo, foreign exchange transactions, post collateral and exposure within the Bank's securitisation vehicles.

In addition to the above exposures to financial institutions:

- in the overseas European Economic Area (EEA as defined by the European Banking Authority) and Switzerland, corporate customer exposures at 30 June 2013 totalled

£172.9m (30 June 2012: £172.3m). There are no exposures to retail customers based outside of the UK and Channel Islands;

- gross exposure to European multilateral development banks (not included in the above table given the supranational status associated with these institutions) stood at £1,764.7m (30 June 2012: £1,333.5m) before credit risk mitigation (£971.1m post credit risk mitigation (30 June 2012: £793.3m)) of which £868.7m matures within a year (30 June 2012: £576.0m); and

- ABS/MBS exposures of £10.8m and £2.8m (30 June 2012: £14.8m and £3.5m) to Spanish and Belgian special purpose entities respectively were outstanding as at 30 June 2013.

The Bank continues to monitor developments daily across all countries as they affect the Treasury portfolio. As a result of proactive management actions taken throughout the eurozone crisis in order to reduce the associated risk within the Treasury portfolio the focus for existing exposures is with counterparties in Northern Europe (eg Germany, the Netherlands, Finland, Norway and Sweden) where economies are more robust. Credit quality and liquidity within the portfolio remains strong given the prevalence of shorter dated debt securities issued by AAA rated supranational financial institutions, government agencies and sovereign or state owned banks. Ongoing activity with financial institutions within the peripheral eurozone is currently restricted to Treasury's nostro accounts and selective vostro overdraft arrangements.

Treasury operates a risk based approach which monitors counterparty limits and exposure via a credit risk register. Both the counterparties and assets held are monitored against a Board approved matrix of risk tolerance and associated indicators. The credit risk register is updated for rating actions, market events and financial results as they are announced which may influence a change in risk status and possible escalation requiring management actions and inclusion on the watchlist.

The Treasury risk team reviews the entire portfolio and watchlists monthly for appropriate risk status bandings and any associated management actions.

As at 30 June 2013 there were no red (highest risk) eurozone exposures outstanding (30 June 2012: £25m).

1.5.2 ***Indirect exposures***

Treasury risk management monitoring extends beyond the direct risk incurred through counterparty trading, to the underlying exposures (eg to peripheral eurozone countries) which Treasury's counterparties may maintain on their own balance sheets. In analysing each counterparty's secondary exposure we assess the vulnerability and impact on that firm should it suffer different degrees of losses.

Where secondary sovereign exposure or contagion risk is deemed to undermine the performance of the counterparty, remedial management actions are taken in respect of Treasury's counterparty limits and exposure, often ahead of any associated rating actions.

2. Liquidity risk

In the period to 30 June 2013, the Bank has continued to maintain a sufficiently strong liquidity position, with a liquid asset ratio of 13.2% at the balance sheet date (30 June 2012: 12.4%). In addition, during the first half of 2013, the Bank proactively managed its liquidity position, maintaining a regulatory liquidity buffer, and has continued to restructure existing exposures to further improve the funding profile and ensure its financial obligations are met as and when they fall due. From a management perspective, liquidity is monitored on a daily basis via a suite of liquidity risk metrics supported by cashflow forecasts and stress tested forecasts.

2.1 Liquidity framework

The Bank's liquidity risk management framework comprises:

- a defined risk appetite, controls and governance in the Bank's liquidity management policies;
- articulation of how liquidity risk is identified, measured, monitored and managed in the Individual Liquidity Adequacy Assessment (ILAA) and procedures and governance in place to mitigate the risk;
- liquidity risk quantification and mitigation techniques and processes;
- management actions linked through to stress testing and liquidity planning models, enabling a method of mitigating the effects of a number of stress scenarios for varying periods of time and to ensure that the Bank operates within its agreed risk appetite parameters in all planning models;
- ongoing development and enhancement of the Bank's liquidity risk appetite framework; and
- a process to attribute the cost, benefit and risks of liquidity to specific business lines via the Bank's funds transfer pricing mechanism.

2.2 Liquidity risk

The Board's risk appetite for liquidity risk is defined in terms of:

- survival periods which measure the degree of sufficiency of liquid assets to support the Bank's activity over time under a number of stress scenarios;
- adherence to strategic liquidity risk measures; and
- compliance with all regulatory liquidity risk limits.

The stress tests encompass survival across various timescales and a range of adverse liquidity events, both firm specific and market wide, which endeavour to cover all aspects of the liquidity risk to which the Bank is exposed.

The strategic measures approved by the Board include:

- customer loan/deposit ratio, 94% (30 June 2012: 101%) – the ratio of customer loans to customer deposits;
- encumbrance ratio, 29% (30 June 2012: 25%) – the ratio of encumbered assets divided by total assets;
- regulatory framework – Net Stable Funding ratio and Internal Liquidity Guidance; and
- internal liquidity stress tests – the survival period of the Bank under a range of stressed scenarios.

2.3 Liquidity risk management overview

Liquidity risk arising from the structure of the balance sheet and stresses occurring from cash withdrawals from customers are managed in line with policies developed by the Liquidity Management Committee (LMC), the Assets and Liabilities Committee (ALCO) and the Board. The Bank's liquidity management policies are reviewed and approved annually by the BRC (on behalf of the Board) and compliance reviewed by LMC, 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 risk appetite is met.

The Bank monitors its liquidity position on a daily basis via liquidity risk metrics and at weekly LMCs which operate to oversee the operational liquidity management. A range of indicators, details of cashflows and media coverage are monitored to attempt to detect early signs of liquidity risk either in the market or specific to the Bank. The LMC, 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.

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. This is supported with detailed contingency funding plans and recovery options which are tested and reviewed on a regular basis. The Bank's liquidity management framework is designed in line with FCA and PRA BIPRU regulations and industry guidelines.

2.3.1 ***Liquid asset portfolios***

The Bank holds a number of marketable asset pools that can be utilised for liquidity management through the Treasury operation. These asset pools have reduced over the period whilst remaining in excess of regulatory minimum as a result of the Bank's announcements and credit rating downgrades in the first half of 2013. These include:

- liquid asset buffer (LAB); the highest quality debt and comprise of cash at the Bank of England, gilts and central government and multilateral development bank bonds. The table below shows the market value and composition of the LAB:

	30 June 2013	*30 June 2012*
Qualifying stock		
Operational balances with central banks	5,060.4	4,050.9
Gilts	272.5	967.4
Central government and multilateral development bank bonds	804.7	880.2
	6,137.6	5,898.5

- non-buffer assets, these assets are not as highly liquid as LAB assets, however they exist to diversify the liquid asset pool; and

- own retained asset pool, the Bank has securitised part of its asset balance sheet and retained the issued notes. These assets are able to be used to obtain funding from third parties and form part of the Bank's contingent funding plans.

The Bank uses any combination of these asset pools to manage its liquidity position, with LAB and non-buffer assets used predominantly for short term cashflow movements, with the own retained asset pool creating longer term or contingent liquidity. Regular realisation through repo transactions and outright sales provide assurance that these asset pools are marketable, or otherwise realisable.

2.3.2 ***Wholesale funding***

The majority of the Bank's funding comes from retail and corporate customer accounts. The Bank's primary objective in respect of wholesale funding is to supplement retail and corporate 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 also has access to a variety of long term wholesale funding sources outstanding including securitisations, covered bonds and Euro Medium Term Notes. The majority of these programmes are being restructured due to the downgrades received by the Bank from rating agencies in the first half of 2013. The Bank will consider further issuance from these programmes after these restructures are complete and if market conditions permit. The Bank has a small presence in the shorter term wholesale liability markets which reduced in the first half of 2013 following downgrades to the Bank.

2.4 **Liquidity gap**

Details of contractual maturities for assets and liabilities underpin the management of liquidity risk. However, in order to reflect more accurately the expected behaviour of the Bank's assets and liabilities, measurement and modelling of the behavioural aspect of each is constructed.

Gross cash flows include interest and other revenue cash flows. The following table is an analysis of:

- gross undiscounted contractual cash flows of financial liabilities held at the balance sheet date; and
- behavioural adjustments that reflect the actual behaviour of customers based on historic cash flow profiles over a period of ten years.

	Carrying value	*Gross nominal outflow*	*Less than 1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*
30 June 2013							
Contractual cash flows							
Non-derivative liabilities							
Deposits by banks	3,517.8	3,809.5	1,210.5	1,903.7	248.1	447.2	–
Customer accounts	34,166.3	35,303.5	23,441.5	2,262.8	4,738.0	4,861.2	–
Customer accounts – capital bonds	756.0	713.6	21.6	33.1	276.1	382.8	–
Debt securities in issue	4,610.0	5,871.4	4.0	194.1	378.8	4,370.9	923.6
Other borrowed funds	1,248.1	2,247.8	7.2	4.5	124.4	702.7	1,409.0
Amounts owed to other Co-operative Group undertakings	123.9	123.9	123.9	–	–	–	–
	44,422.1	48,069.7	24,808.7	4,398.2	5,765.4	10,764.8	2,332.6
Derivative liabilities							
Net outflow	662.7	1,382.2	16.8	41.2	154.7	482.3	687.2
	45,084.8	49,451.9	24,825.5	4,439.4	5,920.1	11,247.1	3,019.8
Other liabilities	532.8	–	–	–	–	–	–
Total recognised liabilities	45,617.6	49,451.9	24,825.5	4,439.4	5,920.1	11,247.1	3,019.8
Unrecognised loan commitments	4,475.5	4,475.5	4,388.9	85.6	1.0	–	–
Total liabilities	50,093.1	53,927.4	29,214.4	4,525.0	5,921.1	11,247.1	3,019.8
Behavioural adjustments							
Customer accounts	–	–	(18,705.5)	2,602.1	(1,504.0)	17,607.4	–
Total liabilities – behavioural	50,093.1	53,927.4	10,508.9	7,127.1	4,417.1	28,854.5	3,019.8

	Carrying value	*Gross nominal outflow*	*Less than 1 month*	*1-3 months*	*3-12 months*	*1-5 years*	*Over 5 years*
30 June 2012							
Contractual cash flows							
Non-derivative liabilities							
Deposits by banks	4,416.0	4,614.6	1,732.1	476.7	1,566.7	839.1	–
Customer accounts	33,054.7	33,210.1	23,083.8	2,784.1	5,421.7	1,920.5	–
Customer accounts – capital bonds	1,141.7	1,121.5	39.3	66.0	302.8	709.1	4.3
Debt securities in issue	4,146.8	5,315.4	83.0	317.3	223.3	3,437.1	1,254.7
Other borrowed funds	1,257.1	1,965.1	7.2	4.4	82.8	933.9	936.8
Amounts owed to other Co-operative Group undertakings	97.7	97.7	97.7	–	–	–	–
	44,114.0	46,324.4	25,043.1	3,648.5	7,597.3	7,839.7	2,195.8

	Carrying value	Gross nominal outflow	Less than 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
Derivative liabilities							
Net outflow	983.1	391.3	319.9	23.1	42.7	38.7	(33.1)
	45,097.1	46,715.7	25,363.0	3,671.6	7,640.0	7,878.4	2,162.7
Other liabilities	332.9	–	–	–	–	–	–
Total recognised liabilities	45,430.0	46,715.7	25,363.0	3,671.6	7,640.0	7,878.4	2,162.7
Unrecognised loan commitments	5,265.5	5,265.5	4,909.8	317.4	38.3	–	–
Total liabilities	50,695.5	51,981.2	30,272.8	3,989.0	7,678.3	7,878.4	2,162.7
Behavioural adjustments							
Customer accounts	–	–	(19,900.2)	(23.2)	1,720.0	18,203.4	–
Total liabilities – behavioural	50,695.5	51,981.2	10,372.6	3,965.8	9,398.3	26,081.8	2,162.7

2.5 Encumbrance

The Bank aims to have sufficient eligible and unencumbered assets available to meet the needs of its secured funding programmes. Details of the Bank's encumbered assets are shown in note 34d Fair value of transferred assets and associated liabilities.

During the period between 30 June 2012 and 30 June 2013, encumbrance was reduced by capital repayments of securitised and covered bond notes totalling £1,055.3m and increased by £689.5m relating to investment securities sold under repurchase agreements, a net decrease of £365.8m. Additional assets have been encumbered since the period end; for further details, see note 35.

3. 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 within the retail and corporate businesses and certain characteristics embedded within these products and basis risk. Treasury also create market risk through its various portfolio management and trading activities along with currency risk.

3.1 Interest rate risk

Interest rate risk policy statements, approved by the ERC on behalf of the Board, specify the scope of the Bank's wholesale market activity, market risk limits and delegated authorities. The policy is managed by the Bank Market Risk Committee (BMRC) and ALCO. Their prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of the Bank's assets and liabilities. The Bank seeks to minimise the volatility of future earnings from interest rate changes and all interest rate risk exposure is removed from the retail and CABB divisions and consolidated at the centre where it is managed from the core balance sheet within agreed limits. Treasury is responsible for interest rate risk management for the Bank. The principal analytical techniques involve assessing the impact of different interest rate scenarios and changes in balances over various time periods.

The Board receives reports on the management of balance sheet risk and BMRC and ALCO review the balance sheet risk positions and the utilisation of wholesale market risk limits.

3.1.1 *Non-treasury interest rate risk*

The Bank (excluding wholesale) uses a gap report and earnings approach for managing interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year.

BMRC monitors the non-trading interest rate risk which is split between certain wholesale portfolios, banking and investment books, and the rest of the Bank's balance sheet. The following describes the Bank non-trading portfolios excluding these certain wholesale portfolios. These positions are managed by Treasury. All interest rate risk is centralised into Treasury using appropriate transfer pricing rates.

Gap reports are based on defined time periods. ALCO sets guidance limits around the gap, principally that the sum of positions maturing in greater than 12 months and non-sensitive balances (includes non-maturity deposits) are no more than a set limit.

Non-maturity deposits which are non-interest bearing are separated into a stable 'core' element, based on a long run average, and the residual balance, which can fluctuate. In the gap report, the residual balance (along with interest bearing non-maturity deposits) are deemed to reprice or mature within one month. The 'core' non-maturity deposits are within the non-sensitive balance on the gap report, along with non-dated capital and other non-sensitive balances. ALCO sets guidance around the treatment of non-sensitive balances to reinvest in fixed rate assets in periods up to five years to smooth the income based upon the prevailing interest rate environment.

Risk limits are formally calculated at each month end. Interest rate risk and effectiveness of hedging is monitored daily using gap positions, incorporating new business requirements. Draw down risk, in particular for fixed rate mortgages, is managed through weekly balance sheet meetings. The asset and liability management team undertake hedges for interest rate risk using derivative instruments and investment securities which are executed via the Treasury markets team to external wholesale markets, and loans and deposits which are executed internally with the Treasury markets team.

Basis risk is the risk that different assets and liabilities reprice with reference to different indices and at different times. This exposes the Bank to income volatility if indices do not move in a ratio of one to one. The overall exposure to basis risk has remained a net base rate asset throughout the first half of 2013 as customers continue to favour variable rate mortgages (where the introductory rate is linked to Bank of England base rate) and administered and fixed rate savings. Basis risk is monitored by BMRC and ALCO monthly and action is taken as required, which includes pricing, new products or external hedging.

The table illustrates the greater than 12 month net gap position at the end of the period on the Bank's balances, excluding wholesale treasury and customer currency balances which are managed within the treasury risk framework. The gap is driven by product pricing and product mix. The gap is calculated by placing all assets and liabilities at the earliest of their repricing or maturity date and then summing by time band. The aim is to have assets evenly spread so that the Bank is not exposed to sudden rate movements. The net position shows the amount that the Bank is either over or under invested at a point in time. The maximum sensitivity for the period shown below equates to approximately a £6.0m (30 June 2012: £5.3m) decrease in income if rates increased by 1%.

	30 June 2013	*30 June 2012*
Net greater than 12 month gap position		
At the period end	(341)	(300)
Average for the period	(434)	(207)
Maximum sensitivity for the period	(600)	(533)
Minimum sensitivity for the period	(341)	(111)

3.1.2 ***Treasury interest rate risk***

Treasury executes short term funding and hedging transactions with the wholesale markets on behalf of the Bank and its customers. There are two prime measures of risk supplemented by additional controls such as maturity and stop loss limits.

3.1.2.1 *Value at risk (VaR)*

VaR measures the daily maximum potential gain or loss due to market volatility within a statistical confidence level of 95% and a one day holding period. The VaR methodology employed is historical simulation using a time series of one year to latest day and was £0.4m at 30 June 2013 for the trading portfolios (30 June 2012: £0.2m). The VaR methodology has inherent limitations in that market volatility in the past may not be a reliable predictor of the future, and may not reflect the time required to hedge or dispose of the position, hence VaR is not used as the sole measure of risk.

3.1.2.2 *PV100*

This illustrates the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates, representing the treasury banking book and treasury trading book. PV100 is the effect on the net present value (NPV) of the wholesale portfolio to a parallel shift of 100 basis points upon the base yield curve. The effects of a 1% increase in interest rates are a loss of £6.8m (30 June 2012: gain of £9.2m) and a 1% decrease results in a gain of £8.3m (30 June 2012: loss of £7.6m).

3.2 **Currency risk**

The Bank's treasury foreign exchange activities primarily involve:

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

The table below provides an analysis of the Bank's assets and liabilities by currency:

	30 June 2013					30 June 2012				
	£	$	€	Other	Total	£	$	€	Other	Total
Assets										
Cash and balances at central banks	5,402.1	–	–	–	5,402.1	4,316.6	–	–	–	4,316.6
Loans and advances to banks	1,607.7	29.3	97.8	2.7	1,737.5	1,896.2	61.3	400.3	1.9	2,359.7
Loans and advances to customers	32,528.0	38.7	128.5	20.7	32,715.9	33,798.6	43.4	146.0	20.4	34,008.4
Fair value adjustments for hedged risk	217.0	–	–	–	217.0	368.2	–	–	–	368.2
Investment securities										
Loans and receivables	30.6	–	–	–	30.6	388.9	22.2	71.9	–	483.0
Available for sale	3,429.7	–	–	–	3,429.7	3,108.5	36.2	72.9	–	3,217.6
At FV through income or expense	1,622.3	–	–	–	1,622.3	782.2	28.7	6.5	–	817.4
Held for trading	–	–	–	–	–	411.3	–	27.7	–	439.0
Derivative financial instruments	804.3	–	–	–	804.3	910.1	0.1	0.6	–	910.8
Equity shares	5.7	–	–	–	5.7	5.7	–	–	–	5.7
Investments in joint ventures	4.3	–	–	–	4.3	3.4	–	–	–	3.4
Goodwill	–	–	–	–	–	0.6	–	–	–	0.6
Intangible fixed assets	29.9	–	–	–	29.9	37.9	–	–	–	37.9
Investment properties	153.0	–	–	–	153.0	172.2	–	–	–	172.2
Property, plant and equipment	48.4	–	–	–	48.4	72.2	–	–	–	72.2
Amounts owed by other Co-operative Group undertakings	0.5	–	–	–	0.5	288.9	–	–	–	288.9
Other assets	43.8	–	0.5	0.1	44.4	51.1	0.2	0.4	–	51.7
Prepayments and accrued income	16.9	–	–	–	16.9	17.6	–	–	–	17.6
Current tax assets	266.3	–	–	–	266.3	37.3	–	–	–	37.3
Deferred tax assets	103.5	–	–	–	103.5	109.9	–	–	–	109.9
Total assets	46,314.0	68.0	226.8	23.5	46,632.3	46,777.4	192.1	726.3	22.3	47,718.1
Liabilities										
Deposits by banks	3,265.4	78.1	174.3	–	3,517.8	3,375.4	155.9	884.6	0.1	4,416.0
Customer accounts	34,084.1	33.5	46.0	2.7	34,166.3	32,968.0	46.1	38.2	2.4	33,054.7
Customer accounts – capital bonds	756.0	–	–	–	756.0	1,141.7	–	–	–	1,141.7
Debt securities in issue	4,610.0	–	–	–	4,610.0	4,102.3	6.4	38.1	–	4,146.8
Derivative financial instruments	662.7	–	–	–	662.7	983.0	0.1	–	–	983.1
Other borrowed funds	1,218.1	–	30.0	–	1,248.1	1,228.8	–	28.3	–	1,257.1
Amounts owed to other Co-operative Group undertakings	123.9	–	–	–	123.9	97.7	–	–	–	97.7
Other liabilities	88.1	0.2	0.2	–	88.5	89.9	0.2	0.5	–	90.6
Accruals and deferred income	33.9	–	–	–	33.9	26.4	–	–	–	26.4
Provisions for liabilities and charges	293.0	–	–	–	293.0	104.4	–	–	–	104.4
Deferred tax liabilities	117.4	–	–	–	117.4	111.5	–	–	–	111.5
Total liabilities	45,252.6	111.8	250.5	2.7	45,617.6	44,229.1	208.7	989.7	2.5	45,430.0
Net on balance sheet position	1,061.4	(43.8)	(23.7)	20.8	1,014.7	2,548.3	(16.6)	(263.4)	19.8	2,288.1

At 30 June 2013, the Bank's net currency position was the equivalent of £1.8m (30 June 2012: £6.9m) and represented a potential loss of £0.1m given a 3% depreciation in sterling (30 June 2012: £0.2m). The Bank manages its currency positions against both an overall limit and individual currency limits.

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

Capital resources

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.

Basel III rules in the EU (collectively known as CRD IV) will be implemented on a transitional basis from 1 January 2014 to full implementation in 2022 (at the earliest). During the transitional period to full implementation of Basel III the Bank will have the opportunity to generate additional capital from earnings and to implement management actions in order to mitigate the impact of Basel III and meet capital ratios.

In March 2013, the Financial Policy Committee (FPC) directed the Prudential Regulation Authority (PRA) to ensure that by December 2013 major UK banks hold capital resources equivalent to at least 7% of their risk-weighted assets, using a Basel III definition of Common Equity Tier 1 but after taking deductions to reflect the FPC's assessment of expected future losses and future costs of conduct redress, and adjusting for a more prudent calculation of risk weights.

The Bank has developed and agreed a Recapitalisation Plan ('the Plan'), as announced on 4 November 2013, which has been discussed with the relevant regulatory bodies. The key objective of the Plan is to significantly strengthen the Bank's Basel III end point Common Equity Tier 1 capital and to refocus its strategy around its strength in core relationship banking providing current accounts, residential mortgages and savings products to individuals and business banking. The main deliverables of this plan include:

- an increase in Common Equity Tier 1 capital of £1.5 billion as follows:
    1. Approximately £1.14 billion from the Exchange Offer and open equity issue;
    2. a further cash contribution to the Bank in 2014 of £333 million committed by The Co-operative Banking Group;
- reduction in the non-core asset portfolio; and
- a simplification and restructuring programme supporting the Core Business specifically focusing on the existing cost base.

The PRA sets Basel II capital requirements and receives information on these requirements for the Bank. The Bank expects its Core Tier 1 ratio to continue to be above the regulatory minimum. Whilst the Bank has recently moved below its individual capital guidance, it continues to meet the Pillar 1 requirements.

The Bank is currently required to disclose its regulatory capital on a Basel II basis. The following disclosures:

- reconcile the Bank's total equity per the balance sheet to its Basel II Core Tier 1 capital; and
- analyse the Bank's Basel II capital resources, capital ratios and risk weighted assets.

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

Tier 1 capital

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

Tier 2 capital

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

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

	30 June 2013	*30 June 2012*
Reconciliation of equity per balance sheet to Core Tier 1 capital		
Total equity per balance sheet	1,014.7	2,288.1
Regulatory adjustments:		
Minority interests	(0.3)	(0.9)
Available for sale reserve	(5.9)	(72.5)
Cashflow hedging reserve	(24.8)	(75.5)
Core Tier 1 capital before regulatory deductions	983.7	2,139.2
Capital resources		
Core Tier 1 capital before regulatory adjustments:		
Permanent share capital	410.0	410.0
Retained earnings	1,304.1	1,733.7
Minority interests	32.8	32.0
Losses for the period	(772.0)	(45.3)
Share premium account	8.8	8.8
Total Core Tier 1 capital before regulatory adjustments	983.7	2,139.2
Regulatory adjustments from Core Tier 1 capital:		
Intangible assets	(115.6)	(30.6)
50% of excess of expected losses over impairment (net of tax)	(58.8)	(111.7)
50% of securitisation positions	(21.0)	(0.7)
Total Core Tier 1 capital after regulatory adjustments	788.3	1,996.2
Other Tier 1 capital:		
Non-cumulative irredeemable preference shares	60.0	60.0
Regulatory adjustments from other Tier 1 capital:		
50% of tax on excess of expected losses over impairment	17.8	36.2
50% of material holdings	(2.2)	(1.7)
Total Tier 1 capital after regulatory adjustments	863.9	2,090.7
Tier 2 capital before regulatory adjustments:		
Revaluation reserves	2.0	1.8
Collective provisions	0.9	0.7
Subordinated notes and perpetual subordinated bonds	1,116.8	1,126.1
Excess on limits for lower Tier 2 capital	(361.7)	–
Total Tier 2 capital before regulatory adjustments	758.0	1,128.6
Regulatory adjustments from Tier 2 capital:		
50% of excess of expected losses over impairment (gross of tax)	(76.6)	(147.9)
50% of securitisation positions	(21.0)	(0.7)
50% of material holdings	(2.2)	(1.7)
Total Tier 2 capital after regulatory adjustments	658.2	978.3
Total capital resources	1,522.1	3,069.0

The Bank contracts with CFSMS, a fellow Banking Group subsidiary, to build certain assets, including IT developments. Whilst these intangible assets are on the balance sheet of CFSMS, at 30 June 2013 the share attributable to the Bank has been deducted from the Bank's capital resources. The £115.6m includes £91.8m of intangibles included on the CFSMS balance sheet. This is in line with the Bank's regulatory reporting to the PRA.

£361.7m of lower Tier 2 capital is currently ineligible due to gearing rules, as lower Tier 2 capital cannot exceed 50% of Tier 1 capital after deductions.

Capital allocation

The allocation of capital among specific operations and activities is driven by optimisation of the return achieved on the capital allocated, and is based upon the regulatory capital. Capital allocation is undertaken independently of those responsible for capital management, and is reviewed by ALCO.

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

1. Principal activities and segmental information

The Bank and its subsidiary undertakings provide an extensive range of banking and financial services in the United Kingdom.

In the period under review, the Bank was managed through two distinct divisions:

- **Core** – The 'core' business represents activity consistent with the strategy and risk appetite for the Bank. This includes the Retail, core Corporate and Business Banking and Treasury/other segments.

  The Retail Banking business (trading as The Co-operative Bank, Britannia and **smile**) offers a range of financial products and services to individuals and households throughout the UK. Retail also includes Platform (the intermediary mortgage business).

  Core Corporate and Business Banking (CABB) comprises corporate banking, business banking and business services, and effectively consists of all the key business to business elements of the Bank.

  Included in the Treasury/other segment are the results of the treasury activities of the business and the results of Unity Trust Bank.

- **Non-core** – Non-core business lines include activities not congruent with the current strategy of the Bank, which are targeted for run down or exit. These non-core lines contain the majority of the impairment risk for the Bank, and predominantly include the Corporate non-core, Optimum (the closed book of intermediary and acquired loan book assets) and Illius (the residential property company) businesses which originated from the non-member Britannia business prior to merger.

This level of information has been presented to the Board throughout the period. Revenues are attributed to the segment in which they are generated. Transactions between the reportable segments are on normal commercial terms and internal charges and transfer pricing adjustments have been reflected in each segment.

	Core				*Non-core*			
	Retail	*CABB core*	*Treasury/ other*	*Total Core*	*Corporate non-core*	*Other non-core*	*Total Non-core*	*Total*
Period to 30 June 2013								
Interest margin	203.5	58.4	6.6	268.5	(8.9)	(10.6)	(19.5)	249.0
Non-interest income	65.0	23.8	28.3	117.1	1.0	(11.3)	(10.3)	106.8
Operating income	268.5	82.2	34.9	385.6	(7.9)	(21.9)	(29.8)	355.8
Operating expenses	(242.8)	(43.7)	(16.3)	(302.8)	(2.6)	(12.0)	(14.6)	(317.4)
Impairment losses on loans and advances	(24.8)	(140.0)	(0.7)	(165.5)	(294.3)	(36.2)	(330.5)	(496.0)
Operating (loss)/profit	0.9	(101.5)	17.9	(82.7)	(304.8)	(70.1)	(374.9)	(457.6)
Significant items (notes 2, 3 and 6)								(346.0)
Share of post tax profits from joint ventures								0.3
Financial Services Compensation Scheme levies								0.1
Fair value amortisation								(8.2)
Loss before taxation								(811.4)
Income tax								39.4
Loss for the period								(772.0)

The Board relies primarily on net interest revenue to assess the revenue performance of each segment. As a result, interest margin is reported on a net basis to the Board. The Bank's activities are primarily in the UK.

Reconciliation to statutory income statement	*Period to 30 June 2013*
Interest margin	
Total interest margin for reportable segments	249.0
Fair value amortisation	(4.2)
Net interest income	244.8
Non-interest income	
Total non-interest income for reportable segments	106.8
Fair value amortisation	0.3
Non-interest income	107.1
Operating expenses	
Total operating expenses for reportable segments	(317.4)
Fair value amortisation	(4.3)
Operating expenses	(321.7)
Fair value amortisation	
Total interest unwind for reportable segments	(8.2)
Interest margin unwind	4.2
Non-interest income unwind	(0.3)
Operating expenses unwind	4.3
Fair value amortisation	–

	Core				*Non-core*			
	Retail	*CABB core*	*Treasury/ other*	*Total Core*	*Corporate non-core*	*Other non-core*	*Total Non-core*	*Total*
Period to 30 June 2012								
Interest margin	196.6	54.0	7.1	257.7	(11.5)	3.0	(8.5)	249.2
Non-interest income	68.4	32.2	26.0	126.6	1.2	8.1	9.3	135.9
Operating income	265.0	86.2	33.1	384.3	(10.3)	11.1	0.8	385.1
Operating expenses	(214.8)	(38.6)	(13.1)	(266.5)	(2.8)	(12.6)	(15.4)	(281.9)
Impairment losses on loans and advances	(18.2)	(17.5)	(0.5)	(36.2)	(56.9)	(1.5)	(58.4)	(94.6)
Impairment gains on investments	–	–	2.7	2.7	–	–	–	2.7
Operating profit/(loss) before group recharges	32.0	30.1	22.2	84.3	(70.0)	(3.0)	(73.0)	11.3
Group recharges	(8.2)	(1.1)	(0.3)	(9.6)	(0.1)	(0.4)	(0.5)	(10.1)
Operating profit/(loss) after re-allocating group recharges	23.8	29.0	21.9	74.7	(70.1)	(3.4)	(73.5)	1.2
Significant items (notes 3 and 6)								(79.3)
Share of post tax profits from joint ventures								0.6
Financial Services Compensation Scheme levies								(0.8)
Fair value amortisation								19.7
Loss before taxation								(58.6)
Income tax								13.3
Loss for the period								(45.3)

Reconciliation to statutory income statement	*Period to 30 June 2012*
Interest margin	
Total interest margin for reportable segments	249.2
Fair value amortisation	22.0
Net interest income	271.2
Non-interest income	
Total non-interest income for reportable segments	135.9
Fair value amortisation	–
Non-interest income	135.9
Operating expenses	
Total operating expenses for reportable segments (including group recharges)	(292.0)
Fair value amortisation	(2.3)
Operating expenses	(294.3)
Fair value amortisation	
Total interest unwind for reportable segments	19.7
Interest margin unwind	(22.0)
Operating expenses unwind	2.3
Fair value amortisation	–

30 June 2013	*Retail*	*Corporate core*	*Corporate non-core*	*Optimum*	*Treasury*	*Total*
Segment assets	17,797.1	5,314.0	2,267.7	7,562.2	11,245.2	44,186.2
Unallocated assets						1,633.9
Total assets for reportable segments						45,820.1
Statutory reclassifications						812.2
Consolidated total assets						46,632.3
Segment liabilities	27,969.4	6,140.9	–	–	9,791.5	43,901.8
Unallocated liabilities						724.6
Total liabilities for reportable segments						44,626.4
Statutory reclassifications						991.2
Consolidated total liabilities						45,617.6

30 June 2012	*Retail*	*Corporate core*	*Corporate non-core*	*Optimum*	*Treasury*	*Total*
Segment assets	17,826.5	5,330.3	3,120.6	7,884.3	10,553.7	44,715.4
Unallocated assets						1,816.2
Total assets for reportable segments						46,531.6
Statutory reclassifications						1,186.5
Consolidated total assets						47,718.1
Segment liabilities	26,453.8	6,683.0	–	–	10,168.6	43,305.4
Unallocated liabilities						930.9
Total liabilities for reportable segments						44,236.3
Statutory reclassifications						1,193.7
Consolidated total liabilities						45,430.0

The 2012 comparatives include balance sheet reclassifications of deferred tax assets and liabilities as shown in note 28.

2. Net interest income

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Interest receivable and similar income						
On financial assets not at fair value through income or expense:						
On loans and advances to customers	643.1	(29.0)	614.1	693.6	–	693.6
On loans and advances to banks	15.4	–	15.4	15.7	–	15.7
On investment securities	75.3	–	75.3	77.3	–	77.3
	733.8	(29.0)	704.8	786.6	–	786.6
On financial assets at fair value through income or expense:						
Net expense on financial instruments hedging assets	(59.4)	(10.0)	(69.4)	(63.1)	–	(63.1)
Net interest income on financial instruments not in a hedging relationship	41.2	–	41.2	21.2	–	21.2
	715.6	(39.0)	676.6	744.7	–	744.7

Significant items are provisions of £29.0m (2012: £nil) for potential customer redress following identification of a technical breach of the Consumer Credit Act and £10.0m (2012: £nil) in relation to past sales of interest rate swaps.

Included within interest receivable is £7.2m (2012: £11.0m) relating to profit on sale of investment securities – available for sale and £3.7m (2012: £nil) relating to the provision for the processing of first payments on certain mortgages.

Interest income accrued on impaired financial assets during the year was £22.6m (2012: £26.9m). Interest due to unwinding of discount on impairment provisions relating to impaired financial assets amounted to £5.3m (2012: £3.6m).

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Interest expense and similar charges						
On financial liabilities not at fair value through income or expense:						
On customer accounts	255.3	–	255.3	268.2	–	268.2
On bank and other deposits	127.5	–	127.5	121.4	–	121.4
On subordinated liabilities	40.1	–	40.1	39.6	–	39.6
On perpetual subordinated debt	20.8	–	20.8	16.8	–	16.8
	443.7	–	443.7	446.0	–	446.0
On financial liabilities at fair value through income or expense:						
Net interest expense on financial instruments hedging liabilities	9.5	–	9.5	9.2	–	9.2
Net interest expense on financial instruments not in a hedging relationship	17.6	–	17.6	18.3	–	18.3
	470.8	–	470.8	473.5	–	473.5

The 2012 comparatives for interest receivable and similar income and interest expense and similar charges reflect reclassifications within interest categories.

3. Net fee and commission income

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Fee and commission income						
On items not at fair value through income or expense	116.0	(94.0)	22.0	127.9	(40.0)	87.9
On trust or fiduciary activities that result from holding or investing in assets on behalf of others	0.2	–	0.2	0.1	–	0.1
	116.2	(94.0)	22.2	128.0	(40.0)	88.0

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Fee and commission expense						
On items not at fair value through income or expense	34.3	–	34.3	35.0	–	35.0
On items at fair value through income or expense	1.9	–	1.9	6.2	–	6.2
	36.2	–	36.2	41.2	–	41.2

Significant items consist of a provision for potential customer redress of £53.0m (2012: £40.0m) relating to past sales of payment protection insurance, £26.0m (2012: £nil) for potential customer redress relating to alleged failings in the introduction of third party sales of card and identity protection products and £15.0m (2012: £nil) for potential customer redress in relation to arrears charges.

4. Net trading income

	Period to 30 June 2013	*Period to 30 June 2012*
Foreign exchange	1.1	4.0
Other interest rate instruments	–	5.3
	1.1	9.3

Foreign exchange net trading income includes gains less losses from spot forward and forward contracts, options, futures and translated foreign currency assets and liabilities.

Other interest rate instruments includes the result of transacting in government securities, money market instruments, interest rate and currency swaps, options and other derivatives.

5. Other operating income

	Period to 30 June 2013	*Period to 30 June 2012*
Profit on sale of investment securities – loans and receivables (note 12)	40.4	21.1
Profit on sale of loans and advances to banks	–	9.7
Rent receivable from investment properties (note 17)	4.5	4.3
Change in fair value of investment properties (note 17)	(18.9)	0.1
Other	–	4.6
	26.0	39.8

The profit on sale of investment securities arose from the restructuring of a portfolio of assets. Profit on smaller disposals in the normal course of business are included in net interest income.

6. Operating expenses

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Staff costs:						
Wages and salaries	93.7	1.2	94.9	97.3	7.3	104.6
Social security costs	7.2	0.4	7.6	7.5	0.6	8.1
Pension costs – defined benefit plans	0.1	–	0.1	0.1	–	0.1
Pension costs – defined contribution plans	13.6	0.4	14.0	18.5	0.7	19.2
Other staff costs	16.9	4.3	21.2	14.7	8.3	23.0
	131.5	6.3	137.8	138.1	16.9	155.0
Administrative expenses	158.7	166.8	325.5	128.9	22.4	151.3
Depreciation of property, plant and equipment	6.0	–	6.0	7.8	–	7.8
Amortisation of intangible fixed assets	3.0	–	3.0	3.0	–	3.0
Impairment of intangible fixed assets	2.0	–	2.0	–	–	–
Profit on sale of property, plant and equipment	–	–	–	(0.4)	–	(0.4)
Impairment of property, plant and equipment	–	9.9	9.9	–	–	–
Operating lease rentals	15.6	–	15.6	14.7	–	14.7
Property provisions for liabilities and charges provided in the period (note 27)	3.6	–	3.6	1.0	–	1.0
Property provisions for liabilities and charges released during the period (note 27)	(0.4)	–	(0.4)	(0.3)	–	(0.3)
Other provisions for liabilities and charges provided in the period (note 27)	–	30.0	30.0	0.1	–	0.1
Other provisions for liabilities and charges released during the period (note 27)	(0.1)	–	(0.1)	–	–	–
Direct expenses from investment properties that generated rental income in the period	1.7	–	1.7	1.4	–	1.4
Direct expenses from investment properties that did not generate rental income in the period	0.1	–	0.1	–	–	–
	321.7	213.0	534.7	294.3	39.3	333.6

Significant items relate to £14.7m (2012: £19.3m) of costs incurred on a programme of investment and integration, £10.0m (2012: £20.0m) of costs incurred as a result of the bid for the Lloyds Bank branches, £148.4m (2012: £nil) of recharged costs relating to impairment of intangible fixed assets, £9.9m (2012: £nil) of impairment of property, plant and equipment and £30.0m (2012: £nil) of provisions made for potential customer redress relating to the processing of first payments on certain mortgages.

7. Income tax

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
Current tax – current period	(22.7)	(80.4)	(103.1)	(9.7)	(17.0)	(26.7)
Current tax – prior period	–	–	–	(13.2)	–	(13.2)
Deferred tax – current period (note 28)	7.6	–	7.6	30.1	(2.4)	27.7
Write off of prior period deferred tax asset (note 28)	56.1	–	56.1	–	–	–
Deferred tax – prior period (note 28)	–	–	–	(1.1)	–	(1.1)
	41.0	(80.4)	(39.4)	6.1	(19.4)	(13.3)

Further information on deferred income tax is presented in note 28. The tax on the Bank's loss before taxation differs from the theoretical amount that would arise using the corporation tax rate in the UK as follows:

	Period to 30 June 2013	*Period to 30 June 2012*
Loss before taxation	(811.4)	(58.6)
Tax calculated at a rate of 23.25% (30 June 2012: 24.5%)	(188.7)	(14.4)
Effects of:		
Preference share interest not deductible for tax purposes	0.7	0.7
Expenses not deductible for tax purposes	2.9	0.3
Depreciation of expenditure not qualifying for capital allowances	2.9	0.1
Profits taxed at lower rates	0.1	0.2
Non-taxable income	(0.7)	(0.6)
Adjustments to tax charge in respect of prior periods	–	0.5
Change in rate of deferred tax	1.0	(0.2)
Losses in period where no deferred tax asset recognised	86.2	–
Write off of prior year deferred tax asset (note 28)	56.1	–
Other differences	0.1	0.1
	(39.4)	(13.3)

The tax credit for the half year ended 30 June 2013 is lower than expected due to losses in the current period for which a deferred tax asset has not been recognised, and a write-off of prior year deferred tax assets in respect of tax losses and fair value adjustments.

8. (Losses)/earnings per share

Basic earnings per share is calculated by dividing the net (loss)/profit attributable to equity shareholders of the Bank by the weighted average number of ordinary shares in issue during the period.

	Period to 30 June 2013			*Period to 30 June 2012*		
	Before significant items	*Significant items*	*After significant items*	*Before significant items*	*Significant items*	*After significant items*
(Loss)/profit attributable to equity shareholders of the Bank	(506.7)	(265.6)	(772.3)	13.8	(59.9)	(46.1)
Ordinary shares in issue (millions)						
At the beginning and end of the period	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0
Weighted average number of ordinary shares in issue (millions)	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0	8,200.0
Basic (losses)/earnings per share (expressed in pence per share)	(6.18)	(3.24)	(9.42)	0.17	(0.73)	(0.56)

9. Cash and balances at central banks

	30 June 2013	*30 June 2012*
Cash in hand	271.3	248.0
Balances with the Bank of England other than mandatory reserve deposits	5,060.4	4,030.3
Included in cash and cash equivalents	5,331.7	4,278.3
Mandatory reserve deposits with the Bank of England	70.4	38.3
	5,402.1	4,316.6

Mandatory reserve deposits are not available for use in the Bank's day to day operations, are non-interest bearing and are not included in cash and cash equivalents.

10. Loans and advances to banks

	30 June 2013	*30 June 2012*
Items in course of collection from other banks	111.4	208.2
Placements with other banks	562.2	1,242.0
Included in cash and cash equivalents	673.6	1,450.2
Other loans and advances to banks	1,063.9	909.5
	1,737.5	2,359.7

11. Loans and advances to customers

	30 June 2013	*30 June 2012*
Gross loans and advances	33,785.5	34,349.5
Less: allowance for losses	(1,069.6)	(341.1)
	32,715.9	34,008.4

Loans and advances to customers include £144.2m (30 June 2012: £148.0m) of financial assets at fair value through income or expense designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency. Of these, £55.1m (30 June 2012: £56.4m) are secured by real estate collateral.

Loans and advances to customers include £10,276.7m (30 June 2012: £9,316.9m) securitised under the Bank's securitisation and covered bond programmes. The Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within deposits by banks (note 21) are £nil (30 June 2012: £61.2m) of loans from external third parties and within debt securities in issue (note 23) are £4,056.7m (30 June 2012: £3,796.5m) of fixed and floating rate notes, all secured on these mortgage assets.

Concentration of exposure

The Bank's exposure is virtually all within the UK. There is a detailed analysis of the concentration of exposure within the risk management disclosures, on pages 321 and 322.

Allowance for losses on loans and advances

	Individual retail	*Individual corporate*	*Collective retail*	*Collective corporate*	*Total*
Period to 30 June 2013					
At the beginning of the period	10.6	433.6	176.4	22.4	643.0
(Release)/charge against profits	(3.7)	355.9	64.2	78.0	494.4
Amounts written off	(3.5)	(37.0)	(21.8)	(0.3)	(62.6)
Unwind of discount allowance	–	(3.5)	(1.8)	–	(5.3)
Interest charged on impaired loans	–	0.1	–	–	0.1
At the end of the period	3.4	749.1	217.0	100.1	1,069.6
Period to 30 June 2012					
At the beginning of the period	9.0	105.1	165.7	12.2	292.0
Charge against profits	2.8	68.7	18.1	6.2	95.8
Amounts written off	(2.8)	(24.8)	(14.8)	(0.7)	(43.1)
Unwind of discount allowance	–	(1.9)	(1.7)	–	(3.6)
Interest charged on impaired loans	–	–	–	–	–
At the end of the period	9.0	147.1	167.3	17.7	341.1

The net impairment charge in the income statement is £496.0m (30 June 2012: £94.6m). This includes a net cost of £0.2m (30 June 2012: net gain of £1.2m) relating to amounts recovered by the Bank against amounts previously written off and costs incurred in relation to those recoveries. The recoveries have been made from the mortgagors and from other parties involved in the origination or acquisition of the mortgages.

The impairment charge also includes a provision of £1.4m (30 June 2012: £nil) made against fair value adjustments for hedged risk during the year (as shown in the fair value adjustments for hedged risk tables).

There are a number of reasons for the increase in the overall impairment charge. Firstly, in the first half of 2013, the amount of assets designated as non-core has increased, the Bank has continued to review its loan book on a case-by-case basis and there has been a change in the work out approach on a significant number of assets. Secondly, there have been further improvements to our credit risk management approach, improving the data on which impairment assessments are made and resulting in increased impairments. This has taken into account the continuing impacts of the corporate real estate environment, prolonged real wage deflation and the lower apparent crystallisation of losses while base rate continues to be low. Impairments which occur in the ordinary course of the business due to changes in customer circumstances have also been incurred in both the core and non-core business.

Loans and advances to customers include finance lease receivables:

	30 June 2013	*30 June 2012*
Gross investment in finance leases may be analysed as follows:		
No later than one year	18.2	23.4
Later than one year and no later than five years	59.5	62.1
Later than five years	59.7	83.2
	137.4	168.7
Unearned future finance income on finance leases	(36.7)	(46.2)
Net investment in finance leases	100.7	122.5
The net investment in finance leases may be analysed as follows:		
No later than one year	12.3	16.8
Later than one year and no later than five years	42.1	41.3
Later than five years	46.3	64.4
	100.7	122.5

There are no unguaranteed residual values for any of the finance leases.

The Bank enters into finance lease and hire purchase arrangements with customers in a wide range of sectors including transport, retail and utilities. The accumulated allowance for uncollectible minimum lease payments receivable is £0.6m (30 June 2012: £0.1m).

Fair value adjustments for hedged risk

The Bank has entered into interest rate swaps that protect it from changes in interest rates on the floating rate liabilities that fund its portfolio of fixed rate mortgages. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed rate mortgages.

	30 June 2013	*30 June 2012*
Gross fair value adjustments for hedged risk	255.4	368.2
Less: impairment provision	(38.4)	–
	217.0	368.2

Impairment provision on fair value adjustments for hedged risk

	30 June 2013	*30 June 2012*
At the beginning of the period	37.0	–
Charge against profits	1.4	–
At the end of the period	38.4	–

12. Investment securities

	30 June 2013	30 June 2012
Loans and receivables		
Unlisted	30.6	483.0
	30.6	483.0
Less: allowance for losses	–	–
	30.6	483.0
Included in cash and cash equivalents	–	–

The movement in investment securities – loans and receivables excluding interest amounts is summarised as follows:

	30 June 2013	30 June 2012
At the beginning of the period	294.7	803.3
Disposals and maturities	(282.5)	(358.6)
Exchange adjustments	–	(4.0)
Fair value movements through income or expense	(10.1)	0.6
Amortisation	28.5	38.1
Release of impairment provision	–	2.7
At the end of the period	30.6	482.1

Impairment analysis of investment securities – loans and receivables

	30 June 2013	30 June 2012
At the beginning of the period	–	2.7
Release during the period	–	(2.7)
At the end of the period	–	–

Investment securities – loans and receivables have decreased during the period due to sales and maturities. Included within other operating income (note 5) is £40.4m (30 June 2012: £21.1m) of profit relating to sales of these investments.

	30 June 2013	30 June 2012
Available for sale		
Listed	3,209.4	2,866.6
Unlisted	240.3	393.3
	3,449.7	3,259.9
Less: allowance for losses	(20.0)	(42.3)
	3,429.7	3,217.6
Included in cash and cash equivalents	125.0	260.0

The movement in investment securities – available for sale excluding interest amounts is summarised as follows:

	30 June 2013	*30 June 2012*
At the beginning of the period	3,775.5	3,405.5
Acquisitions	1,184.6	2,514.6
Disposals and maturities	(1,478.5)	(2,787.7)
Exchange adjustments	8.3	(6.4)
Fair value movements through equity	(44.4)	159.3
Fair value movements through income or expense	(23.5)	(79.4)
Amortisation	(22.7)	(4.5)
Release and utilisation of impairment provision	19.0	–
At the end of the period	3,418.3	3,201.4

Impairment analysis of investment securities – available for sale

	30 June 2013	*30 June 2012*
At the beginning of the period	39.0	42.5
Utilised during the period	(19.0)	–
Exchange adjustments	–	(0.2)
At the end of the period	20.0	42.3

Investment securities – available for sale have decreased during the period due to sales and maturities. The £19.0m utilised during the period relates to a provision on an investment that was sold in the period.

	30 June 2013	*30 June 2012*
Fair value through income or expense		
Listed	1,622.3	817.4
	1,622.3	817.4
Less: allowance for losses	–	–
	1,622.3	817.4
Included in cash and cash equivalents	–	–

The movement in investment securities – fair value through income or expense excluding interest amounts is summarised as follows:

	30 June 2013	*30 June 2012*
At the beginning of the period	1,830.6	339.5
Reclassified from held for trading	447.8	–
Acquisitions	688.0	622.1
Disposals and maturities	(1,351.5)	(163.4)
Exchange adjustments	1.3	(0.2)
Fair value movements through income or expense	(16.3)	7.9
At the end of the period	1,599.9	805.9

	30 June 2013	30 June 2012
Held for trading		
Listed	–	439.0
	–	439.0
Less: allowance for losses	–	–
	–	439.0
Included in cash and cash equivalents	–	–

The movement in investment securities – held for trading excluding interest amounts may be summarised as follows:

	30 June 2013	30 June 2012
At the beginning of the period	954.3	–
Reclassified to fair value through income or expense	(447.8)	–
Acquisitions	12.1	773.3
Disposals and maturities	(516.0)	(342.0)
Exchange movements	4.5	–
Fair value movements through income or expense	(7.1)	5.4
	–	436.7

Investment securities – held for trading have decreased during the period due to sales and maturities and reclassifications to investment securities – fair value through income or expense.

Analysis of investment securities by issuer

	30 June 2013	30 June 2012
Investment securities issued by public bodies:		
Government securities	2,022.4	1,263.9
Other public sector securities	1,498.7	–
	3,521.1	1,263.9
Investment securities issued by other issuers:		
Bank and building society certificates of deposits	240.3	340.6
Other debt securities:		
Other floating rate notes	1,290.6	2,869.5
Mortgage backed securities	30.6	483.0
	1,321.2	3,352.5
	5,082.6	4,957.0

Other floating rate notes (FRNs) relate to sterling denominated FRNs with maturities ranging from nine months to five years from the balance sheet date.

13. Derivative financial instruments

The Bank, as principal, has entered into various derivatives either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk, equity risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the Bank does not have a legal right of offset.

Derivatives held for trading purposes

Trading transactions are wholly interest rate related contracts including swaps, caps and floors, forward rate agreements and exchange traded futures. Trading transactions include derivatives where the Bank enters into a transaction to accommodate a customer together with the corresponding hedge transaction.

Non-trading derivatives

Non-trading transactions comprise derivatives held for hedging purposes to manage the asset and liability positions of the Bank. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. The foreign exchange rate positions are managed using forward currency transactions and swaps. Equity risk is managed using equity swaps.

During the period the Bank has entered into fair value hedges to mitigate price movements due to interest rate sensitivities.

	30 June 2013 Fair value		*30 June 2012 Fair value*	
	Assets	*Liabilities*	*Assets*	*Liabilities*
Derivatives held for trading purposes				
Interest rate derivatives:				
Interest rate swaps	–	–	179.4	162.9
Over The Counter (OTC) interest rate options	–	–	1.3	1.3
Total derivative assets/liabilities held for trading purposes	–	–	180.7	164.2
Derivatives held for non-trading purposes				
Derivatives designated as cashflow hedges:				
Interest rate swaps	75.7	43.7	183.1	69.0
Derivatives designated as fair value hedges:				
Interest rate swaps	92.0	376.7	109.2	571.4
Cross currency interest rate swaps	–	40.1	0.2	59.6
Derivatives held for non-trading purposes for which hedge accounting has not been applied:				
Interest rate swaps	173.4	175.1	52.3	52.0
Embedded derivatives – options	68.0	–	58.5	1.0
Forward currency transactions	334.9	23.8	257.1	62.4
OTC interest rate options	1.0	3.2	–	3.2
Equity swaps	59.3	0.1	69.7	0.3
Total derivative assets/liabilities held for non-trading purposes	804.3	662.7	730.1	818.9
Total recognised derivative assets/liabilities	804.3	662.7	910.8	983.1

The derivatives designated as cashflow hedges are interest rate swaps used to hedge interest rate risk in the Bank's retail operations. Cash flows are hedged by quarterly time periods for durations up to ten years. During the period there were no forecast transactions for which hedge accounting had previously been used but are no longer expected to occur.

The number of non-margin exchange traded contracts held by the Bank as at 30 June 2013 was nil (2012: nil).

In line with industry standards, credit valuation adjustments (CVAs) and debit value adjustments (DVAs) are applied to non-collateralised swaps representing the fair value measurement of counterparty risk. The net credit adjustment across the portfolio was £5.7m as at 30 June 2013 (2012: £3.3m). CVAs and DVAs are not applied to derivatives that are fully cash collateralised.

14. Equity shares

	30 June 2013	*30 June 2012*
Investment securities – unlisted	5.7	5.7
Included above are the following trade investments:		
Vocalink Limited – 4,416,165 ordinary shares of £1 each (2012: 4,416,165)	5.6	5.6

Equity shares are classified as available for sale.

15. Goodwill

	30 June 2013	*30 June 2012*
Net book amount		
At the beginning of the period	–	0.6
At the end of the period	–	0.6

The Bank's goodwill was recognised in 2009 and related to the transfer of engagements of Britannia Building Society.

Each year the Bank tests the asset for impairment by comparing its recoverable amount, determined in accordance with IAS 36, with its carrying amount. In the second half of 2012, the directors concluded that the carrying value should be written down to £nil.

16. Intangible fixed assets

	30 June 2013			*30 June 2012*		
	Internally generated intangible assets	*Other intangible assets*	*Total*	*Internally generated intangible assets*	*Other intangible assets*	*Total*
Cost						
At the beginning of the period	11.6	46.0	57.6	13.5	46.0	59.5
Additions	–	–	–	0.2	–	0.2
At the end of the period	11.6	46.0	57.6	13.7	46.0	59.7
Accumulated amortisation and impairment						
At the beginning of the period	7.2	15.5	22.7	8.0	10.8	18.8
Charge for the period	0.8	2.2	3.0	0.6	2.4	3.0
Impairment	–	2.0	2.0	–	–	–
At the end of the period	8.0	19.7	27.7	8.6	13.2	21.8
Net book value						
At the end of the period	3.6	26.3	29.9	5.1	32.8	37.9
At the beginning of the period	4.4	30.5	34.9	5.5	35.2	40.7

Internally generated intangible assets consist of software development costs.

Other intangible assets consist of a core deposit intangible of £44.0m (30 June 2012: £44.0m) and a brand intangible of £nil (30 June 2012: £2.0m). The brand intangible has been fully impaired in the period.

17. Investment properties

	30 June 2013	*30 June 2012*
Fair value		
At the beginning of the period	173.0	172.7
Additions	0.2	0.1
Disposals	(1.3)	(0.7)
Changes in fair value (note 5)	(18.9)	0.1
At the end of the period	153.0	172.2

All investment properties are held to generate rental income until such time that the Bank considers it appropriate to realise its investment.

Investment properties are carried at fair value, measured under level 3 of the fair value hierarchy. Fair value is calculated by management using a discounted cashflow model applying HPI movements to date on a segmented portfolio basis and applying future expected cashflows over the lifecycle of the portfolio. Model assumptions include occupancy rate, House Price Index, forced sale discount and discount rate.

The key variable within the model is the forced sale discount of 11.9% which has been applied to the portfolio and is based on a sample of valuations undertaken in the period by appropriately qualified independent valuers. A movement of +/-1% in the absolute rate would change the fair value by +/- £1.5m.

The Bank lets investment properties on assured shorthold tenancy agreements, most of which are for contract periods of no more than 12 months. The future minimum lease receipts under non-cancellable operating leases are £1.3m (30 June 2012: £2.0m). The Bank has not recognised any contingent rent in the period (30 June 2012: £nil). None of the lease agreements are individually significant.

Included in other operating income for the period is £4.5m (30 June 2012: £4.3m) of rental income relating to investment properties (note 5).

18. Property, plant and equipment

30 June 2013	*Land and buildings*	*Leasehold improvements*	*Computers and other equipment*	*Total*
Cost				
At the beginning of the period	55.4	24.9	102.9	183.2
Additions	–	–	0.2	0.2
Disposals	–	–	(1.9)	(1.9)
At the end of the period	55.4	24.9	101.2	181.5
Accumulated depreciation and impairment				
At the beginning of the period	7.8	18.3	93.0	119.1
Charge for the period	0.6	2.3	3.1	6.0
Impairment	9.9	–	–	9.9
Disposals	–	–	(1.9)	(1.9)
At the end of the period	18.3	20.6	94.2	133.1
Net book value				
At the end of the period	37.1	4.3	7.0	48.4
At the beginning of the period	47.6	6.6	9.9	64.1

30 June 2012	Land and buildings	Leasehold improvements	Computers and other equipment	Total
Cost				
At the beginning of the period	55.7	25.0	115.3	196.0
Additions	–	–	0.2	0.2
Disposals	(0.2)	–	0.2	–
At the end of the period	55.5	25.0	115.7	196.2
Accumulated depreciation				
At the beginning of the period	6.6	13.4	95.9	115.9
Charge for the period	0.6	2.6	4.6	7.8
Disposals	–	–	0.3	0.3
At the end of the period	7.2	16.0	100.8	124.0
Net book value				
At the end of the period	48.3	9.0	14.9	72.2
At the beginning of the period	49.1	11.6	19.4	80.1

	30 June 2013	30 June 2012
The net book value of land and buildings comprises:		
Freehold	36.6	47.8
Leasehold	0.5	0.5
	37.1	48.3

19. Other assets

	30 June 2013	30 June 2012
Amounts recoverable within one year:		
Trade debtors	27.1	24.4
Other assets	17.3	27.3
	44.4	51.7

20. Prepayments and accrued income

	30 June 2013	30 June 2012
Amounts recoverable within one year:		
Other	8.3	10.5
Amounts recoverable after more than one year:		
Other	8.6	7.1
	16.9	17.6

21. Deposits by banks

	30 June 2013	30 June 2012
Items in course of collection	47.2	47.7
Deposits from other banks	3,470.6	4,368.3
	3,517.8	4,416.0

Included within deposits from other banks are liabilities of £3,461.8m (30 June 2012: £3,654.9m) secured on investment securities with a carrying value of £4,901.7m (30 June 2012: £4,715.2m) which have been sold under sale and repurchase agreements (note 34d).

22. Customer accounts – capital bonds

	30 June 2013	*30 June 2012*
Retail	756.0	1,141.7

Capital bonds are fixed term customer accounts with returns based on the movement in an index (e.g. FTSE 100) over the term of the bond.

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

The fair values for the capital bonds are obtained on a monthly basis from the swap counterparties. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

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

The maximum amount the Bank would contractually be required to pay at maturity for all the capital bonds is £756.0m (30 June 2012: £1,147.1m).

The Bank uses swaps to create economic hedges against all of its capital bonds. The loss on capital bonds in the income statement for the period is £9.4m (30 June 2012: £11.0m). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the period is a gain of £0.3m (30 June 2012: £0.2m).

23. Debt securities in issue

	30 June 2013	*30 June 2012*
Certificates of deposit	36.3	381.3
Commercial paper	–	8.1
Fixed and floating rate notes	4,573.7	3,757.4
	4,610.0	4,146.8

The Bank has entered into cross currency interest rate swaps that protect it from changes in exchange rates and interest rates on its debt securities in issue. Changes in the fair values of these swaps are largely offset by changes in the sterling equivalent carrying value of the debt securities in issue.

Debt securities in issue include fixed and floating rate notes, the majority of which are secured on portfolios of variable and fixed rate mortgages. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets. There is no requirement for the Bank to make good any shortfall out of general funds. The maturity date of the notes matches the maturity date of the underlying assets.

24. Other borrowed funds

	30 June 2013	30 June 2012
Step up callable subordinated notes 2019	37.8	150.0
60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each	60.0	60.0
Floating rate subordinated notes 2016	23.9	20.5
5.625% fixed rate subordinated notes 2021	8.7	150.0
9.25% fixed rate subordinated notes 2021	275.0	275.0
7.875% fixed rate subordinated notes 2022	235.4	–
Fixed rate subordinated notes 2024	164.9	169.5
Fixed rate subordinated notes 2033	117.1	123.7
Perpetual subordinated bonds	296.5	285.9
Issue costs, discounts and accrued interest	28.8	22.5
	1,248.1	1,257.1

The other borrowed funds balances include fair value adjustments for hedged risk (including merger fair value adjustments) of £68.5m (30 June 2012: £88.8m).

Exchange Offer

On 17 June 2013 the Bank announced a Recapitalisation Plan. The details of the Recapitalisation Plan were materially changed on 4 November 2013. As a consequence of the Recapitalisation Plan the investors in preference shares, perpetual subordinated bonds and other subordinated bonds will have their holdings converted as described within the basis of preparation section of this financial information.

Conditional on the successful completion of the Exchange Offer:

- Interest accrued on subordinated bonds will be capitalised; and
- Interest payable on preference shares and perpetual subordinated bonds is as detailed below.

Step up callable subordinated notes 2019

The notes were issued on 1 April 2004 at a discount of 0.946%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an interest rate of 5.875% per annum to (but excluding) 2 April 2014, and thereafter the interest rate will be determined by reference to the gross redemption yield on the five year benchmark gilt, and a margin of 2.25%. Interest is payable annually in arrears on 2 April.

The Bank may redeem all, but not less than all, of the notes at their principal amount on 2 April 2014.

On 19 December 2012 the Bank invited investors to exchange their holdings in the above instrument for a new subordinated note, which resulted in the redemption of £112.2m of the notes (representing 74.8% of the amount outstanding), leaving £37.8m outstanding.

60,000,000 9.25% non-cumulative irredeemable preference shares of £1 each

The preference shares carry the right to a fixed non-cumulative preferential dividend on the capital for the time being paid up, at the rate of 9.25% per annum exclusive of any associated tax credit. The dividends are payable on 31 May and 30 November each year and take priority over dividends to any other class of share in the capital of the Bank.

On a return of capital on winding up, the assets of the Bank shall be applied in repaying the preference share capital in priority to any payments to the holders of any other class of shares in the capital of the Bank. The amount receivable by the holders of the preference shares shall be the greater of the capital paid up or the average quoted price during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to wind up.

The holders of the preference shares shall have the right to vote at a general meeting of the Bank only if and when, at the date of the notice convening the meeting, the dividend due to them has been in arrears for six months or more or if a resolution is to be proposed at the meeting abrogating or varying their rights or privileges or for the winding up of the Bank or other return of capital and then only on that resolution.

Under the terms of the Exchange Offer, the Bank will pay the half yearly dividend (ordinarily payable on 30 November) to preference share holders upon, but conditional on, successful completion of the Exchange Offer.

Floating rate subordinated notes 2016

The notes were issued on 18 May 2006 at a discount of 0.14%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes are denominated in euros and interest is calculated at three months EURIBOR plus a margin of 0.28%. From 18 May 2011 interest has been calculated at three months EURIBOR plus a margin of 0.78%. The first interest coupon was paid in August 2006.

The notes were hedged with a cross currency swap converting the exposure into sterling which paid a floating rate of three months LIBOR with a margin on interest coupon of 0.34125% and received a floating rate of three months EURIBOR plus a margin on interest coupon of 0.28%. The cross currency swap matured on 18 May 2011.

On 28 April 2011 the Bank redeemed €149.2m of the notes (representing 81% of the amount outstanding) leaving €34.9m outstanding. The Bank had the option to call the outstanding notes in whole but not in part on the interest payment date falling on or nearest to May 2011, and now at any interest payment date thereafter subject to prior consent of the Prudential Regulatory Authority (PRA).

5.625% fixed rate subordinated notes 2021

The notes were issued on 16 November 2006 at a discount of 0.189%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.625% up to and including the interest payment date on 16 November 2016, when the interest basis changes to floating rate. During the fixed rate period, interest is payable semi-annually in arrears on 16 May and 16 November.

From 17 November 2016, the notes carry a floating interest rate of three months LIBOR plus a margin of 1.75%. Interest is payable quarterly in arrears on 16 February, 16 May, 16 August and 16 November, commencing on the interest payment date falling in February 2017 up to and including the maturity date.

The Bank may redeem all, but not less than all, of the notes at the principal amount on 16 November 2016, and on any quarterly interest payment date thereafter.

On 19 December 2012 the Bank invited investors to exchange their holdings in the above instrument for a new subordinated note, which resulted in the redemption of £141.3m of the notes (representing 94.2% of the amount outstanding) leaving £8.7m outstanding.

9.25% fixed rate subordinated notes 2021

On 28 April 2011 the Bank issued £275.0m fixed rate subordinated notes due 2021, issued at par.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 9.25% up to (but excluding) 28 April 2021. Interest is payable annually in April.

There is no option to redeem the notes early.

7.875% fixed rate subordinated notes 2022

On 19 December 2012 the Bank issued £235.4m fixed rate subordinated notes due 2022, issued at par.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 7.875% up to 18 December 2022. Interest is payable annually in arrears in December.

There is no option to redeem the notes early.

Fixed rate subordinated notes 2024

The notes were issued on 17 March 2004 at a discount of 1.148%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.75% to 2 December 2019 (reset date). During this period the notes are hedged with interest rate swaps that convert the interest rate payable into floating rates at six months LIBOR plus a margin of 0.72%. The fixed receipt leg of the swap is received annually to match the payment to the noteholders. The floating payment leg of the swap is payable semi-annually in June and December. The interest rate swaps mature on 2 December 2019.

From the reset date the interest rate will be calculated based on the five year benchmark gilt rate plus a margin of 1.94%. The five year benchmark gilt rate being the gross redemption yield determined by the UK government security having a maturity date falling on or nearest the fifth anniversary of the determination date (the determination date being two days prior to the reset date), converted to an annualised yield. The Gross Redemption Yield being calculated on the basis set out by the UK Debt Management Office in the publication 'Formulae for Calculating Gilt Prices from Yields'. From the reset date the interest will be paid annually in arrears until maturity or redemption.

The notes are callable in whole but not in part, at the principal amount, on 2 December 2019, subject to the prior consent of the PRA.

Fixed rate subordinated notes 2033

The notes were issued on 28 March 2002 at a discount of 0.93%.

The notes are an unsecured obligation of the Bank and in the event of the winding up of the Bank, the claims of noteholders will be subordinated in right of payment to the claims of depositors and other creditors of the Bank.

The notes carry an annual interest rate of 5.875% to maturity. Interest is payable semi-annually in March and September.

Of the notes, £100m are hedged with interest rate swaps that have a floating payment leg at six months LIBOR payable in March and September. The fixed interest rate receivable legs on the swaps are £25m at 5.405% and £75m at 5.225%. The semi-annual interest receivable leg on the swap is matched to the dates on the notes.

Perpetual subordinated bonds

Perpetual subordinated bonds (PSBs) with a par value of £110m were issued in 1992 at a discount of 0%. PSBs with a par value of £200m were issued in 2005 at a discount of 0%.

Both the £110m and £200m PSBs are unsecured obligations of the Bank and in the event of the winding up of the Bank, the claims of the bondholders will be subordinated in right of payment of all creditors (including subordinated creditors) of the Bank, and *pari passu* with the non-cumulative preference shares.

The PSBs with a par value of £110m carry an annual interest rate of 13%. Interest is payable semi-annually in January and July.

The PSBs with a par value of £200m carry an annual interest rate of 5.5555% up until the reset date. This coupon is payable semi-annually in June and December. From the reset date of 14 December 2015 the interest rate will be amended to the rate for three month deposits in sterling plus a margin of 2.05% per annum. The interest payments will then be made quarterly in arrears in March, June, September and December, with the interest resetting at each interest payment date.

During the period up until the reset date the PSBs are hedged with an interest rate swap that converts the interest rate payable into floating rates at six months LIBOR plus a margin of 1.175%. The semi-annual interest receivable and payable on the swap is aligned to the interest payment dates of the notes. The interest rate swap matures on 14 December 2015.

Given prior relevant supervisory consent, the Bank may elect to repay all, but not less than all, of these PSBs on 14 December 2015 or on any interest payment date thereafter at their principal amount.

Payment of interest

13% PSBs

On 12 July 2013, the Bank announced that further to the 17 June 2013 Recapitalisation Plan announcement that the discretionary coupon on 31 July 2013 will be deferred. The interest payment deferred and interest accrued up to the date of completion, will be paid at the time of, but conditional on, successful completion of the Exchange Offer.

5.5555% PSBs

Interest accrued since the last coupon payment (14 June 2013), up to the date of completion, will be paid at the time of, but conditional on, successful completion of the Exchange Offer.

25. Other liabilities

	30 June 2013	*30 June 2012*
Amounts falling due within one year:		
ATM creditor	59.1	56.9
Other creditors	25.2	29.4
Amounts falling due after one year:		
Other creditors	4.2	4.3
	88.5	90.6

Other creditors of the Bank include finance lease obligations as follows:

	Present value of lease payments		*Future minimum lease payments*	
	30 June 2013	*30 June 2012*	*30 June 2013*	*30 June 2012*
Due within one year	–	–	–	–
Due between one year and five years	0.1	0.1	0.1	0.1
Due after five years	1.3	1.1	1.6	1.7
	1.4	1.2	1.7	1.8

The future minimum lease payments have been discounted at LIBOR over the term of the lease to give the present value of these payments.

26. Accruals and deferred income

	30 June 2013	*30 June 2012*
Amounts falling due within one year:		
Other	33.8	24.4
Amounts falling due after one year:		
Other	0.1	2.0
	33.9	26.4

27. Provisions for liabilities and charges

Period to 30 June 2013	*Property*	*FSCS levies*	*PPI*	*Other*	*Total*
At the beginning of the period	7.3	38.6	116.0	0.8	162.7
Income statement movements:					
Provided in the period – net interest income	–	–	–	42.7	42.7
Provided in the period – operating expense	3.6	0.1	–	30.0	33.7
Provided in the period – net fee and commission income	–	–	53.0	41.0	94.0
Released in the period – operating expense	(0.4)	(0.2)	–	(0.1)	(0.7)
Utilised during the period	(0.3)	(0.1)	(38.9)	(0.1)	(39.4)
At the end of the period	10.2	38.4	130.1	114.3	293.0
Provisions were analysed as follows:					
Amounts falling due within one year	2.5	25.6	106.6	101.3	236.0
Amounts falling due after one year	7.7	12.8	23.5	13.0	57.0
	10.2	38.4	130.1	114.3	293.0
Period to 30 June 2012					
At the beginning of the period	6.9	25.0	61.7	8.4	102.0
Income statement movements:					
Provided in the period – operating expense	1.0	0.8	–	0.1	1.9
Provided in the period – net fee and commission income	–	–	40.0	–	40.0
Released in the period – operating expense	(0.3)	–	–	–	(0.3)
Utilised during the period	(0.5)	–	(32.3)	(6.4)	(39.2)
At the end of the period	7.1	25.8	69.4	2.1	104.4
Provisions were analysed as follows:					
Amounts falling due within one year	3.1	10.9	69.4	2.1	85.5
Amounts falling due after one year	4.0	14.9	–	–	18.9
	7.1	25.8	69.4	2.1	104.4

Property

The Bank has a number of leasehold properties available for rent. Provisions are made when either the sub-lease income does not cover the rental expense or the property is vacant. The provision is based on the expected outflows during the remaining periods of the leases using a discount rate of 3.8%.

Financial Services Compensation Scheme (FSCS) levies

The FSCS has provided compensation to customers of financial institutions following the collapse of deposit takers in 2008. The compensation paid out to consumers is currently funded through loans from HM Treasury. The Bank will be liable to pay a proportion of the outstanding borrowings that the FSCS has borrowed from HM Treasury. Additionally the Bank is obliged to pay its share of management expenses and compensation based upon the Bank's proportion of the total market protected deposits at 31 December of each year.

The ultimate FSCS levy to the industry as a result of the 2008 collapses cannot currently be estimated reliably as it is dependent on other factors that may affect amounts payable and the timing of amounts payable, including changes in interest rates, potential recoveries of assets by the FSCS and the level of protected deposits.

The Bank has provided £38.4m (30 June 2012: £25.8m) for its share of the levies raised by the FSCS including the interest on the loan from HM Treasury in respect of the levy years to 31 March 2014. The provision includes £26.8m in respect of the interest levy (30 June 2012: £25.8m). The Bank's interest levy provision calculation includes estimates of the total FSCS levy in each levy year and estimates of the Bank's market participation in each levy year. During 2012, the FSCS indicated that it expected to raise a capital levy to cover the estimated shortfall in the amounts recovered from the failed banks to repay HM Treasury loans made to the FSCS. The Bank has provided £11.6m (30 June 2012: £nil) in respect of its share of this levy.

PPI

Provisions have been made in respect of potential customer compensation claims relating to past sales of PPI. Claims are investigated on an individual basis and, where appropriate, compensation payments are made. For a number of years, the Bank, along with many other financial services providers, sold PPI alongside mortgage and non-mortgage credit products and the Bank continues to service its existing PPI business. The Bank stopped selling non-mortgage PPI in 2009 and stopped selling mortgage PPI in March 2012.

The FSA issued a policy statement in August 2010 which amended the 'Disputes Resolution: Complaints' section of its Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to complete a proactive review of all past business to identify mis-sold policies where no complaint has been made. An additional provision of £53.0m (30 June 2012: £40.0m) has been recognised in the period (note 3), in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £297.0m (30 June 2012: £134.3m).

Other provisions

Other provisions principally relate to the estimated costs of other customer redress issues. This includes a provision of £33.7m (30 June 2012: £nil) for potential customer redress relating to the processing of first payments on certain mortgages (of which £30 million is included in significant items), £26.0m (30 June 2012: £nil) for alleged failings in the introduction of third party sales of card and identity protection products, £15.0m (30 June 2012: £nil) for potential customer redress in relation to arrears charges and £10.0m (30 June 2012: £nil) for potential interest rate swap mis-selling. In addition, provisions of £29.0m (30 June 2012: £nil) have been recorded for potential customer redress following identification of a technical breach of the Consumer Credit Act.

28. Deferred tax

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 23% (30 June 2012: 24%).

The movements on the deferred tax accounts are as follows:

	30 June 2013		*30 June 2012*	
	Deferred tax asset	*Deferred tax liability*	*Deferred tax asset*	*Deferred tax liability*
Deferred tax at the beginning of the period	159.6	(121.4)	130.2	(103.8)
Income statement (charge)/credit	(67.7)	4.0	(20.0)	(7.7)
Prior year adjustments	–	–	1.1	–
Charged to equity:				
Cashflow hedges	11.6	–	(1.4)	–
Deferred tax at the end of the period	103.5	(117.4)	109.9	(111.5)
Components of net deferred tax:				
Deferred tax asset	111.5	–	116.8	–
Deferred tax liability	(8.0)	(117.4)	(6.9)	(111.5)
	103.5	(117.4)	109.9	(111.5)

The deferred tax asset above includes an offset for those deferred tax liabilities that are permissable to be offset.

The 2012 balance sheet comparatives have been re-presented to reflect that certain deferred tax liabilities cannot be offset against the deferred tax assets.

	30 June 2013		*30 June 2012*	
	Deferred tax asset	*Deferred tax liability*	*Deferred tax asset*	*Deferred tax liability*
Deferred tax comprises:				
Capital allowances on fixed assets	33.3	–	27.0	–
Capital allowances on assets leased to customers	1.5	–	(2.4)	–
Pensions and other post-retirement benefits	0.9	–	0.9	–
Fair value adjustments – The Co-operative Bank plc	48.8	–	81.8	–
Other temporary differences	27.0	–	24.6	–
Tax losses carried forward	–	–	2.4	–
Cashflow hedges	(7.4)	–	(23.8)	–
Unrealised appreciation on investments	(0.6)	–	(0.6)	–
Fair value adjustments – The Co-operative Bank subsidiaries	–	(117.4)	–	(111.5)
	103.5	(117.4)	109.9	(111.5)

Other temporary differences for the Bank of £27.0m (30 June 2012: £24.6m) include deferred tax assets/liabilities as a result of loss provisions on mortgage assets held by Special Purpose Entities (SPEs), taxation of SPEs under the securitisation regime and spreading of the tax effect of IFRS transitional adjustments.

The deferred tax (credit)/charge in the income statement comprises:

	Period to 30 June 2013	*Period to 30 June 2012*
Capital allowances on fixed assets	–	1.5
Capital allowances on assets leased to customers	(0.1)	(0.3)
Fair value adjustments	8.6	24.8
Other temporary differences	(0.9)	3.0
Tax losses carried forward	–	(2.4)
Write off of prior year deferred tax asset (note 7)	56.1	–
	63.7	26.6

Deferred tax assets expected to be recoverable after one year are £103.5m (30 June 2012: £109.9m). Deferred tax assets from prior year of £51.9m (30 June 2012: £nil) in respect of tax losses carried forward, and £4.2m (30 June 2012: £nil) in respect of fair value adjustments, and deferred tax assets of £86.5m (30 June 2012: £nil) in respect of current period losses have not been recognised, where doubt exists over the availability of sufficient future taxable profits.

Reductions in the UK corporation tax rate from 26% to 24% (effective from 1 April 2012) and to 23% (effective from 1 April 2013) were substantively enacted on 26 March 2012 and 3 July 2012 respectively. Further reductions to 21% (effective from 1 April 2014) and 20% (effective from 1 April 2015) were substantively enacted on 2 July 2013. This will reduce the Bank's future current tax charge accordingly. The deferred tax assets and liabilities at 30 June 2013 have been calculated based on the rate of 23% substantively enacted at the balance sheet date. The enacted 3% rate reduction will reduce the Bank's deferred tax assets by £13.5m and the deferred tax liability by £15.3m.

29. Pensions

Defined contribution basis

The Bank, along with other businesses within the Co-operative Group, participates in The Co-operative Pension Scheme (Pace). Pace is a hybrid scheme, consisting of a defined benefit section and a defined contribution section.

As a Co-operative Group wide pension scheme, Pace exposes the participating businesses to actuarial risks associated with the current and former employees of other Co-operative Group companies with the result that there is no consistent and reliable basis for allocating liabilities, assets and costs of individual companies participating in the scheme.

Therefore, pension costs in respect of the scheme are accounted for on a defined contribution basis and recognised as an expense in the income statement as incurred, based on a fixed percentage as agreed with the Trustees.

The Pace scheme is not sectionalised and operates on a 'last man standing' basis. In the event that other participating employers become insolvent and the full statutory debt is not recovered on insolvency, the Bank would become liable for the remaining liabilities.

The key aspects of Pace are illustrated below. These amounts are not recognised within this financial information and are therefore disclosed for information purposes.

Scheme information

Risks arising in Pace are identified at the The Co-operative Group level, with the impact of any changes to contribution assessed under the Bank's risk management framework. The Bank is therefore exposed to potential future increases in required contributions and capital held for pension risk.

The Pace Trustee, in consultation with the Co-operative Group, is responsible for the risk management arrangements for Pace agreeing suitable contribution rates, investment strategy and for taking appropriate professional advice as required.

Contribution payments

The level of funding for the Pace scheme is agreed between The Co-operative Group and the Pace Trustee.

The Co-operative Group expects to contribute a further c£45m to Pace by 31 December 2013. The Bank expects to contribute a further c£17m by 31 December 2013.

On an accounting basis the Pace scheme is in surplus, however, on a funding basis the scheme is in a deficit position. Following the last actuarial triennial valuation, the Group agreed a recovery plan with the Trustee of the scheme to contribute £20m p.a. over 8 years to repay £248m deficit agreed as at 5 April 2010. Although there is no formal allocation of defined benefit liabilities between the participating employers of the scheme, the Bank currently pays 40% (2012: 40%) of the total deficit recovery contributions. Based on advice from a qualified actuary, the contributions in respect of future service in the defined benefit section, payable by the participating entities up to 6 October 2012, were 16.7% of pensionable salaries. Thereafter, this was reduced to 16.0% of pensionable salaries to reflect an increase in member contributions. The next triennial valuation is currently in progress, the results of which are expected in 2014.

There is no contractual agreement or stated Co-operative Group policy for charging the net defined benefit cost for the scheme as a whole measured in accordance with IAS 19R to individual Co-operative Group entities. Therefore, the Bank, in its individual financial information, cannot recognise the net defined benefit cost so charged. The net defined benefit cost of the pension scheme is recognised fully by the sponsoring employer, which is Co-operative Group Limited.

The Bank also pays contributions in respect of the employed members of the defined contribution sections of the scheme of either 2% or 8% of pensionable salaries.

Key assumptions of the Group pension scheme

The key aspects of The Co-operative Group's Pace scheme are as follows:

	30 June 2013	*30 June 2012*
The principal assumptions used to determine the liabilities of the Pace scheme are:		
Discount rate	4.60%	4.65%
Rate of increase in salaries	5.10%	4.70%
Future pension increases where capped at 5.0% per annum	3.60%	3.20%
Future pension increases where capped at 2.5% per annum	2.50%	2.50%
Assumptions used to determine net pension cost for the Pace scheme are:		
Discount rate	4.60%	4.60%
Rate of increase in salaries	4.80%	4.80%

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Pace scheme at June 2013 is:

	Male	*Female*
Life expectancy:		
Member currently aged 65 (current life expectancy)	22.4	24.0
Member currently aged 45 (life expectancy at age 65)	24.2	25.9

The amounts recognised in the balance sheet of The Co-operative Group are as follows:

	30 June 2013	*30 June 2012*
Fair value of plan assets	7,189.9	6,593.1
Present value of funded obligations	(6,988.4)	(6,212.6)
	201.5	380.5
Present value of unfunded obligations	(4.5)	(4.4)
	197.0	376.1

The asset allocations at the period end were as follows:

	30 June 2013	*30 June 2012*
Equities	2,357.1	1,977.9
Liability driven investments	3,473.8	3,296.6
Alternative growth	956.9	923.0
Property	297.8	329.7
Other	104.3	65.9

The table below shows the value of the assets in each category which have a quoted market price:

	30 June 2013	*30 June 2012*
Equities	2,357.1	1,987.0
Liability driven investments	2,541.9	2,451.6
Alternative growth	–	–
Property	–	–
Other	103.2	65.8

Britannia pension scheme

Defined contribution basis

The Britannia scheme is a hybrid scheme, consisting of a defined benefit section and a defined contribution section. Following the transfer of engagements of Britannia Building Society, CFSMS Management Services Limited (CFSMS), a fellow Banking Group Subsidiary became principal employer of the scheme. The pension cost shown in these accounts is the actual contribution paid by the Bank. The scheme closed on 6 October 2012 with active members at the date of closure being invited to join the Co-operative Pension Scheme (Pace) for future pension accrual. No future service contributions are payable to the scheme due to the closure of the scheme to future accrual during 2012. A fixed allowance for running expenses of £1.0 million per annum is currently payable.

Nature of benefits

The funded element of the defined benefit section pays out pensions at retirement based on service to 6 October 2012 and final pay for employees who commenced employment prior to 1 September 2001, when it closed to new members. The unfunded element is a no charge supplementary arrangement for certain executive directors. Benefits under the unfunded arrangements are valued on the same assumptions as the funded defined benefits and are disclosed as unfunded obligations.

Scheme information

Risks arising in the Britannia scheme are identified in CFSMS, with the impact of any changes to contribution rates assessed under the Bank's risk management framework. The Bank is therefore exposed to potential future increases in required contributions and capital held for pension risk.

The Britannia scheme trustee, is responsible for the risk management arrangements for the scheme, agreeing suitable contribution rates, investment strategy and for taking appropriate professional advice as required.

Contribution rates

There is no contractual agreement or stated policy for charging the net defined benefit cost for the scheme as a whole, as measured in accordance with IAS 19R, to individual entities. Therefore, the Bank, in its individual financial information, cannot recognise the net defined benefit cost so charged. The net defined benefit cost of the pension scheme is recognised fully by the principal employer, CFSMS.

The key aspects of the defined benefit section of the Britannia scheme are as follows:

	30 June 2013	*30 June 2012*
The principal assumptions used to determine the liabilities of the defined benefit section of the scheme are:		
Discount rate	4.60%	4.60%
Rate of increase in salaries	4.80%	4.80%
Future pension increases where capped at 5.0% per annum	3.30%	3.30%
Future pension increases where capped at 2.5% per annum	2.50%	2.50%
Assumptions used to determine net pension cost for the Britannia defined benefit scheme are:		
Discount rate	4.60%	4.60%
Rate of increase in salaries	4.80%	4.80%

The average life expectancy (in years) for mortality tables used to determine defined benefit scheme liabilities for the former Britannia Building Society scheme at June 2013 is:

	Male	*Female*
Life expectancy:		
Member currently aged 65 (current life expectancy)	22.4	24.6
Member currently aged 45 (life expectancy at age 60)	24.2	26.5

The amounts recognised in the balance sheet of CFSMS are as follows:

	30 June 2013	*30 June 2012*
Fair value of plan assets	609.5	584.2
Present value of funded obligations	(593.2)	(624.3)
	16.3	(40.1)
Pension surplus not recognised under IAS 19R	(16.3)	–
Present value of unfunded obligations	(2.9)	(3.0)
	(2.9)	(43.1)

The asset allocations at the period end were as follows:

	30 June 2013	*30 June 2012*
Equities	150.3	146.1
Liability driven investments	281.9	333.0
Alternative growth	126.4	87.6
Property	50.9	17.5

The table below shows the value of the assets in each category which have a quoted market price.

	30 June 2013	*30 June 2012*
Equities	150.3	146.1
Liability driven investments	281.9	267.0

The above disclosure for assets and obligations are estimates which have been calculated by projecting forward from the 31 December 2012 position. The projections assume that all experience without exception has been in line with the assumptions made at 31 December 2012.

Bank (unfunded) pension scheme

The Bank also operates a small unfunded pension scheme.

	30 June 2013	*30 June 2012*
Rate of increase of pensions in payment	3.3%	3.3%
Rate of increase in salaries	4.8%	4.8%
Discount rate	4.6%	4.6%

The assumptions used by the actuary were the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

The values of the assets and liabilities of the unfunded pension scheme were:

	30 June 2013	*30 June 2012*
Present value of unfunded obligations	(4.0)	(4.0)
Deficit in scheme	(4.0)	(4.0)
Related deferred tax asset	0.9	0.9
Net pension liability	(3.1)	(3.1)
Analysis of amount charged to income statement:		
Interest on pension scheme liabilities	0.1	0.1
	0.1	0.1

Changes in the present value of the scheme liabilities are as follows:

	30 June 2013	*30 June 2012*
Opening defined benefit liabilities	4.0	3.9
Interest on liabilities	0.1	0.1
Benefits paid	(0.1)	–
Closing defined benefit liabilities	4.0	4.0

Amounts recognised in the statement of comprehensive income was £nil (30 June 2012: £nil).

The amounts for the current year are as follows:

	30 June 2013	*30 June 2012*
Defined benefit obligation	(4.0)	(4.0)
Scheme assets	–	–
Deficit in scheme	(4.0)	(4.0)
Experience adjustment on scheme liabilities	–	–
Experience adjustment on scheme assets	–	–

30. Contingent liabilities and commitments

The tables below give the contract amounts and risk weighted amounts of contingent liabilities and commitments. The contract amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The risk weighted amounts have been calculated in accordance with the PRA rules.

The contingent liabilities detailed below arise in the normal course of banking business and it is not practical to quantify their future financial effect.

	Contract amount 30 June 2013	*Risk weighted amount 30 June 2013*	*Contract amount 30 June 2012*	*Risk weighted amount 30 June 2012*
Contingent liabilities:				
Guarantees and irrevocable letters of credit	146.3	107.1	221.0	178.6
Other commitments:				
Documentary credits and short term trade related transactions	1.2	0.2	6.1	1.1
Forward asset purchases and forward deposits placed	96.7	1.0	140.4	4.5
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments) (i)	4,377.6	845.2	5,118.9	1,230.1
	4,475.5	846.4	5,265.4	1,235.7

Notes

(i) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,031.1m (2012: £2,119.7m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank's day to day operations. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements.

See note 34d for further details of assets pledged.

Commitments under operating leases

The Bank leases various properties and equipment under non-cancellable operating lease arrangements. The leases have various terms, ranging from six months to 999 years. None of these leases are individually material and none have any material clauses. The table below discloses the minimum operating lease payments the Bank is required to make over the remaining lives of the leases.

	Land and buildings 30 June 2013	Equipment 30 June 2013	Land and buildings 30 June 2012	Equipment 30 June 2012
Falling due:				
Within one year	21.6	0.2	23.0	0.3
Between one and five years	59.7	0.3	68.3	0.5
In five years or more	79.9	–	80.4	–
	161.2	0.5	171.7	0.8

The Bank leases a number of branch and office premises under operating leases. The leases typically run for a period of up to 25 years, with an option to renew the lease after that period. Lease payments are generally reviewed every three to five years to reflect market rentals.

The total value of future minimum sub-lease payments expected to be received under non-cancellable sub-leases for the Bank was £8.8m (2012: £10.3m).

Former Britannia Building Society pension scheme guarantee

Following the transfer of engagements of Britannia Building Society, the Britannia pension scheme transferred to CFS Management Services Ltd (CFSMS). Under the terms of this transfer the Bank entered into a deed of guarantee to provide assurance to the trustees of the pension scheme to support CFSMS in meeting its funding obligations to the scheme should CFSMS be unable to pay its obligations as they fall due.

Intra-group guarantee

The Bank has an indemnification agreement, accounted for as an intra-group guarantee under IFRS 4, with CFSMS in which the Bank has agreed to indemnify CFSMS against all and any liability, loss, damage, costs and expense arising from the agreement.

Other

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies, the media and politicians, there is a risk that certain aspects of the Bank's current or historic business, including, inter alia, mortgages and relationship banking, may be determined by the Financial Conduct Authority (FCA) and other regulatory bodies or the courts as not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment in their opinion.

31. Investments in Group undertakings

Subsidiary undertakings

The Bank has, except in the case of Unity Trust Bank plc, a direct interest in the ordinary share capital of the following principal subsidiary undertakings trading in the businesses indicated. All subsidiary undertakings are included in the consolidated Bank results.

Principal subsidiary undertakings which are registered in England and operating in the UK:

		Bank holding 30 June 2013	*Bank holding 30 June 2012*
Unity Trust Bank plc (held through subsidiary undertaking)	Banking	27%	27%
Co-operative Commercial Limited	Investment company	100%	100%
First Roodhill Leasing Limited	Leasing	100%	100%
Second Roodhill Leasing Limited	Leasing	100%	100%
Third Roodhill Leasing Limited	Leasing	100%	100%
Fourth Roodhill Leasing Limited	Leasing	100%	100%
Britannia Treasury Services Limited	Holding company	100%	100%
Britannia Asset Management Limited	Holding company	100%	100%
Britannia Development and Management Company Limited	Property investment	100%	100%
Illius Properties Limited	Property investment	100%	100%
Moorland Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds	100%	100%

See note 34d for further details of the covered bond transactions.

The accounting policy for Special Purpose Entities (SPEs) is disclosed on page 292.

Unity Trust Bank plc is considered to be a subsidiary undertaking of The Co-operative Bank p.l.c. as The Co-operative Bank p.l.c. elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

Britannia Treasury Services Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Mortgage Agency Services Number One Limited	Mortgage and syndicated lending
Mortgage Agency Services Number Two Limited	Mortgage lending
Mortgage Agency Services Number Four Limited	Mortgage lending
Mortgage Agency Services Number Five Limited	Mortgage lending
Mortgage Agency Services Number Six Limited	Mortgage lending
Western Mortgage Services Limited	Mortgage book administration
Platform Group Holdings Limited	Holding company

Platform Group Holdings Limited has the following principal wholly owned subsidiary undertakings, registered in England, operating in the UK and trading in the businesses indicated:

Platform Consumer Services Limited	Mortgage lending
Platform Funding Limited	Mortgage origination
Platform Home Loans Limited	Mortgage origination and servicing

Platform Consumer Services Limited is the only direct subsidiary of Platform Group Holdings Limited.

Registered in the Isle of Man and operating overseas:

Britannia International Limited	Deposit taking

Registered in Scotland and operating in the UK:

Britannia Life Direct Limited	Direct sales of financial services

Securitisation vehicles

The results of the following securitisation vehicles are consolidated into the results of the Bank:

Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited	Securitisation company
Meerbrook Finance Number Two Limited	Securitisation company
Meerbrook Finance Number Three Limited	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Six Limited	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company
Silk Road Finance Number Three plc	Securitisation company
Cambric Finance Number One plc	Securitisation company
Calico Finance Number One Limited	Securitisation company

All securitisation vehicles are registered in England and operate in the UK, with the exception of Calico Finance Number One Limited, which is registered and operates in the Republic of Ireland.

All of the above companies are related parties to the Bank. See note 32 for the related party disclosures.

See note 34d for further details of securitisation vehicles.

Joint ventures

The Bank's investment in joint ventures is £4.3m (30 June 2012: £3.4m).

The Bank owns 49% of the ordinary shares in Britannia Personal Lending Limited, a company registered in England and operating in the UK. The company trades in the business of unsecured personal lending.

The Bank's interest in Britannia Personal Lending Limited is as follows:

	30 June 2013	*30 June 2012*
Current assets	5.7	11.9
Long term assets	9.5	14.1
	15.2	26.0
Current liabilities	9.2	16.8
Long term liabilities	1.7	5.8
Equity	4.3	3.4
	15.2	26.0
Income	0.6	0.7
Expenses	(0.2)	0.1
Profit before tax	0.4	0.8
Taxation	(0.1)	(0.2)
Profit after tax	0.3	0.6

Joint ventures are accounted for using the equity method.

32. Related party transactions

Parent, subsidiary and ultimate controlling party

The Co-operative Banking Group Limited owns 100% of the issued ordinary share capital of the Bank and is the Bank's immediate holding company. The Co-operative Banking Group Limited is incorporated in England and is registered under the Industrial and Provident Societies Acts. The ultimate holding organisation is The Co-operative Group Limited, which is incorporated in England and registered under the Industrial and Provident Societies Acts. The financial statements of the immediate and ultimate holding organisations are available from 1 Angel Square, Manchester, M60 0AG.

Further details of subsidiary undertakings and joint ventures are disclosed in note 31.

A number of banking transactions are entered into with related parties in the normal course of business on normal commercial terms. These include loans and deposits. Key management, as defined by IAS 24 (Related Party Disclosures), are considered to be Board and executive members of the Bank, and Board and executive members of the Bank's immediate and ultimate holding organisations. The volume of related party transactions, outstanding balances at the period end, and related income and expense for the period are as follows:

Directors, key management personnel and close family

	30 June 2013	*30 June 2012*
Loans outstanding at the beginning of the period	2.6	2.2
Net movement	(1.1)	0.1
Loans outstanding at the end of the period	1.5	2.3
Deposits and investments at the beginning of the period	2.4	1.9
Net movement	(0.8)	0.3
Deposits and investments at the end of the period	1.6	2.2

Directors' loans

	Mortgages 30 June 2013	*Personal loans 30 June 2013*	*Credit cards 30 June 2013*	*Mortgages 30 June 2012*	*Personal loans 30 June 2012*	*Credit cards 30 June 2012*
Number of directors with loan type	3	1	3	5	2	5
Total value of directors' loans	0.7	–	–	1.6	–	–

	Interest and fees received from other Co-operative Group undertakings Period to 30 June 2013	*Interest and fees paid to other Co-operative Group undertakings Period to 30 June 2013*	*Interest and fees received from other Co-operative Group undertakings Period to 30 June 2012*	*Interest and fees paid to other Co-operative Group undertakings Period to 30 June 2012*
Parent undertakings	2.6	0.3	2.2	–
Fellow subsidiary undertakings	0.3	–	0.5	–
	2.9	0.3	2.7	–

	Loans owed by other Co-operative Group undertakings 30 June 2013	*Loans owed to other Co-operative Group undertakings 30 June 2013*	*Loans owed by other Co-operative Group undertakings 30 June 2012*	*Loans owed to other Co-operative Group undertakings 30 June 2012*
Parent undertakings	0.5	45.1	8.4	1.6
Fellow subsidiary undertakings	–	78.8	280.5	96.1
	0.5	123.9	288.9	97.7

Recharges from CFSMS

During the period, operating costs of £481.2m (30 June 2012: £311.8m) incurred on its behalf were charged at cost to the Bank by CFSMS, a fellow subsidiary of the Co-operative Banking Group Limited. £148.4m (30 June 2012: £nil) of these recharges related to the impairment of intangible assets relating to the development of new banking systems. At 30 June 2013, the Bank owed £2.5m to CFSMS (30 June 2012: £280.1m owed by CFSMS).

Key management compensation

	Period to 30 June 2013	*Period to 30 June 2012*
Salaries and short term benefits	1.5	1.4
Termination benefits	–	1.4
	1.5	2.8

33. Share capital

	No. of shares (millions) 30 June 2013	*Share capital 30 June 2013*	*No. of shares (millions) 30 June 2012*	*Share capital 30 June 2012*
Authorised capital (ordinary shares of 5p each)				
At the beginning and end of the period	8,200	410.0	8,200	410.0
Allotted, called up and fully paid (ordinary shares of 5p each)				
At the beginning and end of the period	8,200	410.0	8,200	410.0
Share premium account at the beginning and the end of the period		8.8		8.8

The shareholders have one vote for every share held.

34. Fair values of financial assets and liabilities

The fair values in this note are stated at a specific date and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of the instruments. As a wide range of valuation techniques are available, it may be inappropriate to compare this fair value information to that of independent market or other financial institutions. Assumptions changes and different valuation methodologies can have significant impacts, particularly on fair values which are based on unobservable inputs.

The tables below analyse the balance sheet carrying values of financial assets and liabilities by classification.

Balance sheet categories 30 June 2013	*Held for trading*	*Designated at fair value*	*Loans and receivables*	*Available for sale*	*Liabilities at amortised cost*	*Cashflow hedges*	*Total*
Assets							
Cash and balances at central banks	–	–	5,402.1	–	–	–	5,402.1
Loans and advances to banks	–	–	1,737.5	–	–	–	1,737.5
Loans and advances to customers	–	144.2	32,571.7	–	–	–	32,715.9
Fair value adjustments for hedged risk	–	–	217.0	–	–	–	217.0
Investment securities	–	1,622.3	30.6	3,429.7	–	–	5,082.6
Derivative financial instruments	–	728.6	–	–	–	75.7	804.3
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	0.5	–	–	–	0.5
Total financial assets	–	2,495.1	39,959.4	3,435.4	–	75.7	45,965.6
Non-financial assets							666.7
Total assets							46,632.3

	Held for trading	*Designated at fair value*	*Loans and receivables*	*Available for sale*	*Liabilities at amortised cost*	*Cashflow hedges*	*Total*
Liabilities							
Deposits by banks	–	–	–	–	3,517.8	–	3,517.8
Customer accounts	–	–	–	–	34,166.3	–	34,166.3
Customer accounts – capital bonds	–	756.0	–	–	–	–	756.0
Debt securities in issue	–	–	–	–	4,610.0	–	4,610.0
Derivative financial instruments	–	619.0	–	–	–	43.7	662.7
Other borrowed funds	–	–	–	–	1,248.1	–	1,248.1
Amounts owed to other Co-operative Group undertakings	–	–	–	–	123.9	–	123.9
Total financial liabilities	–	1,375.0	–	–	43,666.1	43.7	45,084.8
Non-financial liabilities							532.8
Total liabilities							45,617.6
Total equity							1,014.7
Total liabilities and equity							46,632.3

Balance sheet categories 30 June 2012	Held for trading	Designated at fair value	Loans and receivables	Available for sale	Liabilities at amortised cost	Cashflow hedges	Total
Assets							
Cash and balances at central banks	–	–	4,316.6	–	–	–	4,316.6
Loans and advances to banks	–	–	2,359.7	–	–	–	2,359.7
Loans and advances to customers	–	148.0	33,860.4	–	–	–	34,008.4
Fair value adjustments for hedged risk	–	–	368.2	–	–	–	368.2
Investment securities	439.0	817.4	483.0	3,217.6	–	–	4,957.0
Derivative financial instruments	180.7	547.0	–	–	–	183.1	910.8
Equity shares	–	–	–	5.7	–	–	5.7
Amounts owed by other Co-operative Group undertakings	–	–	288.9	–	–	–	288.9
Total financial assets	619.7	1,512.4	41,676.8	3,223.3	–	183.1	47,215.3
Non-financial assets							502.8
Total assets							47,718.1
Liabilities							
Deposits by banks	–	–	–	–	4,416.0	–	4,416.0
Customer accounts	–	–	–	–	33,054.7	–	33,054.7
Customer accounts – capital bonds	–	1,141.7	–	–	–	–	1,141.7
Debt securities in issue	–	–	–	–	4,146.8	–	4,146.8
Derivative financial instruments	164.3	778.8	–	–	–	40.0	983.1
Other borrowed funds	–	–	–	–	1,257.1	–	1,257.1
Amounts owed to other Co-operative Group undertakings	–	–	–	–	97.7	–	97.7
Total financial liabilities	164.3	1,920.5	–	–	42,972.3	40.0	45,097.1
Non-financial liabilities							332.9
Total liabilities							45,430.0
Total equity							2,288.1
Total liabilities and equity							47,718.1

The 2012 comparatives include balance sheet reclassifications of deferred tax assets and liabilities as shown in note 28.

a. **Use of financial instruments**

The use of financial instruments is essential to the Bank's business activities, and financial instruments constitute a significant proportion of the Bank's assets and liabilities. The main financial instruments used by the Bank, and the purposes for which they are held, are outlined below:

Loans and advances to customers and customer accounts

The provision of banking facilities to customers is the prime activity of the Bank, and loans and advances to customers and customer accounts are major constituents of the balance sheet. Loans and advances to customers include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer accounts include retail and corporate current and saving accounts.

Loans and advances to banks and investment securities

Loans and advances to banks and investment securities underpin the Bank's liquidity requirements and generate incremental net interest and trading income. Held for trading investments were traded solely for short term profit.

Deposits by banks and debt securities in issue

The Bank issues medium term notes within an established euro medium term note programme and also issues certificates of deposit and commercial paper as part of its normal treasury activities. These sources of funds, alongside other borrowed funds, are invested in marketable investment grade debt securities and short term wholesale market placements and are used to fund customer loans.

Other borrowed funds

The Bank utilises a broad spread of capital funds. In addition to ordinary share capital and retained earnings, when appropriate, the Bank issues preference shares and perpetual and fixed term subordinated notes.

Derivatives

A derivative is a financial instrument that derives its value from an underlying rate or price such as interest rates, exchange rates and other market prices. Derivatives are an efficient means of managing market risk and limiting counterparty exposure. The Bank uses them mainly for hedging purposes and to meet the needs of customers.

The most frequently used derivative contracts are interest rate swaps, exchange traded futures and options, caps and floors, currency swaps and forward currency transactions. Terms and conditions are determined by using standard industry documentation. Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments and are aggregated with other exposures to monitor total counterparty exposure which is managed within approved limits for each counterparty.

Foreign exchange

The Bank undertakes foreign exchange dealing to facilitate customer requirements and to generate incremental income from short term trading in the major currencies. Structured risk and trading related risk are managed formally within position limits which are set by the Assets and Liabilities Committee, to which authority is delegated by the Board.

b. **Valuation of financial instruments carried at fair value**

The following tables analyse financial assets and liabilities carried at fair value by the three level fair value hierarchy defined as follows:

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

	Fair value at end of the reporting period using:			
	Level 1	*Level 2*	*Level 3*	*Total*
30 June 2013				
Non-derivative financial assets				
Held for trading:				
Investment securities	–	–	–	–
Designated at fair value:				
Loans and advances to customers	–	134.0	10.2	144.2
Investment securities	1,622.3	–	–	1,622.3
Available for sale financial assets:				
Investment securities	3,189.5	240.2	–	3,429.7
Equity shares	–	–	5.7	5.7
Derivative financial instruments	–	774.5	29.8	804.3
Total assets carried at fair value	4,811.8	1,148.7	45.7	6,006.2
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	756.0	–	756.0
Derivative financial instruments	–	635.9	26.8	662.7
Total liabilities carried at fair value	–	1,391.9	26.8	1,418.7

	Fair value at end of the reporting period using:			
	Level 1	*Level 2*	*Level 3*	*Total*
30 June 2012				
Non-derivative financial assets				
Held for trading:				
Investment securities	439.0	–	–	439.0
Designated at fair value:				
Loans and advances to customers	–	136.4	11.6	148.0
Investment securities	817.4	–	–	817.4
Available for sale financial assets:				
Investment securities	2,826.8	390.8	–	3,217.6
Equity shares	–	–	5.7	5.7
Derivative financial instruments	–	864.1	46.7	910.8
Total assets carried at fair value	4,083.2	1,391.3	64.0	5,538.5
Non-derivative financial liabilities				
Designated at fair value:				
Customer accounts – capital bonds	–	1,141.7	–	1,141.7
Derivative financial instruments	–	973.1	10.0	983.1
Total liabilities carried at fair value	–	2,114.8	10.0	2,124.8

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 287 to 304 and according to the following hierarchy:

Level 1 – Quoted market prices in active markets

Financial instruments with quoted prices for identical instruments in active markets. The best evidence of fair value is a quoted market price in an actively traded market.

Level 2 – Valuation techniques using observable inputs

Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.

The valuation techniques used to value these instruments employ only observable market data and relate to the following assets and liabilities:

Loans and advances to customers

Loans and advances to customers include corporate loans of £134.0m (30 June 2012: £136.4m) which are fair valued through income or expense using observable inputs. Loans held at fair value are valued at the sum of all future expected cash flows, discounted using a yield curve based on observable market inputs.

Investment securities – available for sale

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

Derivative financial instruments

OTC (ie non-exchange traded) derivatives are valued using valuation models which are based on observable market data. Valuation models calculate the present value of expected future cash flows, based upon 'no arbitrage' principles. The Bank enters into vanilla foreign exchange and interest rate swap derivatives, for which modelling techniques are standard across the industry. Examples of inputs that are generally observable include foreign exchange spot and forward rates, and benchmark interest rate curves.

Customer accounts – capital bonds

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

Level 3 – Valuation techniques using unobservable inputs

This is used for financial instruments valued using models where one or more significant inputs are not observable.

The small proportion of financial assets valued based on significant unobservable inputs are analysed as follows:

Loans and advances to customers

Loans and advances to customers include 25 year fixed rate mortgages of £10.2m (30 June 2012: £11.6m) which are fair valued through income or expense using unobservable inputs. 25 year fixed rate mortgages are valued using future interest cash flows at the fixed customer rate and estimated schedule of customer repayments. Cash flows are discounted at a credit adjusted discount rate; the credit adjustment is based on the average margin of new long dated (five years or greater) fixed rate business written in the last six months, and subject to quarterly review. The eventual timing of future cash flows may be different from that forecast due to unpredictable customer behaviour, particularly on a 25 year product. The valuation methodology takes account of credit risk. A reasonable change in the assumptions would not result in any material change in the valuation.

Equity shares

Equity shares primarily relate to investments held in Vocalink Limited which are unquoted shares. The valuation of these shares is based on the Bank's percentage shareholding and the net asset value of the company according to its most recently published financial statements.

Derivative financial instruments

Derivative financial instruments in the form of interest rate swaps have been entered into between the Bank and its subsidiaries, and external counterparties.

The purpose of the swaps is to convert the fixed and base rate linked revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the Bank's subsidiaries pay to the swap counterparty, the monthly mortgage revenue receipts of the pool of assets and receives from the swap counterparty LIBOR plus a contractual spread on the same notional balance, the spread being sufficient to cover the intercompany loan and any expenses. The Bank has a 'back to back' swap that is the mirror image of the subsidiaries' swaps.

The swaps are valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates. Swap cash flows are discounted to present value using mid-yield curve zero coupon rates, ie no adjustment is made for credit losses, nor for transaction or any other costs.

Movements in fair values of instruments with significant unobservable inputs (level 3) were:

	Fair value at the beginning of the period	*Purchases*	*Sales*	*Unrealised income or expense*	*Fair value at the end of the period*
30 June 2013					
Loans and advances to customers	11.2	(0.6)	–	(0.4)	10.2
Derivative assets	35.4	9.4	–	(15.0)	29.8
Equity shares	5.7	–	–	–	5.7
Derivative liabilities	(12.4)	(16.1)	–	1.7	(26.8)
	39.9	(7.3)	–	(13.7)	18.9
30 June 2012					
Loans and advances to customers	12.4	–	–	(0.8)	11.6
Derivative assets	25.4	–	–	21.3	46.7
Equity shares	5.7	–	–	–	5.7
Derivative liabilities	(13.3)	–	–	3.3	(10.0)
	30.2	–	–	23.8	54.0

Unrealised income or expense is recognised through net interest income.

c. **Fair values of financial instruments not carried at fair value**

The table below sets out a summary of the carrying and fair values of:

- financial assets classified as loans and receivables; and

- financial liabilities classified as held at amortised cost,

unless there is no significant difference between carrying and fair values.

	30 June 2013		*30 June 2012*	
	Carrying value	*Fair value*	*Carrying value*	*Fair value*
Financial assets				
Loans and receivables				
Loans and advances to banks	1,737.5	1,737.5	2,359.7	2,359.8
Loans and advances to customers	32,571.7	28,999.9	33,860.4	34,121.3
Fair value adjustments for hedged risk	217.0	217.0	368.2	368.2
Investment securities	30.6	20.2	483.0	557.4
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	3,517.8	3,519.2	4,416.0	4,416.0
Customer accounts	34,166.3	34,153.5	33,054.7	33,257.3
Debt securities in issue	4,610.0	5,141.8	4,146.8	4,877.7
Other borrowed funds	1,248.1	851.2	1,257.1	1,221.8

In 2013, the Bank reviewed and improved the methods used to calculate the fair values. The 2012 comparatives (with the exception of loans and advances to customers, fair value adjustment for hedged risk and customer accounts) have been re-presented accordingly to reflect these changes in methods.

Key considerations in the calculation of fair values for loans and receivables and financial liabilities at amortised cost are as follows:

Loans and advances to banks/deposits by banks

Loans and advances to banks include interbank placements and items in the course of collection.

The amortised cost value of all loans and advances to banks are deemed to be a close approximation of their fair value (there is a 0.01% difference) due to their short maturity. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

Loans and advances to customers

The fair value of loans and advances to customers is calculated by segmenting the overall balance into Retail, Optimum and Corporate.

(i) **Retail**

Fixed rate loans and advances to customers are revalued to fair value based on future interest cash flows (at funding rates) and principal cash flows discounted using an appropriate market rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historical behavioural experience where relevant. The eventual timing of future cash flows may be different from the forecast due to unpredictable customer behaviour. It is assumed there is no fair value adjustment required in respect of interest rate movement on variable rate assets.

(ii) **Optimum**

Fair values have been calculated using an origination spread income approach. Under this approach, value is measured by determining discounted expected cashflows from the portfolio and applying an origination spread which reflects the difference between current market rates for products with similar characteristics and risk profiles and the actual rates the portfolio is generating.

(iii) **Corporate**

As part of the implementation of the Bank's exit strategy, certain assets have either already been sold after the half year end or plans to sell are well advanced. For these assets, the fair value can therefore be determined from the actual sale price achieved or expected to be received.

For other Corporate assets an expected cashflow income approach has been used. Under this approach, value is measured by determining expected cashflows from the portfolio and then considering credit costs, funding costs and tax to derive equity cashflows which are discounted at an appropriate blended cost of capital.

The fair value of loans and advances to customers is significantly lower than the carrying value as a result of changes to the fair values of the Corporate and Optimum portfolios, which reflect the improved methodology referenced above and enhanced market price information for the Corporate book. The 2012 comparatives for loans and advances to customers have not been re-presented to reflect the change in methods referred to on page 385.

Investment securities

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

Customer accounts

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on future interest cash flows (at funding rates) and principal cash flows, discounted using an appropriate market rate.

Debt securities in issue and other borrowed funds

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

The fair value of debt securities in issue is significantly above the carrying value as a result of the carrying value being net of merger fair value adjustments. The fair value of other borrowed funds is significantly less than the carrying value as quoted market prices of issued debt capital have fallen. Since the period end, the other borrowed funds have been suspended from trading on the London Stock Exchange and current market prices are no longer available.

d. **Fair value of transferred assets and associated liabilities**

Securitisation vehicles

The beneficial ownership of the loans and advances to customers sold to securitisation vehicles by the subsidiaries of the Bank fail the derecognition criteria, and consequently, these loans remain on the balance sheets of the sellers. Each seller therefore recognises a deemed loan financial liability on its balance sheet and an equivalent deemed loan asset is held on each securitisation company's balance sheet. The deemed loans are repaid as and when principal repayments are made by customers against these transferred loans and advances.

The securitisation vehicles have issued fixed and floating rate notes which are secured on the loans and advances to customers. The notes are redeemable in part from time to time, such redemptions being limited to the net capital received from mortgagors in respect of the underlying assets.

The Bank retains substantially all of the risks and rewards of ownership. The Bank benefits to the extent to which surplus income generated by the transferred mortgage portfolios exceeds the administration costs of those mortgages. The Bank continues to bear the credit risk of these mortgage assets.

The results of the securitisation vehicles listed in note 31 are consolidated into the results of the Bank. The table below shows the carrying values and fair values of the assets transferred to securitisation vehicles (where the notes are held externally) and their associated liabilities. The carrying values presented below are the carrying amounts as recorded in the subsidiaries:

	Carrying amount of transferred assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of transferred assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2013					
Leek Finance Number Seventeen plc	605.6	659.9	463.9	650.6	(186.7)
Leek Finance Number Eighteen plc	720.4	810.4	554.4	790.1	(235.7)
Leek Finance Number Nineteen plc	699.7	801.5	529.6	785.3	(255.7)
Silk Road Finance Number One plc	1,611.5	1,630.8	1,611.5	1,647.2	(35.7)
Silk Road Finance Number Two plc	646.2	637.1	647.3	645.0	2.3
Silk Road Finance Number Three plc	641.1	652.2	640.3	661.9	(21.6)
	4,924.5	5,191.9	4,447.0	5,180.1	(733.1)

Transferred assets include securitised gilts and loans and advances to customers that have not been derecognised by the seller. The associated liabilities include the fixed and floating rate notes.

The difference between the fair value and carrying value of the mortgages that have been securitised within Leek 17, 18 and 19 is significantly higher than the fair value to carrying value difference for the associated liabilities. This is because it is expected that the notes will be repaid at par at the call date of the Leek liabilities whereas most of the mortgages will continue to be held on the Bank's balance sheet for a significant period after the notes have repaid and these mortgages have an interest rate which is below the equivalent market rate at the balance sheet date for loans of a similar nature.

The securitisation vehicles receive cash daily in relation to the transferred loans and advances and semi-annually for the transferred gilts. These amounts will be held within loans and advances to banks until the associated liabilities' payments are due. Payments are made quarterly for all associated liabilities except for the variable funding notes associated with the transferred gilts, which are paid semi-annually. The amounts held within loans and advances to banks are not included in the table above but will be used in part to cover the repayments made on the associated liabilities.

	Carrying amount of transferred assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of transferred assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2012					
Leek Finance Number Seventeen plc	627.1	664.9	632.5	621.3	11.2
Leek Finance Number Eighteen plc	745.5	819.2	761.5	754.2	7.3
Leek Finance Number Nineteen plc	727.8	813.0	741.1	760.1	(19.0)
Meerbrook Finance Number Six Limited	81.2	61.1	80.4	13.2	67.2
Silk Road Finance Number One plc	1,957.6	1,970.8	1,957.6	1,974.5	(16.9)
Silk Road Finance Number Two plc	780.3	746.8	782.5	763.1	19.4
	4,919.5	5,075.8	4,955.6	4,886.4	69.2

Covered Bond Limited Liability Partnerships

Moorland Covered Bonds LLP was established as a result of a £1.4bn covered bond retained issuance. Loans and advances to customers of £1.9bn were transferred to Moorland Covered Bonds LLP. The transfer was funded by a loan of £1.4bn and capital contribution of £0.5bn. During October 2011 the

£1.4bn loan was repaid. Following additional capital contribution repayment and on achieving Regulated Covered Bond status there was a public issuance of notes in November 2011 totalling £0.6bn. As a result of these changes, at 30 June 2013, the Bank held a loan of £0.6bn (30 June 2012: £0.6bn) and a capital contribution of £1.1bn (30 June 2012: £1.5bn) with Moorland Covered Bonds LLP.

Moorland Covered Bonds LLP does not have ordinary share capital. The Bank's interest in Moorland Covered Bonds LLP is in substance no different from a wholly owned subsidiary and consequently it is fully consolidated in the Bank accounts. The table below shows the carrying values and fair values of the assets transferred to the covered bond and their associated liabilities:

	Carrying amount of transferred loans and advances to customers	*Carrying amount of fixed and floating rate notes*	*Fair value of transferred loans and advances to customers*	*Fair value of fixed and floating rate notes*	*Net position*
30 June 2013					
Moorland Covered Bonds LLP	1,638.5	600.0	1,603.7	617.0	986.7

	Carrying amount of transferred loans and advances to customers	*Carrying amount of fixed and floating rate notes*	*Fair value of transferred loans and advances to customers*	*Fair value of fixed and floating rate notes*	*Net position*
30 June 2012					
Moorland Covered Bonds LLP	2,071.2	600.0	2,152.9	643.7	1,509.2

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. These deposits are not available to finance the Bank's day to day operations.

	Carrying amount of assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2013					
Investment securities sold under repurchase agreements	4,901.7	3,461.8	4,861.5	2,697.2	2,164.3

	Carrying amount of assets not derecognised	*Carrying amount of associated liabilities*	*Fair value of assets not derecognised*	*Fair value of associated liabilities*	*Net position*
30 June 2012					
Investment securities sold under repurchase agreements	4,715.2	3,654.9	4,243.6	3,654.9	588.7

Associated liabilities are included within deposits by banks.

The Bank has loans and advances to banks of £165.0m (30 June 2012: £550.0m) under reverse sale and repurchase agreements and against which gilts are held with a fair value of £157.1m (30 June 2012: £548.4m). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse purchase agreements. The Bank is permitted to sell or repledge the assets received as collateral in the absence of their default. The Bank is obliged to return equivalent securities. At 30 June 2013 the fair value of collateral repledged amounted to £157.1m (30 June 2012: £548.4m). The Bank does not adjust for the fair value of securities received under reverse sale and repurchase agreements.

35. Post balance sheet events

Adjusting events

It is a requirement of IAS 10 (Events after the balance sheet date) that this financial information reflects events arising since 30 June 2013 that provide evidence of conditions that existed at that date. Accordingly, it is the Board's responsibility to ensure that the Bank has ensured that any such matters that are material have been taken into account in preparing this information.

As a consequence, it is necessary to reflect certain changes to the unaudited results for the six months ended 30 June 2013 that have arisen between those results being approved on 28 August 2013 and 4 November 2013, the date of approval of this financial information:

- The latest forecasts produced in support of the Bank's Recapitalisation Plan show that it is probable that tax losses of £103.5m will be recoverable in future periods, and this amount has been recognised as a deferred tax asset.
- In the light of recent developments, provisions have been increased by £73.0m in respect of conduct risks relating to payment protection insurance, potential customer redress in relation to the processing of first payments on certain mortgages and potential customer redress in relation to arrears charges.

In addition, provisions have been made for £29.0m for potential customer redress following identification of a technical breach of the Consumer Credit Act.

Non adjusting events

Since the period end, the Bank has encumbered an additional £2.2bn of assets for the purpose of strengthening the liquidity position of the Bank, raising and retaining funding balances of £2.9bn at 28 August 2013 (the date of approval of the unaudited interim results), and a further £0.6bn at 4 November 2013 (the date of publication of this audited financial information).

Included in the funding balances raised and retained are £0.8bn of Britannia International (IOM) deposits and £0.2bn of Guernsey deposits collateralised since the period end.

PART B – ACCOUNTANT'S REPORT ON AUDITED FINANCIAL INFORMATION FOR THE SIX MONTHS ENDED 30 JUNE 2013

The Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP
4 November 2013

Dear Sirs

The Co-operative Bank p.l.c. (the 'Company')

We report on the financial information set out on pages 278 to 389 for the six months ended 30 June 2013. This financial information has been prepared for inclusion in the Prospectus dated 4 November 2013 of the Company on the basis of the accounting policies set out on pages 292 to 304 of the Prospectus. This report is in accordance with paragraph 11.1 of Annex XI of the Prospectus Directive Regulation and is given for the purpose of complying with that paragraph and for no other purpose. We have not audited or reviewed the financial information for the six months ended 30 June 2012 which has been included for comparative purposes only, and accordingly do not express an opinion thereon.

Responsibilities

The Directors of the Company are responsible for preparing the financial information on the basis of preparation set out on pages 287 to 291 of the Prospectus and in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS).

It is our responsibility to form an opinion on the financial information and to report our opinion to you.

Save for any responsibility arising under Prospectus Rule 5.5.4R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 13.1 of Annex XI of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Basis of opinion

We conducted our work in accordance with Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of the significant estimates and judgments made by those responsible for the preparation of the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Opinion on financial information

In our opinion, the financial information gives, for the purposes of the Prospectus dated 4 November 2013, a true and fair view of the state of affairs of the Company as at 30 June 2013 and of its losses, cash flows and recognised gains and losses for the six months ended 30 June 2013 in accordance with the basis of preparation and in accordance with International Financial Reporting Standards as set out on pages 287 to 304 of the Prospectus.

Emphasis of matter – Going concern

In forming our conclusion on the financial information, which is not modified, we have considered the adequacy of the disclosures made in the Basis of Preparation section of the financial information set out on pages 289 to 291 of the Prospectus concerning the Company's ability to continue as a going concern; in that section the Directors set out the risks associated with the successful execution of the recapitalisation plan. These conditions indicate the existence of a material uncertainty which may cast significant doubt on the Company's ability to continue as a going concern. The financial information does not include the adjustments that would result if the Company was unable to continue as a going concern.

Declaration

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

PART C – UNAUDITED PRO FORMA FINANCIAL INFORMATION AS AT 30 JUNE 2013

The unaudited pro forma balance sheet as at 30 June 2013 has been prepared to show the pro forma impact of the Liability Management Exercise, on assets, liabilities and equity, as if it had taken place as at 30 June 2013. It has been prepared for illustrative purposes only in accordance with Annex II of the Prospectus Directive (Directive 2003/71/EC as amended) and should be read in conjunction with the notes set out below. Because of its nature, it addresses a hypothetical situation and therefore does not represent the Bank's actual financial position as at 30 June 2013, nor it is indicative of the results that may or may not be expected to be achieved in the future.

The successful completion of the Liability Management Exercise is expected to be earnings enhancing as a result of interest savings on Existing Securities surrendered in the Liability Management Exercise, net of coupon payments on New Securities issued in the Liability Management Exercise.

Balance sheet as at 30 June 2013

		Adjustments			
	As at 30 June 2013(1)	*Liquidity Management Exercise*(2)	*Additional New Ordinary Shares Offer*(3)	*Expenses of the Liquidity Management Exercise*(4)	*Unaudited pro forma*
			(£millions)		
Cash and balances at central banks	5,402.1	–	125.0	(43.0)	5,484.1
Other assets	41,230.2	–	–	–	41,230.2
Total assets	46,632.3	–	125.0	(43.0)	46,714.3
Liabilities					
Other borrowed funds	1,248.1	(1,042.1)	–	–	206.0
Other liabilities	44,369.5	–	–	–	44,369.5
Total liabilities	45,617.6	(1,042.1)	–	–	44,575.5
Total equity	1,014.7	1,042.1	125.0	(43.0)	2,138.8
Total liabilities and equity	46,632.3	–	125.0	(43.0)	46,714.3

Notes:

(1) The financial information as at 30 June 2013 has been extracted, without material adjustment, from the Interim Financial Information set out in "*Part A*" of Section 16 (*Financial Information*) of this Prospectus. The accounting policies adopted in preparing the pro forma balance sheet as at 30 June 2013 are consistent with the accounting policies adopted in preparing the Interim Financial Information. No account has been taken of actual changes in the trading or financial position of the Bank since 30 June 2013.

(2) The Liability Management Exercise is assumed to generate £1,042.1 million of capital on the basis of full participation in the Liability Management Exercise.

(3) £125.0 million of New Ordinary Shares will be issued as a result of the Additional New Ordinary Shares Offer.

(4) The expenses of the Liability Management Exercise to be borne by the Bank are estimated at approximately £51.0 million (inclusive of VAT), of which approximately £8.0 million was recorded in the six months ended 30 June 2013. The remaining balance of approximately £43.0 million will be paid by the Bank out of cash resources. A portion of these expenses may be allocated to the Bank T2 Notes rather than wholly against total equity. This allocation has not yet been determined.

(5) No adjustment has been made to reflect the legally binding and irrevocable commitment, provided to Bank by Co-operative Banking Group on 4 November 2013, conditional only upon the successful completion of the Liability Management Exercise, to contribute £333.0 million of capital to the Bank during 2014.

PART D – ACCOUNTANT’S REPORT ON UNAUDITED PRO FORMA FINANCIAL INFORMATION OF THE BANK

The Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

4 November 2013

Dear Sirs

The Co-operative Bank p.l.c. (the “Company”)

We report on the pro forma financial information (the ‘Pro forma financial information’) set out in Section 16 of Part C of the Prospectus dated 4 November 2013, which has been prepared on the basis described in notes 1-5, for illustrative purposes only, to provide information about how the Company and Co-operative Group Limited’s Liability Management Exercise might have affected the financial information presented on the basis of the accounting policies adopted by the Company in preparing the financial statements for the period ended 30 June 2013. This report is required in order to enable the Company to comply with paragraph 7 of Annex II of the Prospectus Directive Regulation in relation to the Prospectus and is given for that purpose and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company to prepare the Pro forma financial information in accordance with Annex II of the Prospectus Directive Regulation.

It is our responsibility to form an opinion, as required by paragraph 7 of Annex II of the Prospectus Directive Regulation, as to the proper compilation of the Pro forma financial information and to report that opinion to you.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Save for any responsibility arising under Prospectus Rule 5.5.4R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 13.1 of Annex XI of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Basis of Opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the directors of the Company.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America or other jurisdictions and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion:

- the Pro forma financial information has been properly compiled on the basis stated; and
- such basis is consistent with the accounting policies of the Company.

Declaration

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

PART E – ACCOUNTANT'S REPORT ON LOSS FORECAST REPORT

The Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

4 November 2013

Dear Sirs

The Co-operative Bank p.l.c.

We report on the statement contained in Section 12 of the document that "indeed, we do not expect to be profitable for some years and legacy issues will continue to have an impact on the Bank for some time", which constitutes *inter alia* a loss forecast of The Co-operative Bank p.l.c. ('the Company') and its subsidiaries ('the Group') for the year ending 31 December 2013 and the year ending 31 December 2014 (the 'Loss Forecast'). The Loss Forecast, and the material assumptions upon which it is based, are set out on page 213 of the Prospectus issued by the Company dated 4 November 2013. This report is required by paragraph 8.2 of Annex XI of the Prospectus Directive Regulation and is given for the purpose of complying with that paragraph and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company to prepare the Loss Forecast in accordance with the requirements of the Prospectus Directive Regulation.

It is our responsibility to form an opinion as required by the Prospectus Directive Regulation as to the proper compilation of the Loss Forecast and to report that opinion to you.

Save for any responsibility arising under Prospectus Rule 5.5.4R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in connection with this report or our statement, required by and given solely for the purposes of complying with paragraph 13.1 of Annex XI of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

Basis of preparation of the Loss Forecast

The Loss Forecast has been prepared on the basis stated on page 213 of the Prospectus and is based on the audited interim financial results for the six months ended 30 June 2013, the unaudited management accounts for the eight months ended 31 August 2013, a forecast to 31 December 2013 and a forecast to 31 December 2014. The Loss Forecast is required to be presented on a basis consistent with the accounting policies of the Group.

Basis of opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. Our work included evaluating the basis on which the historical financial information included in the Loss Forecast has been prepared and considering whether the Loss Forecast has been accurately computed based upon the disclosed assumptions and the accounting policies of the Group. Whilst the assumptions upon which the Loss Forecast are based are solely the responsibility of the directors of the Company, we considered whether anything came to our attention to indicate that any of the assumptions adopted by the directors of the Company which, in our opinion, are necessary for a proper understanding of the Loss Forecast have not been disclosed and whether any material assumption made by the directors of the Company appears to us to be unrealistic.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Loss Forecast has been properly compiled on the basis stated.

Since the Loss Forecast and the assumptions on which it is based relate to the future and may therefore be affected by unforeseen events, we can express no opinion as to whether the actual results reported will correspond to those shown in the Loss Forecast and differences may be material.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in the United States of America or other jurisdictions and accordingly should not be relied upon as if it had been carried out in accordance with those standards and practices.

Opinion

In our opinion, the Loss Forecast has been properly compiled on the basis stated and the basis of accounting used is consistent with the accounting policies of the Group.

Declaration

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI of the Prospectus Directive Regulation.

Yours faithfully

KPMG Audit Plc

17
SUPERVISION AND REGULATION

SUPERVISION AND REGULATION

1. UK REGULATORS

Under the Financial Services Act 2012 (the **FS Act 2012**), a range of structural reforms to UK financial regulatory bodies were implemented, with the FSA being replaced from 1 April 2013 by the following bodies:

- the PRA;
- the FCA; and
- in addition, a new FPC has been established.

The PRA, a subsidiary of the Bank of England, has responsibility for micro-prudential regulation of financial institutions that manage significant risks on their balance sheets, including banks, insurers and some large investment firms. The FCA, has responsibility for conduct of business regulation in relation to all authorised firms and the prudential regulation of firms not regulated by the PRA. The FCA has also inherited the majority of the FSA's market regulatory functions, and it represents the UK's interests in markets regulation at the European Securities and Markets Authority. The Bank is regulated by both the PRA and the FCA.

The FPC, which sits within the Bank of England, is tasked with macroprudential regulation, or regulation of stability and resilience of the financial system as a whole.

This Section 17 (*Supervision and Regulation*) uses the terms **Relevant Regulator** and **Relevant Regulator(s)** to refer, as the context requires, to one or more of the FSA, PRA and/or FCA.

The PRA's general objective

The PRA has one general objective that it must advance in discharging its general functions. The PRA's general objective is promoting the safety and soundness of PRA-authorised persons. The PRA is required to advance this objective primarily by seeking to:

- ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and
- minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

The FCA's objectives

When discharging its general functions under FSMA, which include rule-making, preparing and issuing codes, giving general guidance or determining the general policy and principles (by reference to which it performs functions under FSMA) the FCA must, so far as is reasonably possible, act in a way which is compatible with its strategic objective of ensuring that relevant markets (as defined in section 1(f) FSMA) function well, and advances one or more of its operational objectives of:

- securing an appropriate degree of protection for consumers (the consumer protection objective);
- promoting effective competition in the interests of consumers in financial markets (the competition objective); and
- protecting and enhancing the integrity of the UK financial system (the integrity objective).

So far as it is compatible with its consumer protection and integrity objectives, the FCA must discharge its general functions in a way which promotes competition.

2. UK REGULATION

2.1 Overview of UK financial services legislation

Financial Services and Markets Act 2000

The cornerstone of the regulatory regime in the UK is FSMA which came into force on 1 December 2001. However, the framework for supervision and regulation of banking and financial services in the UK has been, and continues to be, heavily influenced by EU legislation.

FSMA prohibits any person from carrying on a "regulated activity" by way of business in the UK unless that person is authorised or exempt under FSMA. Regulated activities include: deposit-taking, mortgage activities (such as entering into, administering, or advising or arranging in respect of, the provision of regulated mortgage contracts), effecting and carrying out contracts of insurance as well as insurance mediation, and investment activities (such as dealing in investments as principal or as agent, arranging deals in investments, and managing investments).

FSMA also prohibits financial promotions in the UK unless the promotion is issued or approved by an authorised person or exempt from such requirements.

The relevant regulators are responsible for the authorisation and supervision of institutions that carry on regulated activities including the provision of regulated financial products and services in the UK as defined in FSMA. The Bank is authorised with permission to undertake, among other things, deposit-taking, mortgage and certain investment activities. As an authorised person under FSMA, the Bank is permitted to make financial promotions in the UK.

Authorised firms must at all times meet specified "threshold conditions", which were modified to reflect the regulatory new structure under the FS Act 2012. Dual-regulated firms, such as the Bank, need to meet both the PRA's threshold conditions and the FCA's threshold conditions. At a high level, the PRA threshold conditions require: (i) a firm's head office, and in particular its mind and management, to be in the UK if it is incorporated in the UK; (ii) a firm's business to be conducted in a prudent manner, and in particular that the firm maintains appropriate financial and non-financial resources; (iii) the firm itself to be fit and proper and appropriately staffed; and (iv) the firm and its group to be capable of being effectively supervised.

Financial services handbooks

FSMA (as amended by, amongst other legislation, the FS Act 2012) imposes an on-going system of regulation and control on banks. The detailed rules and prudential standards set by the Relevant Regulators are contained in the FCA and PRA's rule making instruments which are set out in an accessible form online in various parts of their respective handbooks (the **FCA Handbook** and **PRA Handbook**, together the **Financial Services Handbooks**).

Once authorised, and in addition to continuing to meet the threshold conditions for authorisation, firms are obliged to comply with the 'Principles for Businesses', which include maintenance of adequate systems and controls, treating customers fairly and communicating with customers in a manner that is clear, fair and not misleading. The 11 Principles for Businesses are set out in the Financial Services Handbooks.

Manuals of the Financial Services Handbooks which are of particular relevance to banks include the General Prudential sourcebook (**GENPRU**), BIPRU, the Senior Management Arrangements, Systems and Controls sourcebook and the Conduct of Business sourcebook.

2.2 Supervision and enforcement

Supervision

Each of the Relevant Regulators has wide powers, where relevant, to supervise and intervene in the affairs of a firm authorised and regulated under, or pursuant to, FSMA. These powers were extended under the FS Act 2012.

The nature and extent of a Relevant Regulator's supervisory relationship with a firm depends on how much of a risk the Relevant Regulator considers that firm could pose to its statutory objectives. The PRA's supervisory interventions will focus on reducing the likelihood of a PRA-authorised firm failing and on ensuring that, if it does fail, it does so in an orderly manner. The PRA has introduced the 'Proactive Intervention Framework' to support early identification of risks to a firm's viability (and enable appropriate supervisory actions to be taken to address such risks if necessary) on the basis of information collected.

When taking action the Relevant Regulator can, for instance, require firms to provide particular information or documents to it, require the production of a report by a "skilled person" appointed by either the authorised person or the Relevant Regulator, or formally investigate a firm. Where it will advance its objectives, the PRA has a broad power of direction over qualifying unregulated parent undertakings.

Enforcement

The Relevant Regulators have the power to take a range of enforcement actions, including the ability to sanction firms and individuals carrying out functions within them. Most notably enforcement actions may include restrictions on undertaking new business, public censure, restitution, fines and, ultimately, revocation of permission to carry on regulated activities or of an approved person's status. The Relevant Regulators can also vary or revoke the permissions of an authorised firm that has not engaged in regulated activities for 12 months, or fails to meet the threshold conditions.

Challenging the PRA and FCA

If the Bank wanted to challenge the decisions of the PRA or FCA then in many cases it could make formal representations and also bring a case to tribunal (the **Tribunal**). The amendments made to FSMA which introduced the PRA and the FCA made a number of amendments to the appeal process which have broadly reduced the powers of the Tribunal. Although the grounds of making a reference have remained unchanged, the courses of action available to the Tribunal in the event that it disagrees with the regulator have been reduced. Under the previous system, the Tribunal had the power to make its own decision in place of one made by a regulator with which it disagrees. That remains the position for a disciplinary reference or a reference in connection with specific third party rights, but the Tribunal no longer has the power to substitute its own decision for that of the regulator in a supervisory context.

2.3 Capital adequacy

The Bank is subject to capital adequacy guidelines for banks adopted by the PRA, which provide for a minimum ratio of total capital to risk weighted assets expressed as a percentage. The PRA's capital adequacy guidelines for banks are found in the GENPRU and BIPRU sourcebooks of the PRA's Handbook. They broadly implement EU directives on capital adequacy, a high level summary of the background to which is as follows.

European regulatory landscape

- In March 2000, the adoption by the EU of the Banking Consolidation Directive (directive 2006/48/EC) and the Capital Adequacy Directive (directive 2006/49/EC) (each as recast in July 2006 and subsequently amended, together commonly referred to as the Capital Requirements Directive (the **CRD**)) resulted in the consolidation of the main pan-European banking legislation. The principal intention underlying the original CRD was the harmonisation of banking regulation and supervision throughout the EU and Norway, Iceland and Liechtenstein, commonly known as the EEA.

- EU legislation transposing the Basel Accord, through the CRD, was partially implemented at the start of 2007, with more advanced techniques in relation to the calculation of capital requirements for credit risk and operational risk implemented at the start of 2008. The CRD has since been amended by Directive 2009/111/EC (known as **CRD II**). CRD II was implemented in the UK on 31 December 2010. CRD II includes changes to the criteria for hybrid Tier 1 Capital, the control of large exposures and requirements relating to securitisation transactions. The requirements for hybrid capital to count as non-Core Tier 1 Capital were toughened, as were the relative permissible proportions of core, non-core and innovative Tier 1 Capital. However, CRD II provided for a certain proportion of existing instruments that do not comply with the new rules to continue to count as capital for a long transitional period. The CRD was further amended by Directive 2010/76/EU dated 24 November 2010 (known as **CRD III**), which further tightened the capital requirements for trading books and securitisations in accordance with the recommendations of the Basel Committee to amend the Basel framework. CRD III entered into force on 15 December 2010 and, following its implementation, the last of its provisions came into force in the UK on 16 April 2012.

- In Basel III, the Basel Committee approved significant changes to the Basel II framework (as agreed by the Basel Committee between 2011 and 2013) (such changes being commonly referred to as **Basel III**), including new capital and liquidity requirements intended to reinforce capital standards with heightened requirements for global systemically important banks and to establish minimum liquidity standards for credit institutions. In particular, the changes refer to, amongst other things, new requirements for the capital base, measures to strengthen the capital requirements for counterparty credit exposures arising from certain transactions and the introduction of a leverage ratio as well as short-term and longer-term standards for funding liquidity (referred to as the **Liquidity Coverage Ratio** and the **Net Stable Funding Ratio** respectively).

- It is intended that member countries will implement the new capital standards and the new Liquidity Coverage Ratio as soon as possible (with provisions for phased implementation, meaning that the measures will not apply in full until January 2019), and the Net Stable Funding Ratio from January 2018. The Basel III framework requires banks to meet a 7 per cent. ratio of Common Equity Tier 1 Capital to risk weighted assets. This minimum ratio is made up of 4.5 per cent. capital regulatory minimum plus 2.5 per cent. capital conservation buffer to absorb unexpected losses in periods of stress. The Basel III requirements are discussed in greater detail in the risk factor titled *"The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements"* in Section 2 (*Risk Factors*).

- The European Commission published corresponding proposals to implement Basel III through replacing the existing CRD with the PRR and the PRD (together, the PRR and the PRD are referred to as CRD IV) on 20 July 2011. The PRR and PRD draft legislation was approved by the European Council on 20 June 2013 and published on 26 June 2013. For more information on the CRD IV, see the risk factor titled *"The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements."* in Section 2 (*Risk Factors*).

UK implementation of the CRD IV

The PRR will have direct effect in the UK with effect from 1 January 2014. The UK regulators are currently consulting on the implementation of PRD (and the areas of the PRR in which it has discretion) in the UK, which must be implemented by 1 January 2014. For details on the UK's implementation of the CRD IV, see the risk factor titled "*The Bank's business, operating results, financial position and/or its ability to implement its strategy may be adversely impacted by it not maintaining adequate regulatory capital and by future changes to its regulatory capital requirements"* in Section 2 (*Risk Factors*).

2.4 **Controller regime (including shareholders)**

Under section 178 of FSMA, if a person intends to acquire or increase its "control" of UK authorised person (which includes the Bank), it must first notify the appropriate regulator (in the case of the Bank, this is the PRA). The PRA must then (after consulting with the FCA) decide whether to approve the acquisition or increase of control within 60 working days' of receipt of this notice (assuming it has been provided with a complete application). The PRA will not approve any new controller or any increase of control without being satisfied that the controller is financially sound and suitable to be a controller of, or acquire increased control of, the UK authorised person. Acquiring control for the purposes of FSMA includes where a person first holds 10 per cent. or more of the shares or voting power in an authorised person or its parent undertaking. A person will be treated as increasing his or her control over a UK authorised person, and therefore require further approval from the PRA, if the level of his or her shareholding or entitlement to voting power increases from a holding below certain thresholds to a holding above them. The thresholds are 10 per cent., 20 per cent., 30 per cent. or 50 per cent. of shares or voting power.

When determining a person's level of control, that person's holding of shares or entitlement to voting power will be aggregated with the holdings or entitlements of any person with whom he or she is "acting in concert".

Acquisition or increase of control without PRA approval is a criminal offence.

2.5 **Approved persons regime**

Certain key functions in the operation of a regulated firm (**controlled functions**) may only be carried out by persons who are approved for such tasks by either or both of the PRA or FCA under FSMA (**Approved Persons**).

Under FSMA, the Relevant Regulators have powers to regulate two types of individuals: those whose functions have a significant influence on the conduct of an authorised company's affairs and functions and those who deal with customers (or the property of customers).

The 'significant influence' controlled functions include governing functions such as being a director or non-executive director of an authorised person and significant management functions. The PRA or FCA (the Relevant Regulator being determined by the controlled function the individual is seeking approval for) will not grant Approved Person status to an individual unless it is satisfied that the individual has appropriate qualifications and/or experience and is fit and proper to perform those functions.

Approved Persons must comply with (i) the Fit and Proper Test for Approved Persons, and (ii) the Statements of Principle and Code of Practice for Approved Persons, each as set out in the Financial Services Handbooks bearing such title.

2.6 **Recovery and resolution regime**

In light of the crisis in the financial markets, the UK Banking Act 2009 received Royal Assent in February 2009 and certain provisions including those relating to the SRR (as defined below) came into force at that time.

The Banking Act empowers the Authorities where a bank is failing (or likely to fail) the threshold conditions for its authorisation (which includes, amongst other things, the conducting of its business in a prudent manner, which is assessed by reference to its financial and non-financial resources), to impose the special resolution regime (the **SRR**) on relevant entities. The SRR consists of three stabilisation options (which are designed to address a distressed bank which is failing or is likely to fail to meet the threshold conditions and which cannot be addressed through normal regulatory action or market based solutions), a bank insolvency procedure and a bank administration procedure, which may be commenced by the Authorities.

The stabilisation options provide for:

- the transfer of all or part of the failing bank's business (its shares or property, i.e. assets and liabilities) to a third party private sector purchaser. In this case, the Bank may be transferred as a single entity (together with all of its property, including its subsidiaries) or it may be split into a "good bank" and a "bad bank" (the latter of which would most likely be placed into administration). In either circumstance it is likely that the pre-resolution shares in the Bank will have no value and it is unlikely that shareholders would receive compensation in accordance with the No Creditor Worse Off (**NCWO**) principle, which requires that no creditor should be worse off in a resolution than that creditor would be on insolvency proceedings (assuming no resolution of the Bank has occurred);

- the transfer of all or part of the failing bank's business to a "bridge bank" established and wholly owned and controlled by the Bank of England (this is likely to be a temporary option pending a future sale). The business of the Bank may be split into a "good bank" and a "bad bank" (which would most likely be placed into administration) with the assets of the "good bank" being transferred to the bridge bank for continued operation of the business. Note that were this to be applied to the Bank, it is likely that the pre-resolution shares in the Bank would have no value. It is unlikely that the shareholders would receive compensation in accordance with the NCWO principle; and

- temporary public ownership (nationalisation) of the failing bank or its UK-incorporated holding company. In the case of the Bank, this would be achieved by a share transfer order which would transfer the shares from shareholders to a nominee of HM Treasury, such as a company wholly owned and controlled by HM Treasury. It is unlikely that the shareholders would receive compensation in accordance with the NCWO principle. The option to transfer a failing bank to temporary public sector ownership is understood to be the option of last resort.

In each case, the Authorities have been granted wide powers under the Banking Act including powers to modify contractual arrangements in certain circumstances and powers for HM Treasury to disapply or modify laws (with possible retrospective effect) to enable the powers under the Banking Act to be used effectively. Use of any such powers in the case of a resolution of the Bank could impact on the holders' on-going holding of any shares they have in the Bank.

In addition, in June 2012, the European Commission published a legislative proposal for the establishment of an EU wide framework for the recovery and resolution of credit institutions and investment firms (the **RRD**). The proposed RRD, among other things, contemplates the introduction of a package of minimum early intervention and resolution-related tools and powers for relevant authorities. The resolution tools and powers referred to in the RRD include certain tools and powers which overlap in part with those available under the Banking Act and also certain further tools, such as provision for authorities to ensure mandatory write-down of capital instruments at the point of non-viability of the relevant institution. The proposals on capital write-down are expected to cover instruments already in issue when the RRD is implemented. The draft RRD currently contemplates that it will be implemented in Member States by 31 December 2014, except for certain bail-in provisions which are to be implemented by 1 January 2018. The draft RRD is not in final form and changes may be made to it in the course of the legislative process.

2.7 Proposed legislation: structural and other reforms

On 14 June 2012, HM Treasury issued a white paper ("*Banking reform: delivering stability and supporting a sustainable economy*") on how the Government intends to implement the measures recommended by the Independent Commission on Banking (**ICB**) in its final report of 12 September 2011, in which the ICB (which was established by the Government in June 2010) set out its recommendations for reforms to improve competition and stability in the UK banking sector. Broadly, the white paper covers the following areas: the ring-fencing of vital banking services from international and investment banking services; measures on loss absorbency and depositor preference; and proposals for enhancing competition in the banking sector.

On 19 June 2013, the Parliamentary Commission on Banking Standards published its final report ("*Changing banking for good*"). This was followed by the publication of the Government's response on 8 July 2013, accepting the overall conclusions of the report and all of its principal recommendations. Among other things, this included proposals for a new banking standards regime governing the conduct of bank staff, the introduction of a criminal offence for reckless misconduct by senior bank staff, and steps to improve competition in the banking sector. Depending on how the Government decides to implement these proposals, they may have a substantial impact on banks in the UK generally, including the Bank.

The Government has published the Banking Reform Bill. Following the Parliamentary Commission on Banking Standard's final report, published in June 2013, amendments to the Banking Reform Bill have been tabled before parliament. Measures contained in the Banking Reform Bill including (i) ring-fencing domestic retail banking services of UK banks, (ii) increasing UK banks' and building societies' loss-absorbing capacity (including by way of bail-in bonds) and (iii) increasing the ranking of insured depositors on a winding-up to rank ahead of all other unsecured creditors. On 1 October 2013, HM Treasury published amendments to the Banking Reform Bill which propose conferring upon the Bank of England the power to deploy a new stabilisation option (called the "bail-in option") in relation to banks. This would enable the Bank of England to take a range of actions for the purposes of stabilising a failing bank. Actions available under the bail-in option include the making of a resolution instrument with respect to a bank to cancel, reduce or defer the equity liabilities of the bank (including divesting shareholders of their shares in the bank), convert an instrument issued by the bank from one form or class to another (for example, a debt instrument into equity), and/or or transfer some or all of the securities of the bank to an appointed bail-in administrator. HM Treasury's amendments to the Banking Reform Bill are consistent with the range of tools that Member States will be required to make available to Resolution Authorities under the RRD. Though the RRD is still under negotiation, HM Treasury considers that the draft RRD is sufficiently advanced that the bail-in tools can be implemented in the UK without the risk of the need for substantial amendment following the coming into force of the RRD. Further amendments could be made as the Banking Reform Bill passes through the legislative process. The Government intends the Banking Reform Bill to receive Royal Assent by February 2014 and all relevant secondary legislation to be implemented by May 2015.

On 17 July 2013 HM Treasury and the Department for Business, Innovation and Skills published a consultation on proposed secondary legislation under the Banking Reform Bill. The draft secondary legislation included details on the scope of the ring-fence and proposed exemptions that will permit the deposits of larger organisations and high net worth individuals to be held outside the ring-fence. It proposed the establishment of a framework through which non-capital primary loss absorbing capacity requirements will be imposed by the regulator on systemic UK banks and building societies. Further secondary legislation on pensions and building societies will be published at a later date.

At the EU level, following the report of the Liikanen Group, which was published in October 2012, structural reform measures that are similar to some of those contained in the Banking Reform Bill are also under consideration. Further, in addition to the bail-in tools discussed above, the draft RRD provides, amongst other things, for Resolution Authorities to have the power to require institutions and groups to make structural changes to ensure legal and operational separation of "critical functions" from other functions where necessary, or to require institutions to limit or cease existing or proposed activities in certain circumstances. It is currently contemplated that the RRD will be implemented in Member States by 31 December 2014 except for certain bail in provisions which are to be implemented by 1 January 2018. The draft RRD is not in final form and changes may be made to it in the course of the legislative process.

2.8 The UK Government

The UK Government has no operational responsibility for the activities of the PRA, the FCA or the Bank of England. However, there are a variety of circumstances where the PRA, the FCA and the Bank of England will need to alert HM Treasury (the representative of the UK Government) about possible problems, for example, where there may be a need for a support operation or a problem arises which could cause wider economic disruption.

2.9 **Consumer credit regulation**

The Consumer Credit Act 1974, as amended (**CCA**) regulates credit within the definition of "regulated agreement". A credit agreement is a regulated agreement if: (a) the borrower is or includes an "individual" as defined in the CCA; and (b) the credit agreement is not an exempt agreement under the CCA. Certain financial limits in respect of the credit provided applied to credit agreements entered into before 6 April 2008, or before 31 October 2008 in the case of buy-to-let mortgages satisfying prescribed conditions. Buy-to-let mortgages entered into on or after 31 October 2008 and satisfying prescribed conditions are exempt agreements under the CCA.

If requirements under the CCA as to licensing of lenders or brokers or entering into and documenting a credit agreement are not or have not been met, then the affected regulated agreement is unenforceable against the borrower without an order of the Office of Fair Trading (**OFT**) or court order or (for agreements entered into before 6 April 2007) is totally unenforceable, depending on the circumstances. Under sections 75 and 75A of the CCA, in certain circumstances a lender is liable to a customer in relation to misrepresentation and breach of contract by a supplier in a transaction financed by a credit agreement regulated by the CCA or treated as such, and the lender has a statutory indemnity from the supplier against liability under section 75, subject to any agreement between the lender and the supplier.

The Office of Fair Trading

The FS Act 2012 contains provisions enabling the transfer of consumer credit regulation (which includes new and existing second charge mortgages) from the OFT to the FCA. HM Treasury has announced that consumer credit regulation will be transferred to the FCA from 1 April 2014. The related secondary legislation was enacted in July 2013. Under FSMA, as amended by the FS Act 2012, the FCA may make rules under which and from dates to be specified: (a) carrying on certain credit-related regulated activities (including in relation to servicing credit agreements) otherwise than in accordance with permission from the FCA will render the credit agreement unenforceable without FCA approval; and (b) the FCA will have power to render unenforceable contracts made in contravention of its rules on cost and duration of credit agreements or in contravention of its product intervention rules. The FS Act 2012 also provides for formalised co-operation to exist between the FCA and the Financial Ombudsman Service (discussed below), particularly where issues identified potentially have wider implications, with a view to the FCA requiring firms to operate consumer redress schemes.

European regulatory landscape

In April 2008, the European Parliament and the Council of the European Union adopted a second directive on consumer credit (Directive 2008/48/EC) which provides that, subject to exemptions, loans not exceeding €75,000 must be regulated. This directive repeals and replaced the first consumer credit directive and required Member States to implement the directive by measures in force by 11 June 2010. Loan agreements secured by land mortgage are exempted from the consumer credit directives.

2.10 **Mortgage lending**

FSMA regulates mortgage credit within the definition of "regulated mortgage contract" and also regulates certain other types of home finance. A credit agreement is a regulated mortgage contract if it is entered into on or after 31 October 2004 and, at the time it is entered into: (a) the credit agreement is one under which the lender provides credit to an individual or to trustees; (b) the contract provides for the repayment obligation of the borrower to be secured by a first legal mortgage on land (other than timeshare accommodation) in the UK; and (c) at least 40 per cent. of that land is used, or is intended to be used, as or in connection with a dwelling by the borrower or (in the case of credit provided to trustees) by an individual who is a beneficiary of the trust, or by a related person.

If prohibitions under FSMA as to authorisation or financial promotions are contravened, then the affected regulated mortgage contract (and, in the case of financial promotions, other credit secured on land) is unenforceable against the borrower without a court order. The FCA's Mortgages and Home Finance: Conduct of Business sourcebook (**MCOB**) sets out rules in respect of regulated mortgage contracts and certain other types of home finance. Under MCOB rules, an authorised firm (such as the Bank) is restricted from repossessing a property unless all other reasonable attempts to resolve the position have failed, which can include the extension of the term of the mortgage, product type changes and deferral of interest payments.

Any credit agreement intended to be a regulated mortgage contract or unregulated may instead be wholly or partly regulated by the CCA or treated as such. Any credit agreement intended to be regulated by the CCA or treated as such or unregulated may instead be a regulated mortgage contract. This is because of technical rules on determining whether the credit agreement or any part of it falls within the definition of "regulated mortgage contract" under FSMA, or within the definition of "regulated agreement" under the CCA, and technical rules on changes to credit agreements.

Mortgage Market Review

In December 2011, the FSA published a consultation paper that consolidates proposals arising out of its wide-ranging mortgage market review, which was launched in October 2009 the subject of a discussion paper to consider strengthening rules and guidance on, among other things, affordability assessments, product regulation, arrears charges and responsible lending. The FSA's aim was to ensure the continued provision of mortgage credit for the majority of borrowers who can afford the financial commitment of a mortgage, while preventing a re-emergence of poor lending practices as the supply of mortgage credit in the market recovers. In October 2012, the FSA published a policy statement and final rules that will come into force on 26 April 2014. These rules will require, among other things, an assessment of affordability in accordance with detailed requirements, with transitional arrangements where the borrower does not take on additional borrowing except for essential repairs or maintenance work, and will ban self-certificated loans. These rules will permit interest-only loans only where there is a clearly understood and credible strategy for repaying the capital (evidence of which the lender must obtain before making the loan and check at least once during the term of the loan) and the cost of the repayment strategy must be part of the affordability assessment.

European regulatory landscape

In March 2011, the European Commission published a proposal for a directive on credit agreements relating to residential immovable property for consumers. The proposal is to some extent modelled on the second directive on consumer credit and requires, among other things, standard pre-contractual information, calculation of the annual percentage rate of charge in accordance with a prescribed formula, and a right of the borrower to make early repayment. Until the final form of the proposed directive and UK implementing legislation are published, it is not certain what effect its adoption and implementation will have on the Bank's mortgage businesses.

2.11 **Insurance**

The Bank is also authorised for carrying out insurance mediation. The FCA's Insurance: Conduct of Business sourcebook sets out rules in respect of non-investment insurance.

2.12 **Financial Services Compensation Scheme**

FSMA established the FSCS, which pays compensation to eligible customers of authorised financial services firms which are unable, or are likely to be unable, to pay claims against them. The levels of compensation are, for example, for claims against firms declared in default on or after 1 January 2010 (31 December 2010 for deposits): (i) for deposits, 100 per cent. of the first £85,000; (ii) for mortgage advice and arranging, 100 per cent. of the first £50,000; and (iii) for insurance, 90 per cent. of the claim with no upper limit (except compulsory insurance is protected in full). The FSCS only pays compensation for financial loss. Compensation limits are per person, per firm and per type of claim. Directive 2009/14/EC, amending the DGSD requires Member States to set the minimum level of compensation for deposits, for firms declared in default on or after 1 January 2011, at €100,000.

Amendments to the EU Deposit Guarantee Scheme Directive

The DGSD required each member state to introduce at least one deposit guarantee scheme, with implementation by 1 July 1995. The DGSD has been reviewed and a new legislative proposal was published by the European Commission in July 2010. The main changes proposed included a tighter definition of deposits, a requirement that the Deposit Guarantee Scheme repay customers within a week and that banks must be able to provide information (a single customer view) at any time. On 12 June 2013 the European Commission announced that the negotiations on revisions to the DGSD were on hold pending further developments on the RRD.

2.13 **Financial Ombudsman Service**

FSMA established the Financial Ombudsman Service (the **FOS**), which determines complaints by eligible complainants in relation to authorised financial services firms, consumer credit licensees and certain other businesses, in respect of activities and transactions under its jurisdiction. The FOS determines complaints on the basis of what, in its opinion, is fair and reasonable in all the circumstances of the case. The maximum level of money award by the FOS is £150,000 for complaints received by the FOS on or after 1 January 2012 (£100,000 for earlier complaints) plus interest and costs. The FOS may also make directions awards, which direct the business to take steps, as the FOS considers just and appropriate.

2.14 **Money Laundering Regulations**

The UK Money Laundering Regulations 2007 (the **MLRs**) place a requirement on the Bank to verify the identity and address of customers opening accounts with it, and to keep records to help prevent money laundering and fraud.

Guidance in respect of the MLRs is contained in the Guidance Notes of the Joint Money Laundering Steering Group, including in respect of the identification of new clients, record keeping and otherwise. Directive 2005/60/EC, which underpins the MLRs, was reviewed by the European Commission between 2010 and 2012 and it found that there were no fundamental shortcomings in the regime.

In response to the European Commission's review, broad support was expressed for the proposed alignment to the revised Financial Action Task Force standards and for greater clarification of certain issues, in particular in the area of data protection and cross-border transactions. In February 2013, the European Commission published proposals for a directive on the prevention of the use of the financial systems for the purpose of money laundering and terrorism financing and a regulation on information accompanying transfer of funds to secure due traceability of these transfers. These proposals are currently subject to the ordinary EU legislative procedure.

2.15 **Other**

The UK Data Protection Act 1998 regulates the processing of data relating to individual customers including the retention and use of such data. The Office of the Information Commissioner is responsible for overseeing the data protection regime in the UK. The UK Unfair Terms in Consumer Contracts Regulations 1999 (together with, insofar as applicable, the Unfair Terms in Consumer Contracts Regulations 1994) apply to consumer contracts entered into on or after 1 July 1995. The main effect of these Regulations is that a contract term which is "unfair" will not be enforceable against a consumer. This applies to, among other things, mortgages and related products and services. The FSA has issued statements of good practice in this regard in May 2005, January 2007 and January

2012, and since 1 April 2013 the FCA has worked with the Office of Fair Trading to, amongst other things, allocate responsibility for regulation of mortgage products.

The Bank participates in the unclaimed assets scheme established under the Dormant Bank and Building Society Accounts Act 2008. The purpose of this scheme is to enable money in dormant bank and building society accounts (i.e. balances in accounts that have been inactive or dormant for 15 years or more) to be distributed for the benefit of the community, while protecting the rights of customers to reclaim their money.

On 1 November 2009, the FSA introduced its Banking Conduct Regime for retail banking. The main constituents of this regime are: (i) extending certain of FSMA principles for businesses to apply to deposit-taking, from prudential matters only, to conduct of business matters; (ii) conduct of business requirements in the Payment Services Regulations 2009 (the **PSR**), which apply to certain payment services made in euro or sterling; and (iii) the FCA's Banking: Conduct of Business sourcebook, which applies to deposit-taking in respects not covered by the PSR.

On 1 November 2009, the British Bankers' Association, the Building Societies Association and The UK Cards Association launched The Lending Code, a voluntary code on unsecured lending to personal and small business customers, which is monitored and enforced by the Lending Standards Board. The voluntary Banking Code and the Business Banking Code then ceased to have effect.

18
INFORMATION INCORPORATED BY REFERENCE

This section contains a description of the information that is deemed to be incorporated by reference in this Prospectus.

INFORMATION INCORPORATED BY REFERENCE

The following documents, which have been published and filed with the Financial Conduct Authority, shall be incorporated in, and form part of, this Prospectus:

The auditor's report and audited consolidated and non-consolidated annual financial statements of the Bank for the financial years ended 31 December 2012, 31 December 2011 and 31 December 2010, respectively, including the following:

	Annual Report 2010	*Annual Report 2011*	*Annual Report 2012*
Business and Financial Review	Pages 5 to 8	Pages 5 to 7	Pages 6 to 9
Independent auditors' report	Page 29	Page 29	Page 32
Consolidated income statement	Page 30	Page 30	Page 33
Consolidated statement of comprehensive income	Page 31	Page 31	Page 34
Consolidated balance sheet	Page 32	Page 32	Page 35
Bank balance sheet	Page 33	Page 33	Page 36
Consolidated statement of cash flows	Page 34	Page 34	Page 37
Bank statement of cash flows	Page 35	Page 35	Page 38
Consolidated and bank statements of changes in equity	Page 36	Page 36	Page 39
Basis of preparation and significant accounting policies	Pages 37 to 44	Pages 37 to 45	Pages 40 to 50
Notes to the financial statements	Pages 82 to 123	Pages 75 to 122	Pages 83 to 132

Following the publication of this Prospectus a supplement may be prepared by the Bank and approved by the UK Listing Authority in accordance with Article 16 of the Prospectus Directive. Any statement contained in this Prospectus or in a document incorporated by reference herein shall be deemed to be modified or superseded to the extent that a statement contained in any such supplement modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Prospectus.

The documents referred to above are available free of charge from the Bank's registered office at 1 Balloon Street, Manchester M60 4EP and from http://www.morningstar.co.uk/uk/NSM.

Any documents themselves incorporated by reference in the documents incorporated by reference in this Prospectus shall not form part of this Prospectus.

Any non-incorporated parts of a document referred to herein are either deemed not relevant for Holders and other prospective investors or are otherwise covered elsewhere in this Prospectus.

Any website and its contents which is referred to in this Prospectus does not form part of this Prospectus.

19
TAXATION

The following section contains a general guide to certain UK tax considerations relevant to an investment in the Notes.

Further information with respect to the taxation consequences of participation in the Liability Management Exercise is set out in the Offer Memorandum attached as Appendix C (*Consent and Exchange Offer Memorandum*) to this Prospectus.

Holders should read these sections and discuss the taxation consequences with their tax adviser, financial adviser or other professional adviser before deciding whether or not to participate in the Liability Management Exercise.

TAXATION

UK TAXATION

The following statements are intended only as a general guide to certain UK tax considerations and do not purport to be a complete analysis of all potential UK tax consequences of acquiring, holding or disposing of the Notes. They are based on current UK tax law and what is understood to be the current published practice of HM Revenue and Customs (HMRC) as at the date of this Prospectus, both of which are subject to change, possibly with retrospective effect. They are intended to apply only to Noteholders who (unless the position of non-UK resident Noteholders is expressly referred to) are resident in the UK for UK tax purposes, who hold their Notes as investments (other than under an individual savings account) and who are the beneficial owners of their Notes and any interest paid on them. The statements may not apply to certain classes of Noteholders such as dealers in securities.

Prospective Noteholders are also directed to Section I (*Taxation Considerations*) of the Offer Memorandum which contains further information relevant to the potential UK tax consequences of acquiring the Notes pursuant to the LME.

Prospective Noteholders who are in any doubt as to their tax position regarding the acquisition of Notes pursuant to the LME, ownership and disposition of the Notes or who are subject to tax in a jurisdiction other than the UK should consult their own tax advisers.

A. Interest on the Notes

1. ***Payment of interest on the Notes***

Payments of interest on the Notes may be made without deduction of or withholding on account of United Kingdom income tax provided that the Notes continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the **Act**). The London Stock Exchange is a recognised stock exchange. Securities will be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of FSMA) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Notes remain so listed, interest on the Notes will be payable without withholding or deduction on account of United Kingdom tax.

Interest on the Notes may also be paid without withholding or deduction on account of United Kingdom tax where interest on the Notes is paid by a company and, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Notes is paid reasonably believes) that the beneficial owner is within the charge to United Kingdom corporation tax as regards the payment of interest, provided that HMRC has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the above exemption is not available in respect of such payment of interest at the time the payment is made) that the interest should be paid under deduction of tax.

In other cases, an amount must generally be withheld from payments of interest on the Notes on account of United Kingdom income tax at the basic rate (currently 20 per cent.). However, where an applicable double tax treaty provides for a lower rate of withholding tax (or for no tax to be withheld) in relation to a Noteholder, HMRC can issue a notice to the Issuer to pay interest to the Noteholder without deduction of tax (or for interest to be paid with tax deducted at the rate provided for in the relevant double tax treaty).

2. ***Information Reporting***

HMRC has powers, in certain circumstances, to obtain information relating to securities.

The information HMRC can obtain includes: details of the beneficial owner of securities; details of the person for whom the securities are held, or the person to whom the payment is to be made (and, if more than one, their respective interests); information and documents relating to securities transactions; and, in relation to interest paid or credited on money received or retained in the United Kingdom, the identity of the security under which interest is paid.

The persons from whom HMRC can obtain information include: a person who receives (or is entitled to receive) a payment derived from securities; a person who makes such a payment (received from, or paid on behalf of another person); a person by or through whom interest is paid or credited; a person who effects or is a party to securities transactions (which includes an issue of securities) on behalf of others; registrars or administrators in respect of securities transactions; and each registered or inscribed holder of securities.

In certain circumstances the information which HMRC has obtained using these powers may be exchanged with tax authorities in other jurisdictions.

3. ***EU Savings Directive***

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State or to certain limited types of entities established in that other Member State. However, for a transitional period, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have adopted similar measures (a withholding system in the case of Switzerland). In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1 January 2015, in favour of automatic information exchange under the Directive.

The European Commission has proposed certain amendments to the Directive, which may, if implemented, amend or broaden the scope of the requirements described above.

4. ***Further United Kingdom Income Tax Issues***

Interest on the Notes constitutes United Kingdom source income for tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding.

However, interest with a United Kingdom source received without deduction or withholding on account of United Kingdom tax will not be chargeable to United Kingdom tax in the hands of a Noteholder (other than certain trustees) who is not resident for tax purposes in the United Kingdom unless that Noteholder carries on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency in connection with which the interest is received or to which the Notes are attributable (and where that Noteholder is a company, unless that Noteholder carries on a trade in the United Kingdom through a permanent establishment in connection with which the interest is received or to which the Notes are attributable). There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Noteholders.

B. Further United Kingdom Tax Consequences of holding the Notes

1. ***United Kingdom Corporation Tax Payers***

In general, Noteholders which are within the charge to United Kingdom corporation tax will be charged to tax as income on all returns, profits or gains on, and fluctuations in value of, the Notes (whether attributable to currency fluctuations or otherwise) broadly in accordance with their statutory accounting treatment.

2. ***Individuals***

Interest

Noteholders who are either individuals or trustees and are resident for tax purposes in the United Kingdom or who carry on a trade, profession or vocation in the United Kingdom through a branch or agency to which the Notes are attributable will generally be liable to United Kingdom tax on the amount of any interest received in respect of the Notes.

Taxation of Chargeable Gains

The Notes are expected to constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992. Accordingly, a disposal by a Noteholder of a Note should not give rise to a chargeable gain or an allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Income Scheme

On a disposal of Notes by a Noteholder, any interest which has accrued since the last interest payment date may be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the Act, if that Noteholder is resident or ordinarily resident in the United Kingdom or carries on a trade in the United Kingdom through a branch or agency to which the Notes are attributable.

Taxation of discount

The Notes may constitute "deeply discounted securities" for the purposes of Chapter 8 of Part 4 Income Tax (Trading and Other Income) Act 2005. Whether the Notes are deeply discounted securities will depend on the market value of the Dated Notes exchanged for the Notes at the time of the exchange compared to the amount payable on redemption. If the Notes are deeply discounted securities, any gain realised on redemption or transfer of the Notes by a Noteholder who is within the charge to United Kingdom income tax in respect of the Notes should generally be taxable as income but such Noteholder will not be able to claim relief from income tax in respect of costs incurred on the acquisition, transfer or redemption, or losses incurred on the transfer or redemption, of the Notes.

Noteholders should consult their own tax advisors to determine whether the Notes are deeply discounted securities.

C. Stamp Duty and Stamp Duty Reserve Tax (SDRT)

No UK stamp duty or SDRT should be payable on the issue or transfer of a Note or on its redemption.

THE ABOVE DESCRIPTION OF TAXATION IS GENERAL IN CHARACTER. IF YOU ARE IN ANY DOUBT AS TO YOUR TAX POSITION, YOU SHOULD CONSULT AN APPROPRIATE PROFESSIONAL ADVISER WITHOUT DELAY.

The Proposed Financial Transactions Tax (FTT)

The European Commission has published a proposal for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the **participating Member States**).

The proposed FTT has very broad scope and could, if introduced in its current form, apply to certain dealings in the Notes (including secondary market transactions) in certain circumstances.

Under current proposals the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in the Notes where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (i) by transacting with a person established in a participating Member

State or (ii) where the financial instrument which is subject to the dealings is issued in a participating Member State.

The FTT proposal remains subject to negotiation between the participating Member States and is the subject of legal challenge. It may therefore be altered prior to any implementation, the timing of which remains unclear. Additional EU Member States may decide to participate. Prospective holders of the Notes are advised to seek their own professional advice in relation to the FTT.

FOREIGN ACCOUNT TAX COMPLIANCE ACT

Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986 (**FATCA**) impose a new reporting regime and potentially a 30 per cent. withholding tax with respect to certain payments to any non-U.S. financial institution (a "foreign financial institution", or **FFI** (as defined by FATCA)) that does not become a **Participating FFI** by entering into an agreement with the U.S. Internal Revenue Service (**IRS**) to provide the IRS with certain information in respect of its account holders and investors or is not otherwise exempt from or in deemed compliance with FATCA. The Bank is classified as an FFI.

The new withholding regime will be phased in beginning 1 July 2014 for payments from sources within the United States and will apply to **foreign passthru payments** (a term not yet defined) no earlier than 1 January 2017. This withholding would potentially apply to payments in respect of (i) any Notes characterised as debt (or which are not otherwise characterized as equity and have a fixed term) for U.S. federal tax purposes that are issued on or after the **grandfathering date**, which is the later of (a) 1 July 2014 and (b) the date that is six months after the date on which final U.S. Treasury regulations defining the term foreign passthru payment are filed with the Federal Register, or which are materially modified on or after the grandfathering date and (ii) any Notes characterised as equity or which do not have a fixed term for U.S. federal tax purposes, whenever issued.

The United States and a number of other jurisdictions have announced their intention to negotiate intergovernmental agreements to facilitate the implementation of FATCA (each, an **IGA**). Pursuant to FATCA and the "Model 1" and "Model 2" IGAs released by the United States, an FFI in an IGA signatory country could be treated as a **Reporting FI** not subject to withholding under FATCA on any payments it receives. Further, an FFI in a Model 1 IGA jurisdiction generally would not be required to withhold under FATCA or an IGA (or any law implementing an IGA) (any such withholding being **FATCA Withholding**) from payments it makes. The Model 2 IGA leaves open the possibility that a Reporting FI might in the future be required to withhold as a Participating FFI on foreign passthru payments. Under each Model IGA, a Reporting FI would still be required to report certain information in respect of its account holders and investors to its home government or to the IRS. The United States and the United Kingdom have entered into an agreement (the **US-UK IGA**) based largely on the Model 1 IGA.

The Bank expects to be treated as a Reporting FI pursuant to the US-UK IGA and does not anticipate being obliged to deduct any FATCA Withholding on payments it makes. There can be no assurance, however, that the Bank will be treated as a Reporting FI, or that it would in the future not be required to deduct FATCA Withholding from payments it makes The Bank and financial institutions through which payments on the Notes are made may be required to withhold FATCA Withholding if any FFI through or to which payment on such Notes is made is not a Participating FFI, a Reporting FI, or otherwise exempt from or in deemed compliance with FATCA

In respect of any Notes which are held within the clearing systems, it is expected that FATCA will not affect the amount of any payments made under, or in respect of, the Notes by the Bank, any paying agent and the common depositary, given that each of the entities in the payment chain between the Bank and the participants in the clearing systems is a major financial institution whose business is dependent on compliance with FATCA and that any alternative approach introduced under an IGA will be unlikely to affect the Notes. The documentation expressly contemplates the possibility that the Notes may go into definitive form and therefore that they may be taken out of the clearing systems. If this were to happen, then a non-FATCA compliant holder could be subject to FATCA Withholding. However, definitive Notes will only be printed in remote circumstances.

FATCA is particularly complex and its application is uncertain at this time. The above description is based in part on regulations, official guidance and model IGAs, all of which are subject to change or may be implemented in a materially different form. Prospective investors should consult their tax advisers on how these rules may apply to the Bank and to payments they may receive in connection with the Notes.

TO ENSURE COMPLIANCE WITH IRS CIRCULAR 230, EACH TAXPAYER IS HEREBY NOTIFIED THAT: (A) ANY TAX DISCUSSION HEREIN IS NOT INTENDED OR WRITTEN TO BE USED, AND CANNOT BE USED BY THE TAXPAYER FOR THE PURPOSE OF AVOIDING U.S. FEDERAL INCOME TAX PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER; (B) ANY SUCH TAX DISCUSSION WAS WRITTEN TO SUPPORT THE PROMOTION OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) THE TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISER.

20
ADDITIONAL INFORMATION

Holders should be aware of a number of other matters that may not have been addressed in detail elsewhere in this Prospectus.

These include the availability of certain relevant documents for inspection, confirmations from the Bank and details of the listing of the Notes.

ADDITIONAL INFORMATION

1. INCORPORATION AND REGISTERED OFFICE

1.1 The Bank was incorporated and registered in England and Wales under the name of Co-operative Bank Limited on 5 October 1970. On 21 May 1981 the Bank was re-registered as a public company and changed its name to Co-operative Bank Public Limited Company. On 10 January 1993 the Bank changed its name to The Co-operative Bank p.l.c.

1.2 The registered and head office of the Bank is at P.O. Box 101, 1 Balloon Street, Manchester M60 4EP (telephone number: + 44 (0) 161 832 3456, fax number: +44 (0) 161 829 4475).

1.3 The principal legislation under which the Bank operates, and under which the New Ordinary Shares will be created, is the Companies Act.

2. AUTHORISATION

The issue of the Notes was duly authorised by a resolution of the Board of Directors of the Issuer dated 1 November 2013.

3. LISTING

3.1 It is expected that the admission of the Notes to the Official List will be granted on or about the Issue Date. Application has been made to the UK Listing Authority for the Notes to be admitted to the Official List and to be admitted to trading on the London Stock Exchange's regulated market. Admission of the Notes to trading is also expected to occur on or about the Issue Date.

3.2 The amount of expenses related to the issue of the Notes will be specified when the final principal amount of Notes to be issued (if any) is announced by the Issuer.

4. CERTIFICATES

No temporary documents of title shall be issued by the Bank in respect of the Notes. The Registrar will, from the Issue Date, commence despatching the Certificates to all holders who hold their Notes in certificated form, at the risk of the persons entitled thereto, by post to the address on the register or if such holder has completed an Exchange Instruction with another address, to such address.

5. CLEARING SYSTEMS

5.1 The Notes in uncertificated form have been accepted for clearance in CREST and with Euroclear and Clearstream, Luxembourg through CREST. The ISIN for the Notes is GB00BFXW0853 and the SEDOL is BFXW085.

5.2 The current address of CREST is Euroclear UK & Ireland Limited, 33 Cannon Street, London EC4M 5SB.

5.3 The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L 1855 Luxembourg.

6. NO SIGNIFICANT CHANGE AND NO MATERIAL ADVERSE CHANGE

Save as set out in "*Current Trading*" of Section 12 (*Operating Financial Review*), there has been no significant change in the financial or trading position of the Bank or its subsidiaries since 30 June 2013, the date to which the last historical audited consolidated financial information of the Bank was prepared. Save as set out in "*Current Trading*" of Section 12 (*Operating Financial Review*), there has been no material adverse change in the prospects of the Bank or its subsidiaries since 30 June 2013.

7. AUDITORS

7.1 The financial statements for the financial years ended 31 December 2012, 2011 and 2010 which have been incorporated by reference into this Prospectus have been audited without qualification, by KPMG. The Interim Financial Information for the half-year ended 30 June 2013 has been audited for the purposes of this Prospectus and the audit opinion provided by KPMG is qualified by an "emphasis of matter".

7.2 KPMG Audit Plc's address is 15 Canada Square, London E14 5GL, United Kingdom.

7.3 KPMG Audit Plc is a member of the Institute of Chartered Accountants in England and Wales and has no material interest in the Bank.

7.4 KPMG Audit Plc has given and has not withdrawn its written consent to the inclusion in this Prospectus of its name, its accountants' reports in "*Part B*", "*Part D*" and "*Part E*" in Section 16 (*Financial Information*), and references to its name and those documents in the form and context in which they appear and has authorised the contents of those parts of this Prospectus which comprise its reports for the purposes of PR 5.5.4R(2)(f) of the Prospectus Rules.

8. DOCUMENTS AVAILABLE FOR INSPECTION

Copies of the following documents are available for inspection during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) for a period of 12 months from the date of this Prospectus at the Bank's registered office at P.O. Box 101, 1 Balloon Street, Manchester M60 4EP:

(a) the existing memorandum and articles of association of the Bank;

(b) the reports from KPMG set out in Section 16 (*Financial Information*);

(c) this Prospectus;

(d) the consent letters referred to in paragraph 7 "*Auditors*" above;

(e) the audited consolidated financial statements of the Issuer for the financial years ended 31 December 2012, 31 December 2011 and 31 December 2010, together with the audit reports thereon. The Issuer currently prepares audited consolidated financial statements only on an annual basis;

(f) the Interim Financial Information;

(g) the Trust Deed and the Registrar Agreement; and

(h) the Offer Memorandum.

9. YIELD

The yield of the Notes is 11 per cent. per annum calculated on the basis of the issue price of the Notes and as at the date of this Prospectus.

10. DEALER MANAGERS TRANSACTING WITH THE ISSUER

The Dealer Managers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services for the Issuer and its affiliates in the ordinary course of business.

11. MATERIAL CONFLICTS OF INTEREST IN THE OFFER

HSBC has been appointed as a dealer manager and adviser to the Bank and UBS has been appointed as a dealer manager, to facilitate the Liability Management Exercise. HSBC will be paid fees and expenses by the Bank in connection with the Liability Management Exercise. Please also see paragraph 10 above.

12. SUMMARY OF THE BANK'S ARTICLES OF ASSOCIATION

The articles of association of the Bank which will be proposed for approval at a general meeting of the Bank held on 15 November 2013, will include provisions with the effect as described below.

12.1 Objects

The objects of the Bank, in accordance with section 31(1) of the Companies Act, are unrestricted. The Bank shall promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement having regard to the highest standards of ethical principles and with the aim of being recognised as a good corporate citizen and contributing to building a stronger and sustainable society. The Bank shall promote and conduct its business in this manner in relation to:

(a) how it relates to, communicates with, balances the interests of, and otherwise deals with, its stakeholders; and

(b) how it applies the profits of the Bank, in accordance with the dividend policy.

Among the factors to which the directors must have regard in exercising their duties are (i) the promotion of co-operative values and ethical policies as approved and adopted by the Board from time to time after recommendation by the V&E Committee, (ii) the promotion of the desirability of customers of the Bank continuing to be able to participate in membership of Co-operative Group (for so long as Co-operative Group remains a bona fide co-operative society and directly or indirectly holds 20 per cent. or more of the Bank's ordinary shares), and (iii) the conduct of the Bank's business with respect to ethical standards and the interests of the customers, suppliers, employees and other stakeholders of the Bank in a manner consistent with the values and ethical policies approved and adopted by the Board.

12.2 Limited liability

The liability of the members is limited to the amount, if any, unpaid on the shares in the Bank respectively held by them.

12.3 Preference Shares

(a) Dividends – The Preference Shares carry the right to a fixed, non-cumulative preferential dividend on the capital for the time being paid up thereon at the rate of 9.25 per cent. per annum, exclusive of any associated tax credit. Such dividends shall be payable half-yearly on 31 May and 30 November in each year. Such dividends shall be payable out of the profits of the Bank available for distribution and resolved to be distributed. The holders of the Preference Shares shall be entitled to payment of such dividend in priority to any payment of dividend to the holders of any other class of shares in the capital of the Bank. If any instalment of the dividend cannot be paid because the distributable profits and reserves of the Bank are insufficient to enable payment in full or if in the judgement of the directors the payment of such instalment would breach or cause a breach of the Bank of England's capital adequacy requirements currently applicable to the Bank, each Preference Shareholder eligible for payment of such dividend shall (subject to the following sentence) be allotted, credited as fully paid, such additional nominal amount of further Preference Shares equal to the cash amount of such dividend multiplied by four-thirds. Such allotment will only be made if the amount standing to the credit of the profit and loss account, reserves, share premium account or capital redemption reserve fund of the Bank are sufficient to enable the allotments of additional preference stock in full.

(b) Capital – a return of capital on a winding-up or other return of capital (other than on redemption of any class of redeemable share capital), the assets of the Bank shall be applied in priority to any payments to the holders of any other class of shares in the capital of the Bank in repaying to the holders of the Preference Shares a sum equal to (A) the greater of (1) the capital paid up or credited as paid up on the Preference Shares and (2) a sum equal to the average of the middle market quotations (as derived from the Daily Official List of The London Stock Exchange) during the three months immediately preceding the date of the notice convening the meeting to consider the resolution to approve the winding-up or other return of capital and (B) the amount that would have been properly payable by way of dividend at the annual rate thereof calculated on an annual pro rata basis by reference to the actual number of days elapsed on and from whichever of 1 June or 1 December shall have last occurred up to and including the date of the commencement of such winding-up or other return of capital.

(c) Voting and General Meetings – the holders of the Preference Shares shall have the right to speak and vote at a general meeting of the company only if and when, at the date of the notice convening such meeting, the fixed preferential dividend payable to them respectively has been in arrears for six months or more after any date fixed for payment thereof, or if a resolution is to be proposed at such meeting abrogating or varying any of the respective rights or privileges attaching to their shareholding or the winding up of the company or other return of capital and then on such resolution only.

(d) Modification of Rights – rights attaching to Preference Shares can only be varied by consent of the holders of three-fourths of the Preference Shares. This consent is required in accordance with the articles of association for:

(i) issue by the Bank of any share capital or the grant by the Bank of any rights to subscribe for or to convert shares or other securities into share capital ranking in priority to or pari passu with the Preference Shares as regards participation in the profits or assets of the Bank or being capable of being redeemed whilst any of the Preference Shares are in issue or the variation of the rights of any class of shares so as to fall within the foregoing;

(ii) the repayment or (otherwise than in accordance with these rights and conditions) the reduction of all or any part of the capital paid up on any shares in the capital of the Bank for the time being in issue (other than a repayment in the course of a winding-up of the Bank) including share premium account and capital redemption reserve fund or the acquisition by the Bank or any of its subsidiaries of any share capital of the Bank; and

(iii) the capitalisation for appropriation to the holders of the New Ordinary Shares of any part of the sums standing to the credit of the profit and loss account or to the credit of any reserve accounts of the Bank available for distribution if after such capitalisation the aggregate of the sums standing to the credit of the profit and loss account and to the credit of the Bank's reserves available for distribution would be a sum less than five times the aggregate amount of the annual preferential dividend (exclusive of any associated tax credit) payable on the new Preference Shares.

12.4 **Rights attaching to shares**

(a) Voting rights of members – subject to the articles of association and to any special rights or restrictions as to voting for the time being attached to any shares the provisions of the Companies Act shall apply in relation to voting rights. On a show of hands, every member or authorised corporate representative present has one vote and every proxy present has one vote except if the proxy has been duly appointed by more than one member and has been instructed by (or exercises his discretion given by) one or more of those members to vote for the resolution and has been instructed by (or exercises his discretion given by) one or more other of those members to vote against it, in which case a proxy has one vote for and one vote against the resolution. On a poll, every member present in person or by proxy has one vote for every share of which he is a holder. In the case of joint holders, the vote of the person whose name stands first in the register of members and who tenders a vote is accepted to the exclusion of any votes tendered by any other joint holders.

(b) Dividends – subject to the rights attached to any shares issued on any special terms and conditions, dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls should be treated for these purposes as paid up on the share.

(c) Return of capital – if the Bank is in liquidation, the liquidator may, with the sanction of extraordinary resolution of the Bank and any other authority required by any applicable statutory provision: (A) divide among the members in specie the whole or any part of the assets of the Bank; or (B) vest the whole or any part of the assets in trustees on such trusts for the benefit of members as the liquidator shall think fit, but no member shall be compelled to accept any assets upon which there is any liability.

(d) Capitalisation of reserves – the Board may, with the authority of an ordinary resolution of the Bank: (A) resolve to capitalise any sum standing to the credit of any reserve account of the Bank (including share premium account and capital redemption reserve) or any sum standing to the credit of profit and loss account not required for the payment of any preferential dividend (whether or not it is available for distribution); and (B) appropriate that sum as capital to the holders of shares in proportion to the nominal amount of the share capital held by them respectively and apply that sum on their behalf in paying up in full any shares or debentures of the Bank of a nominal amount equal to that sum and allot the shares or debentures credited as fully paid to those members, or as they may direct, in those proportions or in paying up the whole or part of any amounts which are unpaid in respect of any issued shares in the Bank held by them respectively, or otherwise deal with such sum as directed by the resolution provided that the share premium account and the capital redemption reserve, any redenomination reserve and any sum not available for distribution in accordance with the Companies Act may only be applied in paying up shares to be allotted credited as fully paid up.

12.5 **Transfer of shares**

A member may transfer all or any of his shares in any manner which is permitted by applicable statutory provisions and is from time to time approved by the Board. The Bank shall maintain a record of uncertificated shares in accordance with the relevant statutory provisions.

A member may transfer all or any of his certificated shares by an instrument of transfer in any usual form, or in such other form as the Board may approve. The instrument of transfer shall be signed by or on behalf of the transferor and, except in the case of a fully paid share, by or on behalf of the transferee. The Board may, in its absolute discretion, refuse to register any instrument of transfer of any certificated share which is not fully paid up (but not so as to prevent dealings in listed shares from taking place on an open and proper basis) or on which the Bank has a lien. The Board may also refuse to register any instrument of transfer of a certificated share unless it is left at the registered office, or such other place as the Board may decide, for registration, accompanied by the certificate for the shares to be transferred and such other evidence (if any) as the Board may reasonably require to prove title of the intending transferor or his right to transfer shares; and it is in respect of only one class of shares. If the Board refuses to register a transfer of a certificated share it shall, as soon as practicable and in any event within two months after the date on which the instrument of transfer was lodged, give to the transferee notice of the refusal together with its reasons for refusal. The Board must provide the transferee with such further information about the reasons for the refusal as the transferee may reasonably request. Unless otherwise agreed by the Board in any particular case, the maximum number of persons who may be entered on the register as joint holders of a share is four.

12.6 **Alteration of share capital**

The Bank may exercise the powers conferred by the applicable statutory provisions to:

(a) increase its share capital by allotting new shares;

(b) reduce its share capital, any capital redemption reserve and any share premium account in any way;

(c) subdivide or consolidate and divide all or any of its share capital;

(d) redenominate all or any of its shares and reduce its share capital in connection with such redenomination;

(e) issue redeemable shares; and

(f) purchase all or any of its own shares including any redeemable shares.

12.7 **Authority to allot shares and grant rights and disapplication of pre-emption rights**

The Bank may from time to time pass an ordinary resolution authorising, in accordance with section 551 of the Companies Act, the Board to exercise all the powers of the Bank to allot shares in the Bank or to grant rights to subscribe for or to convert any security into shares in the Bank up to the maximum nominal amount specified in the resolution. The authority shall expire on the day specified in the resolution (not being more than five years from the date on which the resolution is passed).

Subject (other than in relation to the sale of treasury shares) to the Board being generally authorised to allot shares and grant rights to subscribe for or to convert any security into shares in the Bank in accordance with section 551 of the Companies Act, the Bank may from time to time resolve, by special resolution, that the Board be given power to allot equity securities for cash as if section 561 of the Companies Act did not apply to the allotment but that power shall be limited: (A) to the allotment of equity securities in connection with a rights issue; and (B) to the allotment (other than in connection with a rights issue) of equity securities having a nominal amount not exceeding in aggregate the sum specified in the special resolution.

12.8 **Variation of rights**

Whenever the share capital of the Bank is divided into different classes of shares, the special rights for the time being attached to any class of shares in issue may be varied or abrogated either whilst the Bank is a going concern or during or in contemplation of a winding-up either with the consent in writing of the holders of three-fourths of the issued shares of that class or with the sanction of an extraordinary resolution passed at a separate class meeting of the holders of the shares of the class, but not otherwise. At any separate class meeting, the quorum is two members present in person or proxy holding at least one-third in nominal amount of the issued shares of the class in question (but at any adjourned meeting, the quorum is one member present in person or by proxy holding shares of the class) and the holders of shares of the class shall, on a poll, have one vote in respect of every share of the class held by them respectively.

12.9 **Creation or issue of further shares**

The special rights conferred upon the holders of any class of shares issued with preferred or other special rights shall be deemed to be varied by the reduction of the capital paid up on such shares but shall not (unless otherwise expressly provided by the articles of association of the Bank or by the conditions of issue of such shares) be deemed to be varied by the creation or issue of further shares ranking in some or all respects pari passu therewith or subsequent thereto.

12.10 **Disclosure of interests in shares**

If the holder of, or any person appearing to be interested in, any share has been given a notice requiring any of the information mentioned in section 793 of the Companies Act (section 793 notice) and, in respect of that share (a default share), has been in default for a period of 14 days after the section 793 notice has been given in supplying to the Bank the information required by the section 793 notice, the following restrictions shall apply: (A) if the default shares in which any one person is interested or appears to the Bank to be interested represent less than 0.25 per cent. of the issued shares of the class, the holders of the default shares shall not be entitled, in respect of those shares, to attend or to vote, either personally or by proxy, at any general meeting of the Bank; or (B) if the default shares in which any one person is interested or appears to the Bank to be interested represent at least 0.25 per cent. of the issued shares of the class, the holders of the default shares shall not be entitled, in respect of those shares:

(a) to attend or to vote, either personally or by proxy, at any general meeting of the Bank; or

(b) to receive any dividend or other distribution; or

(c) to transfer or agree to transfer any of those shares or any rights in them.

12.11 **Uncertificated shares – general powers**

In relation to any uncertificated share, the Bank may utilise the relevant system in which it is held to the fullest extent available from time to time in the exercise of any of its powers or functions under any applicable statutory provision or the articles of association or otherwise in effecting any action. Any provision in the articles of association in relation to uncertificated shares which is inconsistent with any applicable statutory provision shall not apply. The Bank may, by notice to the holder of an uncertificated share, require the holder to change the form of that share to certificated form within such period as may be specified in the notice. For the purpose of effecting any action by the Bank, the Board may determine that shares held by a person in uncertificated form and in certificated form shall be treated as separate holdings but they shall not be treated as separate classes of shares.

12.12 **Directors**

(a) The directors (other than alternate directors) shall not, unless otherwise determined by an ordinary resolution of the Bank, be less than two.

(b) A director need not be a member of the Bank.

(c) The directors shall retire from office at each annual general meeting. A retiring director shall be eligible for re-election, and a director who is re-elected will be treated as continuing in office without a break. A retiring director who is not re-elected shall retain office until the close of the meeting at which he retires. If the Bank, at any meeting at which a director retires in accordance with the articles of association, does not fill the office vacated by such director, the retiring director, if willing to act, shall be deemed to be re-elected, unless at the meeting a resolution is passed not to fill the vacancy or to elect another person in his place or unless the resolution to re-elect him is put to the meeting and lost.

(d) The non-executive directors shall be paid such fees not exceeding in aggregate £1.5 million per annum (or such larger sum as the Bank may, by ordinary resolution, determine) as the directors may decide to be divided among them in such proportion and manner as they may agree, or failing agreement, equally.

(e) The Board may grant special remuneration to any director who performs any special or extra services to or at the request of the Bank. Such special remuneration may be paid by way of lump sum, salary, commission, participation in profits, provision for retirement or insurance benefit or otherwise as the Board may decide in addition to his ordinary remuneration (if any) as a director.

(f) The directors shall also be paid out of the funds of the Bank all expenses properly incurred by them in and about the discharge of their duties, including their expenses of travelling to and from the Board meetings, committee meetings and general meetings.

(g) The Board may exercise all the powers of the Bank to:

(i) pay, provide, arrange or procure the grant of pensions or other retirement benefits, and death, disability or sickness benefits, health, accident and other insurances or other such benefits, allowances, gratuities or insurances, including in relation to the termination of employment, to or for the benefit of any person who is or has been at any time a director of the Bank or in the employment or service of the Bank or of any undertaking which is or was associated with the Bank or of the predecessors in business of the Bank or any such associated undertaking or the relatives or dependants of any such person. For that purpose the Board may procure the establishment and maintenance of, or participation in, or contribution to, any pension fund, scheme or arrangement or the payment of any insurance premiums;

(ii) establish, maintain, adopt and enable participation in any profit-sharing or incentive scheme including shares, share options or cash or any similar schemes for the benefit of any director or employee of the Bank or of any associated undertaking, and to lend money to any such director or employee or to trustees on their behalf to enable any such schemes to be established, maintained or adopted; and

(iii) support and subscribe to any institution or association which may be for the benefit of the Bank or of any associated undertaking or any directors or employees of the Bank or associated undertaking or their relatives or dependants or connected with any town or place where the Bank or an associated undertaking carries on business, and to support and subscribe to any charitable or public object whatsoever.

(h) If a situation (a **Relevant Situation**) arises in which a director has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Bank but which does not arise in relation to a transaction or arrangement with the Bank, the director must declare the nature and extent of his interest to the other directors and the directors (other than the director, and any other director with a similar interest, who shall not be counted in the quorum at the meeting and shall not vote on the resolution) may (A) if the Relevant Situation arises from the appointment or proposed appointment of a person as a director of the Bank, resolve to authorise the appointment of the director and the Relevant Situation on such terms as they may determine and (B) if the Relevant Situation arises in other circumstances, resolve to authorise the Relevant Situation and the continuing performance by the director of his duties on such terms as they may determine. Any terms of such authorisation may be imposed at the time of the authorisation or may be imposed or varied subsequently and may include (without limitation):

(i) whether the interested directors may vote (or be counted in the quorum at a meeting) in relation to any resolution relating to the Relevant Situation;

(ii) the exclusion of the interested directors from all information and discussion by the Bank of the Relevant Situation; and

(iii) (without prejudice to the general obligations of confidentiality) the application to the interested directors of a strict duty of confidentiality to the Bank for any confidential information of the Bank in relation to the Relevant Situation.

(i) Any authorisation of a Relevant Situation may provide that, where the interested director obtains (other than through his position as a director of the Bank) information that is confidential to a third party, he will not be obliged to disclose it to the Bank or to use it in relation to the Bank's affairs in circumstances where to do so would amount to a breach of that confidence.

(j) If a director is in any way, directly or indirectly, interested in a proposed or an existing transaction or arrangement with the Bank, he must usually declare the nature and extent of that interest to the other directors.

(k) Subject to any applicable statutory provisions and to having declared his interest to the other directors, a director may:

(i) enter into or be interested in any transaction or arrangement with the Bank, either with regard to his tenure of any office or position in the management, administration or conduct of the business of the Bank, or as vendor, purchaser or otherwise;

(ii) hold and be remunerated in respect of any other office or place of profit with the Bank (except that of auditor) in conjunction with his office of director;

(iii) act by himself or his firm in a professional capacity for the Bank (except as auditor) and be entitled to remuneration for professional services as if he were not a director;

(iv) be or become a member or director of, or hold any other office or place of profit under, or otherwise be interested in, any parent undertaking or subsidiary undertaking of that parent undertaking or any undertaking in which the Bank may be interested; and

(v) be or become a director of any other undertaking in which the Bank does not have an interest if that cannot reasonably be regarded as likely to give rise to a conflict of interest at the time of his appointment as a director of that other undertaking.

(l) A director shall not vote (or be counted in the quorum at a meeting) in respect of any resolution concerning his own appointment (including fixing and varying its terms), or the termination of his own appointment, as the holder of any office or place of profit with the Bank or any other undertaking in which the Bank is interested but, where proposals are under consideration concerning the appointment (including fixing or varying its terms), or the termination of the appointment, of two or more directors to offices or places of profit with the Bank or any other undertaking in which the Bank is interested, those proposals may be divided and considered in relation to each director separately; and in such case each of the directors concerned (if not otherwise debarred from voting under the articles of association) shall be entitled to vote (and be counted in the quorum) in respect of each resolution except that concerning his own appointment or the termination of his own appointment.

(m) A director shall not vote (or be counted in the quorum at a meeting) in respect of any resolution relating to any transaction or arrangement with the Bank in which he has an interest which may reasonably be regarded as likely to give rise to a conflict of interest. Notwithstanding the above, a director may vote (and be counted in the quorum) on: (A) any transaction or arrangement in which he is interested by virtue of an interest in shares, debentures or other securities of the Bank or otherwise in or through the Bank; (B) the giving of any guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of, or for the benefit of, the Bank or any of its subsidiary undertakings; or a debt or obligation of the Bank or any of its subsidiary undertakings for which he himself has assumed responsibility in whole or in part (either alone or jointly with others) under a guarantee or indemnity or by the giving of security; (C) indemnification (including loans made in connection with it) by the Bank in relation to the performance of his duties on behalf of the Bank or of any of its subsidiary undertakings; (D) any issue or offer of shares, debentures or other securities of the Bank or any of its subsidiary undertakings in respect of which he is or may be entitled to participate in his capacity as holder of any such securities or as an underwriter or sub-underwriter; (E) any transaction or arrangement concerning any other company in which he does not hold, directly or indirectly as shareholder, or through his direct or indirect holdings of financial instruments (within the meaning of Chapter 5 of the Disclosure and Transparency Rules) voting rights representing 1 per cent. or more of any class of shares in the capital of such company; (F) any arrangement for the benefit of employees of the Bank or any of its subsidiary undertakings which does not accord to him any privilege or benefit not generally accorded to the employees to whom the arrangement relates; and (G) the purchase or maintenance of insurance for the benefit of directors or for the benefit of persons including directors.

12.13 **General meetings**

An annual general meeting shall be held in accordance with the applicable statutory provisions at such place as may be determined by the Board. Other general meetings shall be held whenever the Board thinks fit or on the requisition of shareholders in accordance with the Companies Act.

Subject to the applicable statutory provisions, an annual general meeting shall be called by at least 21 clear days' notice and all other general meetings shall be called by not less than 14 clear days' notice or by not less than such minimum notice period as is permitted by the applicable statutory provisions.

The requisite quorum for general meetings of the Bank shall be two qualifying persons, representing different members and entitled to vote on the business to be transacted at the meeting. A qualifying person is an individual who is a member of the Bank; a corporate representative; or a proxy.

12.14 **Borrowing powers**

There is no requirement on the directors to restrict the borrowing of the Bank or any of its subsidiary undertakings.

12.15 **Change of name**

The Board may change the name of the Bank.

12.16 **Values and Ethics Committee**

(a) The values and ethics committee (the **V&E Committee**) shall be a committee of the Board and shall recommend to the Board for its approval and adoption the co-operative values and ethical policies of the Bank and shall represent, monitor, and advise the Board on matters concerning the interests of all stakeholders in their dealings with the Bank in line with the objects of the Bank, whilst having regard to: (i) to the legal and regulatory requirements applicable to the Bank and the directors; (ii) the need for the Bank's operations to be commercially sustainable and profitable; and (iii) the desirability of maintaining and enhancing the public reputation and image of the Bank. The V&E Committee shall have the right to engage with any of the directors or senior management of the Bank upon matters of relevance to its purpose and authority.

(b) The V&E Committee shall at least annually prepare and present to the Board for its approval a report on its activities and on its assessment as to the Bank's performance having regard to its values and ethical policies, and the report (in a form approved by the Board) shall be included in the Bank's annual report and accounts in a form approved by the Board. The Bank's shareholders shall be entitled to raise questions on the work of the V&E Committee and the report at the annual general meeting.

(c) The V&E Committee shall be comprised of a minimum of five and a maximum of seven members, of whom: (A) the majority shall be independent directors of the Bank; and (B) at least five shall be directors. The V&E Committee may contain up to two members who are not directors of the Bank, one or both of whom must be senior executives of the Bank and one of whom may be an individual who is not a senior executive of the Bank provided that the individual has credentials appropriate for the role. The chairman of the V&E Committee shall be an independent director of the Bank specifically appointed to act as chairman.

(d) For so long as Co-operative Group directly or indirectly holds 20 per cent. or more of the Bank's ordinary shares, it shall have the right to appoint one of the directors as a member of the V&E Committee, and may at any time remove such director as a member of the V&E Committee by appointing another director in his or her place.

(e) For so long as Co-operative Group directly or indirectly holds 20 per cent. or more of the Bank's ordinary shares, all provisions contained in the articles of association relating to the V&E Committee, the provisions relating to co-operative values and ethical principles, the Co-operative Group's nominee directors and the dividend policy may be amended or repealed only with the prior written consent of Co-operative Group in addition to the passing of a special resolution approving such changes. This provision shall cease to apply upon the earlier to occur of: (i) Co-operative Group ceasing to hold directly or indirectly 20 per cent. or more of the Bank's ordinary shares; and (ii) Co-operative Group ceasing to be a bona fide co-operative society.

12.17 **Co-operative Group Limited Nominee Directors**

For so long as Co-operative Group remains a bona fide co-operative society and directly or indirectly controls:

(a) 25 per cent. or more of the voting rights exercisable at general meetings of the Bank, it shall be entitled to appoint, remove and replace up to two natural persons as directors; or

(b) 20 per cent. or more (but less than 25 per cent.) of the voting rights exercisable at general meetings of the Bank, it shall be entitled to appoint, remove and replace one natural person as a director.

The articles of association also contain details as to the mechanism for such appointments, removals and replacements.

12.18 **Dividends**

(a) Declaration of dividends – the Bank may, by ordinary resolution, declare a dividend to be paid to the members, according to their respective rights and interests in the profits, and may fix the time for payment of such dividend, but no dividend shall exceed the amount recommended by the Board.

When considering any dividend, the board shall take into account the Bank's capital and financial position, cash requirements and liquidity and profits available as well as the Bank's regulatory outlook, capital position, investment needs and principal relevant risk factors subsisting at the time. In addition, the board shall consider the need to balance the division of profits between:

(i) distributions to its shareholders;

(ii) investment in products and services;

(iii) retaining earnings for future development; and

(iv) support for social and/or environmental objectives.

(b) Fixed and interim dividends – the Board may pay such interim dividends as appear to the Board to be justified by the financial position of the Bank and may also pay any dividend payable at a fixed rate at intervals settled by the Board whenever the financial position of the Bank, in the opinion of the Board, justifies its payment. If the Board acts in good faith, none of the directors shall incur any liability to the holders of shares conferring preferred rights for any loss such holders may suffer in consequence of the payment of an interim dividend on any shares having non-preferred or deferred rights.

(c) Calculation and currency of dividends – except insofar as the rights attaching to, or the terms of issue of, any share otherwise provide: (A) all dividends shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is paid, but no amount paid up on a share in advance of calls shall be treated as paid up on the share; (B) all dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid; and (C) dividends may be declared or paid in any currency and the Board may agree with any member that dividends which may at any time or from time to time be declared or become due on his shares in one currency shall be paid or satisfied in another, and may agree the basis of conversion to be applied and how and when the amount to be paid in the other currency shall be calculated and paid and for the Bank or any other person to bear any costs involved.

(d) Dividends not to bear interest – no dividend or other moneys payable by the Bank on or in respect of any share shall bear interest as against the Bank unless otherwise provided by the rights attached to the share.

(e) Calls or debts may be deducted from dividends – the Board may deduct from any dividend or other moneys payable to any person (either alone or jointly with another) on or in respect of a share all such sums as may be due from him (either alone or jointly with another) to the Bank on account of calls or otherwise in relation to shares of the Bank.

(f) Dividends *in specie* – with the authority of an ordinary resolution of the Bank and on the recommendation of the Board, payment of any dividend may be satisfied wholly or in part by the distribution of specific assets and in particular of paid up shares or debentures of any other company.

(g) Scrip dividends – the Board may, with the authority of an ordinary resolution of the Bank, offer any holders of shares the right to elect to receive further shares by way of scrip dividend instead of cash in respect of all (or some part) of any dividend specified by the ordinary resolution.

(h) Unclaimed dividends – any dividend unclaimed for a period of 12 years after having been declared shall be forfeited and cease to remain owing by the Bank.

12.19 **Forfeiture of shares**

If the whole or any part of any call or instalment remains unpaid on any share after the due date for payment, the Board may give a notice to the holder requiring him to pay so much of the call or instalment as remains unpaid, together with any accrued interest.

If the requirements of a notice are not complied with, any share in respect of which it was given may (before the payment required by the notice is made) be forfeited by a resolution of the Board. The forfeiture shall include all dividends declared and other moneys payable in respect of the forfeited share and not actually paid before the forfeiture.

Every share which is forfeited or surrendered shall become the property of the Bank and (subject to the applicable statutory provisions) may be sold, re-allotted or otherwise disposed of, upon such terms and in such manner as the Board shall decide either to the person who was before the forfeiture the holder of the share or to any other person and whether with or without all or any part of the amount previously paid up on the share being credited as so paid up.

12.20 **Communications by the Bank**

Subject to the applicable statutory provisions, a document or information may be sent or supplied by the Bank to any member in electronic form to such address as may from time to time be authorised by the member concerned or by making it available on a website and notifying the member concerned (in accordance with the applicable statutory provisions) of the presence of a document or information on the website. A member shall be deemed to have agreed that the Bank may send or supply a document or information by means of a website if the applicable statutory provisions have been satisfied.

12.21 **Directors' indemnity, insurance and defence**

As far as the applicable statutory provisions allow, the Bank may:

(a) indemnify any director of the Bank (or of an associated body corporate) against any liability;

(b) indemnify a director of a company that is a trustee of an occupational pension scheme for employees (or former employees) of the Bank (or of an associated body corporate) against liability incurred in connection with the company's activities as trustee of the scheme;

(c) purchase and maintain insurance against any liability for any director referred to in paragraph (a) or paragraph (b) above; and

(d) provide any director referred to in paragraph (a) or paragraph (b) above with funds (whether by loan or otherwise) to meet expenditure incurred or to be incurred by him in defending any criminal, regulatory or civil proceedings or in connection with an application for relief (or to enable any such director to avoid incurring such expenditure).

12.22 **Corporate Governance**

For so long as the Ordinary Shares are not admitted to the premium listing segment of the Official List (and there can be no guarantee that the Bank will be able to satisfy the necessary eligibility criteria in order to do so), the Bank shall: (i) use all reasonable endeavours to comply with the UK Corporate Governance Code; and (ii) comply with the provisions of LR 9.8.6R(5) and LR 9.8.6R(6) of the Listing Rules as if they applied to the Bank, in each case, as if the Bank were in the FTSE 350.

12.23 **Significant Transactions, Related Party Transactions, Circulars etc.**

Following, and for the duration of, any admission of the Ordinary Shares to the standard segment of the Official List, the Bank shall adopt and follow policies requiring the Bank to comply with the rules in Chapter 10 (significant transactions), Chapter 11 (related party transactions), Chapter 12 (dealing in own securities and treasury shares) and Chapter 13 (contents of circulars) of the Listing Rules (the **10-13 LRs**), on a voluntary basis, as if the Bank were listed on the premium segment of the Official List.

For so long as the Ordinary Shares are not admitted to either the standard segment or premium segment of the Official List (and there can be no guarantee that the Bank will be able to satisfy the necessary eligibility criteria in order to do so), the Bank shall adopt and follow policies to comply with 10-13 LRs to the extent reasonably practicable and in accordance with the spirit of the 10-13 LRs.

13. DIRECTORS AND SENIOR MANAGEMENT

13.1 The biographies of the Directors and Senior Management are set out in Section 9 (*Directors, Senior Management, Employees and Corporate Governance*).

13.2 The business address of each of the Directors and each of the Senior Managers is CIS Tower, Miller Street, Manchester M60 4EP, United Kingdom.

13.3 In addition to their directorships of the Bank and its subsidiaries, the Directors and members of Senior Management hold, or have held, the following directorships and are or were members of the following partnerships, within the past five years:

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
DIRECTORS			
Niall Booker	Director	Banking Group	Previous
	Deputy Chief Executive	Co-operative Group	Previous
	Chief Executive Officer	HSBC North America Holdings Inc.	Previous
	Chief Executive Officer	HSBC Finance Corporation International	Previous
	Member of Group Management Board	HSBC Holdings plc	Previous
	Chair	Committee of Council of Glenalmond College	Current
Rodney Jensen Bulmer	Director	The Co-operative Academy of Manchester	Current
	Director	CFS Services Limited	Previous

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
	Director	Co-operative Legal Services Limited	Previous
	Director	Banking Group	Previous
	Director	RLUM (CIS) Limited	Previous
	Director	RL Marketing (CIS) Limited	Previous
	Director	Royal London Asset Management (CIS) Limited	Previous
	Chairman	The Co-operative Academy of Manchester	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
Richard Pym	Chairman	Nordax Finans AB (publ)	Current
	Chairman	UK Asset Resolution Limited	Current
	Chairman	Bradford & Bingley plc	Current
	Chairman	Northern Rock (Asset Management) plc	Current
	Chairman	BrightHouse Group plc	Current
	Chairman	Banking Group	Previous
	Non-Executive Director	The British Land Company plc	Previous
	Chairman	Halfords Group plc	Previous
	Group Chief Executive	Mortgage Express	Previous
	Director	Old Mutual plc	Previous
John Richard Coates	Non-Executive Director	Police Mutual Assurance Society	Current
	Director	Banking Group	Previous
	Managing Director	Baseline Capital Limited	Previous
	Non-Executive Director	Northern Rock PLC	Previous
Anne Margaret Gunther	Venture Partner	Octopus Investment Managers	Current
	Non-Executive Director	MBNA Limited	Current
	Non-Executive Director	North East and West Devon NHS Clinical Commissioning Group	Current
	Chair	Warwick Business School	Current
	Director	Banking Group	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
	Chief Executive	Standard Life Healthcare	Previous
	Chief Executive	Standard Life Bank plc	Previous
	Director	Standard Life Assurance Limited	Previous
	Director	Standard Life Client Management Limited	Previous
	Director	Standard Life Wealth Limited	Previous
	Director	Norwich & Peterborough Building Society	Previous
	Director	Lynch Wood Insurance Services Limited	Previous
	Director	Lynch Wood Services Limited	Previous
	Director	Norwich & Peterborough General Insurance Services Limited	Previous
	Director	Norwich & Peterborough Sharedealing Services Limited	Previous
	Director	Water Lunniss Nominees Limited	Previous

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
	Trustee and Chair of Audit/Finance Committee	Arts & Business	Previous
	Council Member	Council of Mortgage Lenders	Previous
Merlyn Vivienne Lowther	Trustee	Winston Churchill Memorial Trust	Current
	Trustee and Vice Chairman	The Henry Smith Charity	Current
	Director	Banking Group	Previous
	Director	Royal London Asset Management (CIS) Limited	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
	Non-Executive Director	Schroders plc	Previous
Euan Angus Sutherland	Non-Executive Director	Super Group plc	Current
	Chief Executive	Co-operative Group	Current
	Director	Banking Group	Current
	Chief Executive Officer	Kingfisher UK & Ireland	Previous
	Chief Operating Officer	Kingfisher plc	Previous
	Chairman	B&Q plc	Previous
Richard Graeme Barclay Hardie	Member	Shelter Scotland	Current
	Director	Northpoint Consultancy Services Limited	Current
	Non-Executive Director	FNZ (UK) Limited	Current
	Director	Banking Group	Previous
	Non-Executive Director	Metro Bank UK Limited	Previous
	Non-Executive Director	Dunfermline Building Society	Previous
	Director	Abbey National Bank plc	Previous
	Senior Adviser	Hartford Life (Europe) Limited	Previous
Bennett Lyle Edward Reid	Member of the Board of Governors	University of Wolverhampton	Current
	Director	Co-operative Group Holdings (2011) Limited	Current
	Director	Co-operative Group	Current
	Chair	Walsall Healthcare NHS Trust	Current
	Chief Executive	The Midcounties Co-operative	Current
	Non-Executive Director	Banking Group	Previous
	Director	CIS General Insurance	Previous
	Director	Royal London (CIS) Limited	Previous
	Chief Executive Officer	Walsall Regeneration Company Limited	Previous
William Gennydd Thomas	LLP Member	The Invicta Film Partnership, LLP	Current
	Non-Executive Independent Director	XChanging plc	Current
	Independent Director	Balfour Beatty plc	Current
	Non-Executive Independent Director	GFI SA	Current
	Chair of Advisory Board	Cranfield University School of Management	Current
	Member of Advisory Board	Leeds University Business School	Current

Name	*Position*	*Company/Society/Partnership*	*Status (Current/ Previous)*
	Corporate President	EDS Finance Limited	Previous
	Corporate President	HP Enterprise Services Defence & Security UK Ltd	Previous
	Corporate President	HP Enterprise Services UK Ltd	Previous
	Corporate President	E.D.S. International Limited	Previous
	Corporate President	EDS Nominees Limited	Previous
SENIOR MANAGERS			
John Baines	Director	John Baines Consulting Limited	Current
	Chief Financial Officer	Aldermore Bank plc	Previous
	Director	Aldermore Bank plc	Previous
	Chief Executive Officer, Wealth Management Division	Royal Bank of Scotland Group plc	Previous
	Director	AC Acquisitions Limited	Previous
	Director	Coutts & Company	Previous
	Director	RBS Coutts Bank Limited	Previous
Grahame McGirr	Director	Naissance UK Limited	Current
	Director	Naissance Capital Limited	Current
	Representative of the Members on the LLP Management Committee	The Covered Bond LLP	Current
	Representative of the Members on the LLP Management Committee	Moorlands Covered Bonds Limited Liability Partnership	Current
	Chief Risk Officer	Banking Group	Previous
Liam Coleman	Non-Executive Director	The Great Western Hospitals NHS Foundation Trust	Current
	Deputy Group Treasurer	Royal Bank of Scotland plc	Previous
	Group Director, Treasury	Nationwide Building Society	Previous
Julie Harding	HR Director	Banking Group	Previous
	Global Head HR Transformation	HSBC Holdings plc	Previous
	Head of HR UK Bank	HSBC Bank plc	Previous
Robert Rickert	Chief Operating Officer and Finance Director and Board Member	DTZ Holdings PLC	Previous
	Managing Director	UBS	Previous
	Chief Information Officer, Global Retail	Barclays Global Retail and Commercial Bank	Previous

13.4 Save as disclosed below, as at the date of this Prospectus none of the Directors or members of the Senior Management has at any time within at least the past five years:

(a) save as disclosed in this paragraph 13, been a director or partner of any companies or partnerships; or

(b) had any convictions in relation to fraudulent offences (whether spent or unspent); or

(c) been adjudged bankrupt or entered into an individual voluntary arrangement; or

(d) been a director of any company at the time of, or within 12 months preceding, any receivership, compulsory liquidation, creditors' voluntary liquidation, administration, company voluntary arrangement or any composition or arrangement with that company's creditors generally or with any class of its creditors; or

(e) been a partner in a partnership at the time of, or within 12 months preceding, any compulsory liquidation, administration or partnership voluntary arrangement of such partnership; or

(f) had his assets form the subject of any receivership or been a partner of a partnership at the time of, or within 12 months preceding, any assets thereof being the subject of a receivership; or

(g) been subject to any official public incrimination and/or sanctions by any statutory or regulatory authority (including any designated professional body); or

(h) ever been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company.

13.5 Richard Graeme Barclay Hardie was a non-executive director of Dunfermline Building Society from September 2008 to March 2009. A sale process was conducted by the Bank of England in March 2009 under the Special Resolution Regime provisions of the Banking Act. Richard was brought in by Dunfermline Building Society to assist with the challenges it was facing at the time.

Richard Pym has been Chairman of Northern Rock (Asset Management) plc since January 2010. Northern Rock plc was nationalised and taken into Government ownership in February 2008 and was then restructured into two legal entities on 31 December 2009 – Northern Rock plc and Northern Rock (Asset Management) plc. Richard was appointed Chief Executive of Bradford & Bingley in August 2008 and was appointed Chairman in November 2008. On 29 September 2008, all of Bradford & Bingley's retail branches and its savings accounts were transferred to Abbey, and subsequently rebranded Santander. The remainder of the business, including the mortgage books of Bradford & Bingley and specialist lending arm Mortgage Express were nationalised and taken into public ownership by the Government. Since July 2010 Richard has been Chairman of UK Asset Resolution Limited which was established to facilitate the orderly management of the closed mortgage books of both Bradford & Bingley plc and Northern Rock (Asset Management) plc to maximise value for taxpayers.

14. DIRECTORS' AND SENIOR MANAGERS' INTERESTS IN THE BANK

14.1 As at the date of this Prospectus and as is expected to be the position immediately following completion of the Liability Management Exercise, neither the Directors nor the Senior Managers, and none of their respective immediate families, have any interests in the share capital of the Bank which:

(a) are required to be notified to the Bank pursuant to Chapter 3 of the Disclosure and Transparency Rules; or

(b) are interests of a connected person (within the meaning of Schedule 11B of FSMA) which would be required to be disclosed under paragraph (a) above and the existence of which is known to or could with reasonable diligence be ascertained by that Director or Senior Manager.

14.2 No Director or Senior Manager will have any interest in the share capital or loan capital of the Bank on completion of the Liability Management Exercise and there is no person to whom any capital of any member of the Bank or any of its subsidiaries is under award or option or agreed unconditionally to be put under award or option.

14.3 Euan Angus Sutherland is the Chief Executive of Co-operative Group and a director of Banking Group. Bennett Lyle Edward Reid is a director of Co-operative Group Holdings (2011) Limited and Co-operative Group. Euan and Bennett are nominee directors of Co-operative Group and are intended to constitute nominee directors for the purposes of the Articles of Association of the Bank which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, and as referred to in the Relationship Agreement. Under the terms of the Relationship Agreement, Co-operative Group acknowledges that its nominee director(s) shall not be able to vote at Board meetings of the Bank on any matter where there is a conflict of interests or potential conflict of interests between the Bank or any of its subsidiaries (on the one hand) and Co-operative Group or any of its subsidiaries (excluding the Bank and its subsidiaries) (on the other hand).

Save as disclosed in this paragraph, none of the Directors or Senior Managers has any potential conflict of interest between their duties to the Bank and their private interests and/or their duties to third parties.

14.4 None of the Directors or Senior Managers has or has had any interest in any transaction which is or was unusual in its nature or conditions or significant to the business which was effected by the Bank or any of its subsidiaries during the current or immediately preceding financial year, or which was effected during an earlier financial year and remains in any respect outstanding or unperformed.

14.5 None of the Directors or Senior Managers has or had a beneficial interest in any contract to which the Bank or any of its subsidiaries was a party during the current or immediately preceding financial year.

14.6 Except as disclosed below, no Director or Senior Manager was selected to act in such capacity pursuant to any arrangement or understanding with any shareholder, customer, supplier or any other person having a business connection with the Bank or any of its subsidiaries.

Pursuant to the Articles of Association of the Bank, which will be proposed for approval at a general meeting of the Bank to be held on 15 November 2013, and as referred to in the Relationship Agreement, Co-operative Group will have the right to nominate up to two persons to be members of the Board for so long as certain circumstances continue to exist. As at the date of this Prospectus, Co-operative Group's nominated directors are Euan Angus Sutherland and Bennett Lyle Edward Reid and they are intended to constitute as such under the Articles of Association of the Bank. Please refer to paragraph 20.3 titled "*Relationship Agreement*" in this Section 20 (*Additional Information*) for further details of the Relationship Agreement.

14.7 There are no family relationships between any of the Directors or Senior Managers.

15. MATERIAL SHAREHOLDINGS

Apart from the Liability Management Exercise, the result of which, if successful, will reduce Banking Group's shareholding of the issued Ordinary Shares in the Bank to 30 per cent., the Bank and the Directors are not aware of any arrangement the operation of which may at a subsequent date result in a change in control of the Bank.

16. SHARE INCENTIVE PLANS

The Directors intend to consider after completion of the Liability Management Exercise the long-term incentive arrangements over the Ordinary Shares of the Bank and will seek shareholder approval in respect of such arrangements, as required.

17. PENSION SCHEMES

(a) Summary of UK pension benefits

17.1 The Co-operative Pension Scheme (Pace) (**Pace**)

The Bank participates in Pace. Pace is a non-segregated hybrid scheme providing defined contribution benefits and defined benefits based on a member's average career salary and length of contributory membership of the scheme. The defined contribution benefits are provided under two defined contribution sections, Pace Essential (**Pace Essential**) and Pace Extra (**Pace Extra**). Although any employee may join the Pace Essential and the Pace Extra sections, employees can choose to join the defined benefit section, Pace Complete (**Pace Complete**), once they have completed two or more consecutive years' service. In addition, benefits accrued on a defined benefits basis prior to 6 April 2006 continue to be linked to final salary. The introduction of the automatic enrolment legislation requires qualifying employees to be automatically enrolled into a pension scheme and Pace Essential was designed with this legislation in mind.

As at June 2013, Pace had 133,826 members (54,984 active members (of whom 15,193 belong to Pace Complete), 41,591 deferred pensioners (of whom 40,226 belong to Pace Complete) and 37,251 pensioners (all of whom belong to Pace Complete)). Members of Pace Essential make contributions of 1 per cent. with Co-operative Group and those of its subsidiaries participating in Pace contributing 2 per cent. and members of Pace Extra make contributions of 4 per cent. with Co-operative Group and those of its subsidiaries participating in Pace contributing 8 per cent. The member contribution rate to Pace Complete is currently 8 per cent. In the financial year ended 31 December 2012 the Bank made contributions of £29.1 million to Pace (of which £8.3 million related to the past service deficit in Pace Complete).

Pace is currently undergoing an actuarial valuation as at 5 April 2013. The most recent actuarial valuation of Pace was carried out as at 5 April 2010. This valuation reported assets at a value of £5,827 million and liabilities of £6,075 million and a funding deficit of £248 million. The most recent update to this valuation as at 5 April 2013 indicated that the funding deficit had increased to £715 million. Under the schedule of contributions agreed following the 2010 actuarial valuation, the participating employers in Pace agreed to pay deficit reduction contributions of £20 million a year, from 1 April 2011 until 31 March 2019 inclusive. In the financial year ended 31 December 2012, the Bank contributed £8.3 million out of the £20 million.

17.2 Britannia Pension Scheme (the **Britannia Scheme**)

The Bank has granted two guarantees in respect of the Britannia Scheme: one in respect of CFSMS' scheme funding and employer debt obligations in relation to the Britannia Scheme and one in respect of the participating employers' liabilities in relation to the Britannia Scheme up to 105 per cent. funding on the section 179 Pensions Act 2004 valuation basis, which is used for the purposes of calculating the scheme-based element of the Pension Protection Fund levy payable by a defined benefit pension scheme. The Britannia Scheme is a hybrid scheme providing defined benefit and defined contribution benefits. The Britannia Scheme closed to future accrual from 6 October 2012. Defined benefits built up to this date continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier. As at 5 April 2013, the Britannia Scheme had 5,138 members (734 active/closure members, 3,290 deferred pensioners and 1,114 pensioners). Members of the Britannia Scheme were invited to join Pace in October 2012.

The most recent actuarial valuation of the Britannia Scheme was carried out as at 5 April 2011. This valuation reported that there was a deficit on the funding basis of £3.7 million. A lump sum was paid to the Britannia Scheme of £3.7 million by 30 April 2012 to eliminate this deficit. The most recent update to this valuation as at 5 April 2013 indicated that the funding deficit had increased to £61 million. During the financial year ended 31 December 2012, the Bank paid £7.9 million to the Britannia Scheme to cover contributions to the defined benefit and defined contribution sections and contributions under salary sacrifice. A fixed allowance of £1 million per annum for running expenses was also paid. As the Britannia Scheme is now closed to future accrual, there will be no further contributions in respect of future service accrual.

17.3 Other pension schemes

The Bank is connected and/or associated with employers in Co-operative Group that participate in other Co-operative Group defined benefit pension schemes, all of which are closed to new entrants and future accrual (other than a final salary link for past service). The Bank does not however participate in or guarantee the liabilities of these schemes.

17.4 Unfunded arrangements

The Bank operates several unfunded unregistered retirement benefit arrangements relating to a discretionary early retirement facility and pension arrangements for current and former Bank executives. The most recent actuarial valuations of these arrangements indicated that the Bank's unfunded pension liabilities amounted to £4 million as at 31 December 2012.

(b) Co-operative Group has engaged in discussions with the trustees of the funded pension schemes and the Pensions Regulator. These discussions have centred on the effect on the pension schemes of the turnaround plan, in particular on the future funding of the pension schemes and the position of the trustees as creditors compared with that of other creditors. These discussions have not yet concluded and Co-operative Group continues to seek to satisfy the trustees and the Pensions Regulator on the matters they have raised.

(c) There are currently no provisions made or amounts set aside or accrued by the Bank for the pensions of the Directors and Senior Managers for the year ended 31 December 2012.

(d) Summary of overseas pension benefits

Britannia International Limited, a wholly owned subsidiary of the Bank, contributes to a group personal pension plan, called the Britannia International Group Personal Pension Plan. This is a defined contribution arrangement in the Isle of Man.

18. SIGNIFICANT SUBSIDIARY AND ASSOCIATED UNDERTAKINGS

18.1 The following table shows details of the Bank's significant subsidiary companies:

Name	*Owner*	*Percentage Ownership*	*Country of incorporation/ residence*	*Principal activity*
Unity Trust Bank plc *(held through subsidiary undertaking)*[(1)]	Bank	27	England	Banking
Co-operative Commercial Limited	Bank	100	England	Investment company
First Roodhill Leasing Limited	Bank	100	England	Leasing
Second Roodhill Leasing Limited	Bank	100	England	Leasing
Third Roodhill Leasing Limited	Bank	100	England	Leasing
Fourth Roodhill Leasing Limited	Bank	100	England	Leasing
Britannia Treasury Services Limited	Bank	100	England	Holding company
Britannia Asset Management Limited	Bank	100	England	Holding company
Britannia Development and Management Company Limited	Bank	100	England	Property investment
Illius Properties Limited	Bank	100	England	Property investment
Moorland Covered Bonds LLP	Bank	100	England	Mortgage acquisition and guarantor of covered bonds
Britannia International Limited	Bank	100	Isle of Man	Deposit taking
Britannia Life Direct Limited	Britannia LAS Direct Limited[(2)]	100	Scotland	Direct sales of financial services
Mortgage Agency Services Number One Limited	Britannia Treasury Services Limited	100	England	Mortgage and syndicated lending

Name	*Owner*	*Percentage Ownership*	*Country of incorporation/ residence*	*Principal activity*
Mortgage Agency Services Number Two Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Mortgage Agency Services Number Four Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Mortgage Agency Services Number Five Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Mortgage Agency Services Number Six Limited	Britannia Treasury Services Limited	100	England	Mortgage lending
Western Mortgage Services Limited	Britannia Treasury Services Limited	100	England	Mortgage book administration
Platform Group Holdings Limited	Britannia Treasury Services Limited	100	England	Holding Company
Platform Consumer Services Limited	Platform Group Holdings Limited	100	England	Mortgage lending
Platform Funding Limited	Platform Consumer Services Limited	100	England	Mortgage origination
Platform Home Loans Limited	Platform Consumer Services Limited	100	England	Mortgage origination and servicing

Notes:

(1) Unity Trust Bank plc is considered to be a subsidiary undertaking of the Bank as the Bank elects a majority of the directors and appoints the chair and managing director. This provides the power to control.

(2) Britannia LAS Direct Limited was incorporated in Scotland and is a dormant wholly-owned subsidiary of the Bank.

18.2 The results of the principal securitisation vehicles listed below are consolidated into the results of the Bank under SIC 12 (Consolidation: Special Purpose Entities). All securitisation vehicles are registered in England and operate in the UK.

Name	*Principal activity*
Leek Finance Number Seventeen plc	Securitisation company
Leek Finance Number Eighteen plc	Securitisation company
Leek Finance Number Nineteen plc	Securitisation company
Leek Finance Number Twenty plc	Securitisation company
Leek Finance Number Twenty One plc	Securitisation company
Leek Finance Number Twenty Two plc	Securitisation company
Meerbrook Finance Number One Limited	Securitisation company
Meerbrook Finance Number Two Limited	Securitisation company
Meerbrook Finance Number Three Limited	Securitisation company
Meerbrook Finance Number Four Limited	Securitisation company
Meerbrook Finance Number Six Limited	Securitisation company
Silk Road Finance Number One plc	Securitisation company
Silk Road Finance Number Two plc	Securitisation company
Silk Road Finance Number Three plc	Securitisation company
Cambric Finance Number One plc	Securitisation company

19. PROPERTY, PLANT AND EQUIPMENT

19.1 The following are the principal establishments and assets of the Bank and its subsidiaries:

Name and Location	*Notes*	*Type of facility/asset*	*Tenure*
9th Floor Arndale Tower Manchester M3 3AQ	1	Office	Leasehold
CIS Building Miller Street Manchester M60 0AL	2	Office	Leasehold
The Money Centre Drake Circus Plymouth PL1 1QH		Office	Leasehold
Britannia House Cheadle Road Leek Staffordshire ST13 5RG	3	Office	Freehold
Newton House Leek ST13 5RG	4	Office	Freehold
Prescot Street 9 Prescot Street London E1 8AZ		Office	Leasehold
1 Balloon Street Manchester M60 4EP		Office / Branch	Leasehold

Name and Location	*Notes*	*Type of facility/asset*	*Tenure*
Olympic House 6 Olympic Court Montford Street Salford Greater Manchester M5 2QP		Data Centre	Freehold
Montford House Unit 540 Montford Court Montford Street Salford Greater Manchester M5 2SN		File Store	Leasehold
Delf House Southway Skelmersdale Lancashire WN8 6NY	5	Office	Leasehold
Pennylands CNT Building Pennylands Skelmersdale Lancashire WN8 8AZ		Office	Freehold
The Pyramid Kings Valley Office Park Yew Street Stockport Cheshire SK4 2JN	6	Office	Freehold
Sandalwood Court Springwood Way Tytherington Business Park Macclesfield SK10 2XR		Data Centre	Leasehold
St Pauls House 8-12 Warwick Lane London EC4M 7BP	7	Office	Sublease

Notes:

(1) CFSMS has a lease over this property which is guaranteed by the Bank. It is expected that the Bank will have the right to occupy the property pursuant to an underlease which will be entered into on arm's length commercial terms and in the ordinary course of business.

(2) Co-operative Group owns the freehold to this property. The Bank will shortly be acquiring a lease over the property from Co-operative Group which will be entered into on arm's length commercial terms and in the ordinary course of business.

(3) The freehold for this property is owned by a wholly-owned subsidiary of the Bank and the Bank has a lease over the property with the subsidiary.

(4) The freehold for this property is owned by a wholly-owned subsidiary of the Bank and the Bank has a lease over the property with the subsidiary.

(5) The Bank had a 25-year lease over this property which ended on 28 September 2013. The Bank is currently in negotiation with the landlord over the terms of renewal.

(6) The freehold for this property is owned by a wholly-owned subsidiary of the Bank and the Bank has a lease over the property with the subsidiary.

(7) Co-operative Group owns the interest in the head-lease to this property. The Bank will shortly be acquiring a sublease over four floors of the property with Co-operative Group which will be entered into on arm's length commercial terms and in the ordinary course of business.

19.2 No single tangible fixed asset (including property, plant and equipment) accounts for more than 10 per cent. of the Bank's net turnover or production.

20. MATERIAL CONTRACTS

The following is a summary of each contract (not being a contract entered into in the ordinary course of business) that has been entered into by the Bank or any of its subsidiaries either (a) within two years preceding the date of this document which are material to the Bank or any of its subsidiaries; or (b) at any time and contains any provision under which the Bank or any of its subsidiaries has an obligation or entitlement that is material to the Bank or any of its subsidiaries and is outstanding at the date of this Prospectus:

20.1 Project Unity

In connection with Project Unity, the Bank and CFSMS entered into intra-group agreements between 2011 and 2013 to govern the provision of certain services by Co-operative Group (as service provider) to Banking Group (as service recipient). The Bank expects to enter into amended versions of these agreements on or prior to completion of the Liability Management Exercise. Details of the current agreements and the revised agreements in the form in which they were contemplated for the purposes of the 17 June Plan, are summarised below. As mentioned in paragraph 8 titled "*Separation*" in Section 8 ("*Description of the Bank*"), the Bank and Co-operative Group are considering whether any additional amendments (including to the scope of services and key terms) are required to the Project Unity agreements to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

(a) IT Services Agreement

The Bank currently receives IT services under an agreement dated 5 July 2012 (as amended and restated from time to time and including most recently on 22 May 2013) with Co-operative Group and CFSMS, pursuant to which Co-operative Group provides members of Banking Group and Co-operative Insurance Society Limited with a wide range of IT services (the **Existing IT Services Agreement**). It is intended that the Existing IT Services Agreement will be amended prior to or on completion of the Liability Management Exercise.

The Bank originally appointed CFSMS as its agent in order to perform all of its obligations and exercise all of its rights under the Existing IT Services Agreement. However, in light of the importance of these services to the Bank, it was proposed under the New IT Services Agreement, that Bank terminate the appointment of CFSMS as its agent so that it could enforce its rights directly against Co-operative Group.

Under the New IT Services Agreement contemplated for the 17 June Plan, it was proposed that Co-operative Group provide the Bank with the following services:

- colleague technology services (the technologies that individuals rely upon to do their daily work), including:
  - Bank branch maintenance – support and the maintenance of the agreed equipment of the agreed branch estate;
  - managed print services – technical support, repair and provision of multifunctional devices and printers for all sites as agreed,
  - e-mail and collaboration – maintain and make available the email and collaboration services (e.g. intranet); and
  - managed desktop and mobile devices – provide software and hardware support for the desktops and mobile devices;

- network services (provision of the communications infrastructure), including:
  - data network services – maintain and make available the data network infrastructure to support the services;
  - voice network services – maintain and make available voice network and telephony infrastructure to support the services; and
  - remote access services – provision and maintain the remote access services to allow remote workers to connect securely to the data network;
- core services (provision of the main computing infrastructure), comprising:
  - enterprise computing: (i) mainframe services; (ii) mid-range services; (iii) database services; (iv) storage management; (v) capacity planning; and (vi) intel services. This service maintains current and future availability of the mainframe and mid-range computing environments to host the business's applications, supported with appropriate database and storage technologies, to meet the business's current and forecasted requirements;
  - output management – develop and maintain bulk print management solutions to support customer correspondence according to the needs of the business;
  - middleware services – maintain and make available the (middleware) services to ensure that all data and messages are successfully delivered between key systems and internal and external services;
  - systems management – maintain and make available the systems management environments to ensure that all key platforms, systems and services are proactively managed in line with agreed service levels;
  - data centre management – provide and manage data centre facilities required to host the computer hardware and infrastructure required to deliver the services; and
  - computer operations and production support – running the online services and continuous batch processing of mainframe and mid-range computer systems that deliver the services;
- service management services (support for the day-to-day operational service and future service planning);
  - problem management – to minimise the adverse impact of problems resulting from one or more incidents;
  - change management – provide standardised methods and procedures for the handling of IT/project change and mandatory IT/project change in order to minimise disruption to the services;
  - service desk and incident management – provide a single point of contact for incident notification and escalation and to attempt 'first level' incident resolution, and to manage incidents that have not been classed as major incidents from detection to restoration so as to endeavour to minimise the adverse impact of incidents;
  - major incident management – manage incidents that have been classed as 'major incidents' from detection to the point of service restoration;
  - request fulfilment – provide capability for the logging of service requests to order IT supplied goods and services, and the subsequent management of such service requests through to completion;

  - service level management (management information and reporting) – manage the quality, quantity and performance of the services provided; and
  - capacity management – provide infrastructure capacity management service based upon customer projection and current usage;
- change management services (support the introduction of new/amended systems and infrastructure);
  - environment management – ongoing support, management (including rationalization), monitoring and reporting of the non-production environments;
  - non-function testing service – operational acceptance testing, performance testing;
  - data provision services – provide compliant data provisioning and control services in compliance with data governance policy, data protection policy and security policies and standards;
  - infrastructure build – build required infrastructure components as defined in the infrastructure design document that complies with agreed IT policies and standards;
  - service authority – to ensure that new systems can be accepted into IT operations without disruption, or to prepare IT operations for the transition of new systems; and
  - technical design – the creation, documentation and agreement of the design of IT programmes which would be built to meet the requirements of a new project;
  - IT programme management office – provide a centralised IT Programme Management Office (**PMO**). The PMO would define and maintain all IT frameworks and standards for the 'delivery community'. The PMO would also be the source of guidance and metrics whilst assuring quality and management information on all supported projects; and

It was proposed that the IT service continuity and disaster recovery function, which is currently provided to the Bank by Co-operative Group under the Existing IT Services Agreement, would return to the Bank under the New IT Services Agreement and that Bank would manage the Bank's receipt of Co-operative Group's provision of these services.

Under the New IT Services Agreement it was further proposed that Bank would manage the receipt of the Co-operative Group's provision of the services provided. The Bank's head of 'IT Service Management' (who reports into the Bank's Chief Information Officer) will manage the receipt of the services provided by Co-operative Group under the New IT Services Agreement.

Key Terms of the New IT Service Agreement

The day-to-day operational management of the services supplied under the New IT Services Agreement would be monitored by a Co-operative Group contract manager (as the supplier of the services), a Bank contract manager (as a customer), functional leads for Co-operative Group and the Bank and risk, audit and compliance for the Bank.

Under the New IT Services Agreement, unless service levels are expressly agreed between the parties in respect of a service to be provided under the agreement, Co-operative Group would be required to provide the services to the same standards as those provided to Banking Group before the service commencement date. The Bank would be required to ensure that its systems are in good working order and suitable for purpose, and assets are maintained to a reasonable level of currency. Co-operative Group would be relieved from its responsibility to provide the services where caused by failure of any Bank system, or any legacy Bank systems used by Co-operative Group, which would have a material adverse effect on the ability of Co-operative Group to provide the services.

Under the New IT Services Agreement, services would be provided by Co-operative Group in accordance with Co-operative Group policies, unless Co-operative Group and the Bank agreed, or agreed in the future, that a Bank policy should apply in substitution for the relevant Co-operative Group policy. The Bank could require that Co-operative Group provides the services in accordance with Bank policies where required by law or a regulator.

Charges would be paid quarterly and in arrears unless a "Special Resolution Event" occurred, in which case charges would be payable three months in advance.

The New IT Services Agreement would continue in force until terminated by any party.

The Bank would have step-in rights to perform or manage the services, or appoint a third party to do so, upon notice to Co-operative Group following the occurrence of certain defined trigger events (e.g. a material breach by Co-operative Group). An exit plan would be prepared and kept updated. During the exit period, Co-operative Group would be required to provide any reasonable assistance required by the Bank to allow relevant services to continue.

The Bank and CFSMS would each be entitled to nominate persons to which all or part of the business of a service recipient had been transferred as a result of a special resolution event, excluding affiliates of service recipients (**Special Resolution Recipients**) who would be entitled to the benefit of the New IT Services Agreement for an interim period. Any Special Resolution Recipient could enforce certain provisions in the agreement even though the relevant provision may only refer to the Bank or other service recipients. Co-operative Group, upon request by the service recipient, would offer to enter into a direct agreement with the Special Resolution Recipient to which all or part of the business of the service recipient has been transferred for the supply of services on the same terms as the New IT Services Agreement. The Bank and CFSMS would each be entitled to nominate divested entities (which include normal course of business disposals as well as disposals on a special resolution event) to receive services under the New IT Services Agreement and exit services for up to 12 months, but with the addition of a mark-up of 20 per cent. on the charges. During the interim period prior to the Special Resolution Recipient entering into a direct agreement with Co-operative Group, the Bank would remain responsible for payment of any charges in relation to services provided to Special Resolution Recipients nominated by the Bank, as well as for any liability arising from any act or omission of the Special Resolution Recipient that would have given rise to liability on the part of the Bank if it was an act or omission of the Bank.

(b) MSA

The Bank entered into a professional services master services agreement with Co-operative Group and CFSMS dated 14 February 2013 (as amended from time to time) pursuant to which Co-operative Group provides the Bank with certain services (the **Existing MSA**). It is intended that the Existing MSA will be amended prior to or on completion of the Liability Management Exercise. The Bank initially appointed CFSMS as its agent in order to perform all of its obligations and exercise all of its rights under the Existing MSA. However, in light of the importance of these services to the Bank, it was proposed under the New MSA that Bank terminate the appointment of CFSMS as its agent so that it could enforce its rights directly against Co-operative Group.

The New MSA is a framework agreement, intended to establish a flexible contractual arrangement to enable the Bank and CFSMS to obtain certain professional services from Co-operative Group as agreed from time to time in service contracts.

Service contracts that would be entered into pursuant to the New MSA would be in substantially the same form as one another as they are to be based on a template contained in the New MSA and serve to give effect to and implement the purposes of the New MSA. Each service contract would detail the services to be provided under that service contract and include details of certain key provisions relating to the term, charges, service levels, governance and business continuity. Each service contract would also contain an exit plan based on a template contained in the New MSA and any other additional requirements specific to the services being provided pursuant to that service contract.

As contemplated for the 17 June Plan, it was proposed that services contracts would be entered into (on or before completion of the Liability Management Exercise) in relation to the following:

(i) Secretariat (Governance)

Under the Existing MSA the Bank's secretariat governance function is provided by Co-operative Group. Pursuant to the New MSA, the company secretary for the Bank and the Bank chair would be appointed by the Bank's Board, reporting to the CEO of the Bank and the Bank chair, and would lead a team of specialist company secretaries. The Bank company secretary's duties will include:

- setting governance schedules and agendas in line with the Bank's requirements and obligations; and
- directing the preparation of company records, accounts and regulatory returns and, at his discretion, utilising administrative support from Co-operative Group.

Co-operative Group would provide the following logistical and administrative support to the Bank, as directed by the Bank:

- organising meetings (including annual general meetings, board meetings, and board committee meetings);
- collating briefing materials (as per the agenda) on segregated file storage to maintain confidentiality;
- distributing briefing materials via segregated infrastructure; and
- signing and sealing of documents as required.

Minutes of meetings would be kept by the company secretary of the Bank and be distributed via Co-operative Group's logistical and administrative support function.

The operation of the FCA Approved Persons Regime would, under the New MSA, continue to be undertaken within the Bank.

Monthly service reviews would monitor the effectiveness of Co-operative Group's logistical and administrative support to the Bank, with operational issues being escalated by the Bank's company secretary to Co-operative Group's company secretary.

(ii) Legal

Under the Existing MSA, Co-operative Group provides the Bank with a variety of legal services. Under the New MSA, Co-operative Group would no longer provide these services to the Bank. Instead, the Bank would, on or prior to completion of the Liability Management Exercise, appoint a General Counsel (as 'Head of Legal') to report to the CEO of the Bank. The Bank's Head of Legal would be supported by the following specialist legal roles:

- 'Senior Manager Treasury (Legal)' with a supporting team of appropriate expertise providing core bank corporate banking and treasury markets capability; and

- ‘Head of Regulatory (Legal)’ with a supporting team of appropriate expertise providing regulatory support product documentation and compliance capability.

(iii) Corporate Affairs

Under the Existing MSA, Co-operative Group provides the Bank with corporate affairs services (which comprises (a) internal communications; (b) public relations; (c) public affairs; and (d) social goals and sustainability and ethics).

Under the New MSA, these functions would be controlled and managed by the Bank. The Bank would provide Co-operative Group with instructions in the form of briefing memos, setting out the communication action to be carried out by Co-operative Group, who would execute the instructions. Furthermore, pursuant to the New MSA, the parties to the New MSA would establish a service management framework under which the Bank would conduct a monthly review of the corporate affairs services to be provided by Co-operative Group.

Internal Communications

The ‘Internal Communications’ function:

- promotes employee engagement;
- deals with the communication of day-to-day business information and updates to employees;
- provides advice and practical support to senior managers delivering major change programmes;
- protects, promotes and enhances business interests and corporate reputation through internal communications; and
- designs, develops and implements employee-influencing strategies to shape regulation and legislation for the benefit of the Bank.

Investor Relations

Under the New MSA, the Bank’s ‘Investor Relations’ function would be led from within the Bank by a ‘Head of Investor Relations’, who would be responsible for the Bank’s Investor Relations activities and would provide direction to Co-operative Group’s public relations team, who would carry out the Head of Investor Relations’ directions.

Public Relations

The Bank’s ‘Public Relations’ function consists of: (i) reputational risk management; (ii) PR campaign management; (iii) PR monitoring and evaluation; and (iv) media relations.

Public Affairs:

The ‘Public Affairs’ function:

- protects, promotes and enhances business interests and corporate reputation;
- designs, develops and implements influencing strategies to shape regulation and legislation for the benefit of the Bank;
- provides timely monitoring and intelligence to the Bank executive on legislative developments and advises on their potential significance, monitoring the external political and regulatory landscape with a view to managing challenges and opportunities in terms of reputational impact;

- supports development and promotion of public policy positions;
- advises and provides guidance to senior managers to support their engagement with public affairs stakeholders; and
- identifies and optimises business development opportunities created and controlled by government.

Social Goals & Sustainability and Ethics

Direction of this service would be set by the Bank's ethical policy and plan which is approved by the Bank's board of directors. Oversight would be provided throughout at the Bank's executive meetings.

The 'Social Goals and Sustainability and Ethics' function provides the following services:

- New SME customer 'ethical checking' for the Bank;
- protecting, promoting and enhancing corporate reputation;
- direction on sustainability matters, in particular via Co-operative Group ethical plan;
- day-to-day management of environmental, ethical, community and sustainability programmes;
- support for the management of relations with democratic structures/active democrats;
- oversight of the distribution of Co-operative Group community dividend and operational management of connected community and campaigns programmes;
- sustainability accounting and reporting;
- management of the implementation of the Bank's ethical policy, home and motor insurance products;
- management of ISO140001 environmental management certification;
- advice and practical support;
- securing external recognition for the service recipients, e.g., FT Sustainable Bank of the Year; and
- stakeholder engagement and investment and campaigns management services with the common objective of ensuring that Co-operative Group would be viewed as the UK's most socially responsible business.

(iv) Marketing

The direction of the Bank's marketing strategy is currently determined by the Bank's Distribution Director via the Bank's governance forums (being the Bank's customer committee, the data governance forum and quality assurance committee). The Bank's distribution director (for the Core Business) from within the Bank is responsible for the 'Marketing' function of the Bank and directs Co-operative Group on the marketing services it requires. Under the New MSA, Co-operative Group would be required to provide those services in accordance with the Bank's instructions. In addition, Co-operative Group would provide the Bank with the following support services:

- *Insight* – Customer level analytics, input into customer contact strategies, provision of agency partner options and marketing campaign and research projects management and delivery;

- *Brand* – (i) support, guidance and governance over the use of the Co-operative brand including any relationships with businesses which subscribe to the brand and its services, including sponsorship relationships; (ii) digital marketing best practice guidance; (iii) management and appointment of marketing rostered agencies; (iv) brand governance and sponsorship; and

- *Membership* – provides members who join Co-operative Group membership scheme through the Bank with an identical membership service to the membership they provide to any other member.

(v) Finance

Under the New MSA, the Bank would produce all of its financial accounts information in respect of the Bank and its subsidiaries. However, the Bank would utilise Co-operative Group's 'Finance Shared Service Centre', an accounting administration function established within Co-operative Group, to undertake the bulk of general transactional finance processes and Co-operative Group would provide general transactional finance process services required to operate the Bank's business.

In particular, Co-operative Group's Finance Shared Service Centre would provide the Bank with the following services:

- accounting support for financial control including general ledger and Bank reconciliations, accruals and prepayments, journal processing and system integrity balancing, cash allocation and cash management, cost centre management inquiries and support, IS invoice matching and processing, corporate invoicing, insurance premium tax returns preparation, AP – master-file maintenance and Leek CHAPS processing;

- accounts payable – includes processing and payment of supplier invoices/staff expenses and management of supplier relations in respect of processing and payment of services;

- accounts receivable – credit management services, activities include processing and despatch of customer sales ledger, credit risk assessments, credit control activities through to litigation, processing and reconciliation of sales ledger payments, debtor reporting and review meetings with business partners, reconciliation, accounting and reporting of redeemed coupons;

- processing and resolution of claims relating to direct deliveries invoicing;

- processing of GI cheque stops and the POSPAY process (a system for validating cheques in the clearing cycle);

- current account servicing in branches reconciliation and settlement;

- maintenance of the delegated financial authorities database and ensuring adherence to the delegated financial authorities policy; and

- supplier and process compliance, reporting and development.

Procurement

Under the New MSA, Co-operative Group would provide the Bank with procurement services at the direction of the procurement director of the Bank, facilitating the purchase of all of the Bank's goods and services, to the extent that they fall within the scope of Co-operative Group procurement policy. This would include (i) running supplier tenders and sourcing; (ii) developing business insight across categories and business areas to support informed sourcing activity; (iii) forming sourcing teams to effectively source goods and services; (iv) consolidating service requirements into standard tender documents; (v) directing tendering approach and evaluation criteria; (vi) providing expert industry knowledge and market intelligence to the sourcing process; (vii) planning and providing skilled negotiation support; (viii) commercially evaluating supplier proposals; (ix) making recommendations regarding supplier award; (x) undertaking supplier financial due diligence and facilitating reasonable other forms of due diligence with customer functional experts (i.e. data security, IT security etc.) highlighting to the business potential risks to inform award decisions; (xi) providing support during significant contractual changes and disputes; (xii) engaging with the Co-operative Group's legal team to implement a robust supplier contract; (xiii) co-ordinating the signing of contracts; (xiv) supporting the Bank in the smooth transition and implementation of these services; (xv) recommending annual savings targets to the Bank; (xvi) highlighting, where possible, areas of missed savings opportunity; ensuring all contract and supplier commitments are signed off through the appropriate channel in line with the customer's delegations of authority and governance hierarchy as advised to Co-operative Group by the customer. The Bank would instruct Co-operative Group on the services it required Co-operative Group to provide.

Tax

Under the New MSA Co-operative Group would provide the Bank with tax assistance. Co-operative Group would report to the Bank's chief financial officer on tax matters and would provide the following tax-related services:

- fulfilling the Bank's statutory and regulatory obligations for corporation tax, value added tax, insurance premium tax, operational taxes and PAYE;
- preparation of current and deferred tax provisions and disclosure notes for inclusion in statutory accounts; and
- managing the relationship with external and internal auditors, and external advisers in respect of tax affairs.

Acquisitions & Disposals

Pursuant to the New MSA, Co-operative Group would provide the Bank with assistance on acquisitions and disposal, when instructed to do so by the Bank. The services which may be provided by Co-operative Group to the Bank in this regard include: (i) overall acquisitions & disposal strategy; (ii) pre-transaction analysis, including methodologies for evaluation of potential acquisition targets including financial and strategic fit metrics, potential synergies and transaction implications; and (iii) structuring transactions; and (iv) undertaking M&A transactions; and appointing and managing external advisers.

(vi) Corporate HR

The Bank's HR function is currently led from within the Bank by the Bank's HR director and is responsible for all of the Bank's HR activities. Existing HR teams within the Bank provide regulatory training, managers advice (the 'Ask HR' service) and resourcing and will be extended to exert appropriate control over services provided by third parties and Co-operative Group and oversee the correct governance and control processes including the appropriate Bank risk framework, and the following services:

- business partnering – providing a service to the retained Bank including the Core Business and the Non-core Business as well as the relevant support services; and

- service management for HR contracts, people risk and Bank policy.

Under the Existing MSA Co-operative Group's 'Corporate HR' function provides the Bank with the following services:

- employee relations: employee relations strategy and policy;
- reward: reward strategy, benefits administration, policy framework, benefits management and organisation design;
- talent and organisational capability: talent sourcing for leadership roles, senior talent assessment, graduate programme and apprenticeships;
- employee engagement & diversity – annual employment measurement survey, diversity policy and the employee assistance programme;
- pensions: provision of pension scheme for Bank employees, advice, governance and risk management; and
- HR policy development, advice and communications.

Co-operative Group seeks to provide these services in a way that enables the Bank to comply with applicable law and regulation.

(vii) People Services

Under the New MSA, the Bank would continue to utilise Co-operative Group's HR shared service centre and people services established within Co-operative Group, to undertake the bulk of general transactional HR processes required to operate the Bank's business.

In particular, Co-operative Group's HR shared service centre would provide the Bank with the following services:

- service delivery advice line: advice and support from trained advisers on payroll related queries and advice, new starter administration, general HR administration and routing of appropriate tier two calls to the Bank 'Ask HR' team;
- payroll: payments to the Bank's employees including salary, bonus and deductions. The payroll and administration service would continue to be provided by Co-operative Group under the New MSA as an arm's length agreement. The service has been provided in this way for nearly 12 months. The service operates through a series of control meetings including weekly operational service meetings, periodic service review meetings and quarterly executive review meetings. The HR Director for the Bank oversees control of the service and the service manager reports directly to the HR Manager;
- HR self service: Oracle HRMS Self Service;
- HR administration: for exit and family friendly policies;
- new starters: on-boarding activities and pre-screening activities in line with Bank defined screening policy;
- HR governance, portfolio & management information: provision of management information to the Bank HR Director's requirements;
- HR systems and support: for HR technology

The Bank HR service management function would manage the services provided by the 'Corporate HR' and 'People Services'. It would be managed and controlled according to the governance framework within the Existing MSA, with formal monthly service review meetings and a quarterly executive meeting. As part of the service review meetings the risks would be reviewed and any mitigating actions agreed. The Bank's risk, control and self-assessment processes would be used as well as the agreed governance framework. The service would also be reviewed by the third line Bank audit function.

(viii) Estates

This service was established pre-Unity, and would continue to be provided by Co-operative Group. Direction would be provided by the Bank, either directly in the form of Bank strategy, or as acceptance/rejection of recommendations from Co-operative Group in response to the Bank strategy or requirements. Conflicts of interest would be avoided by allocating separate individual representation for Co-operative Group and the Bank in any situation where a conflict could arise. Dedicated service management would be established within the Bank to ensure:

- focused and relevant management information is delivered;
- service is provided as agreed;
- costs are managed; and
- governance and control via five separate (monthly and quarterly) forums.

Services to be provided by Co-operative Group under the New MSA would include:

- facilities management shared services: manage the maintenance and repair of property assets and property services that are delivered through a number of third parties;
- project management and construction;
- trading property:
- property management service to maximise long-term value of the Bank's trading premises (branches etc.) whilst minimising costs and ensuring that the Bank can maintain and fulfil its contractual obligations as a tenant or owner of those trading properties;
- analysis, locating and acquiring and disposing of the Bank branches;
- capital investment service, for expert planning and effective delivery of planned investments into the Bank branch estate;
- commercial and investment property;
- ensures the Bank meets its contractual obligations as a landlord or tenant, and realises value from its non-trading properties (eg vacant branches, adjunct premises, onerous leasehold properties and other property investments);
- acquisition and disposal of major occupancies;
- energy, environment and engineering tenders for and purchases utilities using Co-operative Group's buying power and professional expertise in buying and negotiating for utilities, and in line with the Bank's energy risk management policy and procedures; and
- premises strategy and business change strategic direction and workplace strategy for the major occupancies, in line with business requirements. Plans and delivers

moves, capital works and business programmes across the major occupancy estate.

(ix) Illius (Property Management)

Co-operative Group would ensure the long-term value of the residential properties that were transferred into Illius Properties Limited is maximised. This would be done by seeking to hold the portfolio until a point in time when each disposal can be achieved in suitable market conditions, and meanwhile seeking to rent the property.

(x) Risk

Co-operative Group would return the following services to the Bank, specifically:

- specific crime or act of reputational damage (fraud investigations team) – investigation and prevention of certain specific crimes or acts of reputational damage; namely employee fraud; external fraud in excess of £25,000; linked funds; external frauds; vulnerable victims of fraud; repeated allegation frauds; incidents with serious reputational impact etc.
- business continuity, health & safety and environmental compliance oversight; and
- insurance: expertise to provide direction and to set strategy in respect of risk appetite and pricing.

Co-operative Group would continue to provide the following services:

- health and safety and environmental compliance – expertise would be required in the Bank to provide oversight;
- health and safety – ensuring the Bank meets its health and safety obligations in respect of employees, subcontractors, visitors, customers and the general public, including health and safety assessments, training and incident management;
- fire – ensuring the Bank meets its obligations to comply with current fire safety legislation, ensuring it protects its employees, subcontractors, visitors, customers and the general public from the dangers of fire, including fire prevention, assessment, training, drills and incident management;
- environmental compliance – ensuring the Bank maintains its compliance with all applicable environmental laws and regulations, as well as helping to identify and correct unregulated environmental hazards, including by managing environmental risks and incidents;
- business continuity – ensuring the Bank has tactical capacity to plan for and respond to incidents and business disruptions in order to continue business operations at an acceptable pre-defined level, including business continuity planning, support and compliance monitoring;
- crime – investigation and prevention of general crimes, such as: robbery, burglary, minor physical assault, arson, suicide, riot and terrorism;
- physical security – specify requirements, prepare policy and provide support to ensure all Bank's premises are safe and secure at all times so as to protect and preserve people, assets and premises. Including through specification of physical security requirements; recommendations post-incident and ATM installation risk assessments;

(xi) Internal Audit

The 'Internal Audit' capability has already returned to the Bank to execute audits within the Bank on the Bank's behalf only.

Separately, the Bank would commission Co-operative Group's Internal Audit function to audit the services provided by Co-operative Group.

Key Terms of the New MSA

Under the New MSA, the Bank, and CFSMS would manage and supervise the services through three key governance forums: (1) the 'Unity Outsourcing Steering Group', which would be responsible for (i) overall strategic direction of the provision of services under the Unity Agreements; (ii) the review of the overall operating model; (iii) the review of the governance model; and (iv) the resolution of escalated issues, and would be attended by the appropriate Co-operative Group director responsible for the management of the Unity Agreements and director of financial control for Co-operative Group, the appropriate Bank Director responsible for the management of the Unity Agreements and the director of financial control, risk director and contract manager for the Bank and persons performing equivalent roles for CFSMS; (2) the 'Service Review', which would meet quarterly and be responsible for overall performance and cost, upcoming developments, staffing, overall review of change programme and significant changes, review of the risks register, review of compliance and audit programme findings and resolution of escalated issues; and (3) the 'Functional Service Review' for each functional area, which would meet monthly and be responsible for functional performance and costs, functional issues, achievement of function-specific objectives, compliance and risk issues and review of service specific change and change costs.

The day-to-day operational management of the services supplied under the New MSA would be monitored by a Co-operative Group contract manager (as the supplier of the services), a Bank contract manager (as a customer), functional leads for Co-operative Group and the Bank and risk, audit and compliance for the Bank. The Existing MSA service contract service levels were documented on the basis that, unless service levels are expressly agreed between the parties in respect of a service to be provided under a service contract, Co-operative Group is required to provide the services to the same standards as those received by the Bank immediately before the commencement of the relevant service contract. There is a principle of no betterment of service levels compared to those provided to Banking Group before the service commencement date under the relevant service contract. The Bank is required to ensure that its systems are in good working order and suitable for purpose, and assets are maintained to a reasonable level of currency. Co-operative Group is relieved from its responsibility to provide the services where caused by failure of any Bank system, or any legacy Bank system used by Co-operative Group, which has a material adverse effect on the ability of Co-operative Group to provide the services.

Under the New MSA, services would be provided by Co-operative Group in accordance with Co-operative Group policies, unless Co-operative Group and the Bank agreed, or agreed in the future, that a Bank policy should apply in substitution for the relevant Co-operative Group policy. The Bank could require that Co-operative Group provides the services in accordance with Bank policies where required by law or a regulator.

Charges would be paid quarterly and in arrears unless a "Special Resolution Event" has occurred, in which case charges would be payable three months in advance.

The New MSA would continue in force until terminated by a party.

The Bank would have step-in rights to perform or manage the services, or appoint a third party to do so, upon notice to Co-operative Group following the occurrence of certain defined trigger events (eg a material breach by Co-operative Group). An exit plan for each service contract would be prepared and kept updated. Charges will be agreed in the New MSA in respect of all service contracts, and are to be payable quarterly in arrears unless a "Special Resolution Event" occurred, in which case charges would be payable three months in advance.

The Bank and CFSMS would each be entitled to nominate persons to which all or part of the business of a service recipient had been transferred as a result of a special resolution event, excluding affiliates of service recipients (**MSA Special Resolution Recipients**) who would be entitled to the benefit of the New MSA and any relevant service contract(s) for an interim period. Any MSA Special Resolution Recipient could enforce certain provisions in the agreement and the relevant services contract(s) even though the relevant provision may only refer to the Bank or other service recipients. The Co-operative Group, upon request by the service recipient, would offer to enter into a direct agreement with the MSA Special Resolution Recipient to which all or part of the business of the service recipient has been transferred for the supply of services on the same terms as the New MSA and the relevant service contract(s). Under the New MSA, the Bank and CFSMS would each be entitled to nominate divested entities (which include normal course of business disposals as well as disposals on a special resolution event) to receive services under the New MSA and the relevant service contract(s) and exit services for up to 12 months, but with the addition of a mark-up of 20 per cent. on the charges. During the interim period prior to the MSA Special Resolution Recipient entering into a direct agreement with Co-operative Group, the Bank would remain responsible for payment of any charges in relation to services provided to MSA Special Resolution Recipients nominated by the Bank, as well as for any liability arising from any act or omission of the MSA Special Resolution Recipient that would have given rise to liability on the part of the Bank if it was an act or omission of the Bank.

20.2 CFSMS-Bank Framework Agreement

On 16 February 2006, the Bank and CFSMS entered into the CFSMS-Bank 2006 Agreement pursuant to which CFSMS provides assets such as office equipment, materials and office space, and other facilities and services, and consultants who act as secondees to the Bank, in each case strictly in accordance with the Bank's instructions and directions from time to time. This is a cost-based agreement terminable by CFSMS on six months' notice with a 12 months run–off period. The Bank has no right to terminate unless CFSMS is subject to a change of control. The Bank provides CFSMS with an indemnity for all liabilities, losses, damages, costs and expenses of any nature as a result of CFSMS entering into and performing the agreement in respect of the assets, services and personnel provided to the Bank.

By the date of completion of the Liability Management Exercise, the Bank and CFSMS intend to have replaced the CFSMS-Bank 2006 Agreement with appropriate revised arrangements under the CFSMS-Bank Framework Agreement pursuant to which it is proposed that CFSMS supply services, secondees, and procure the supply of certain third party services and assets, to the Bank and its subsidiaries. Details of certain terms of the CFSMS-Bank Framework Agreement, as contemplated for the 17 June Plan are summarised below. The Bank and Co-operative Group are considering whether any additional amendments are required to the CFSMS-Bank Framework Agreement to reflect that Co-operative Group will be a minority shareholder in the Bank following completion of the Liability Management Exercise.

Once agreed by the Bank and Co-operative Group as part of the separation process, the CFSMS-Bank Framework Agreement will establish a flexible contractual framework that shall enable the Bank and its subsidiaries to obtain from CFSMS those existing services and secondees, and procure the supply of third party procured services and assets, that CFSMS currently provides to the Bank (under the CFSMS-Bank 2006 Agreement or otherwise), and will also cover any new services and CFSMS secondees, and third party supplied services and assets that the Bank procures through CFSMS.

Under the terms of the CFSMS-Bank Framework Agreement, CFSMS would be entitled separately to provide some of the services and secondees and third party procured services and assets, on a shared basis, to other current and former members of Banking Group from time to time.

CFSMS would be required to provide the services to the same standards as those received by the Bank immediately before commencement. There is a principle of no betterment of service levels compared to those provided to the Bank before the service commencement date under the CFSMS-Bank Framework Agreement.

Charges would be paid daily in advance based on an estimate of costs to be incurred by CFSMS for that day unless a "Special Resolution Event" has occurred, in which case charges would be payable three months in advance.

The CFSMS-Bank Framework Agreement would continue in force until terminated by either party.

The Bank would have step-in rights to perform or manage CFSMS services and to perform or manage CFSMS' obligations in relation to the provisions of assets, the then current secondees or third party procured services, or appoint a third party to do so, upon notice to CFSMS following the occurrence of certain defined trigger events (eg a material breach by CFSMS).

An exit plan would be prepared and kept updated. During the exit period, CFSMS would be required to provide any reasonable assistance required by the Bank to allow the relevant secondees, assets or third party procured services to continue to be enjoyed without interruption or adverse effect.

The Bank would be entitled to nominate persons to which all or part of the business of a service recipient had been transferred as a result of a special resolution event, (excluding affiliates of service recipients) (**CFSMS Special Resolution Recipients**) who would be entitled to the benefit of the CFSMS-Bank Framework Agreement for an interim period. Any CFSMS Special Resolution Recipient could enforce certain provisions in the agreement even though the relevant provision may only refer to the Bank or other service recipients. CFSMS, upon request by the service recipient, would offer to enter into a direct agreement with the CFSMS Special Resolution Recipient to which all or part of the business of the service recipient had been transferred for the supply of services, secondees, assets or third party procured services on the same terms as the CFSMS-Bank Framework Agreement. The Bank would be entitled to nominate divested entities (which include normal course of business disposals as well as disposals on a special resolution event) to receive services under the CFSMS-Bank Framework Agreement and exit services for up to twelve months, but with the addition of a mark-up of 20 per cent. on the charges. During the interim period prior to the CFSMS Special Resolution Recipient entering into a direct agreement with CFSMS, the Bank would remain responsible for payment of any charges in relation to services provided to CFSMS Special Resolution Recipients nominated by the Bank, as well as for any liability arising from any act or omission of the CFSMS Special Resolution Recipient that would have given rise to liability on the part of the Bank if it was an act or omission of the Bank.

20.3 Relationship Agreement

The Bank has entered into the Relationship Agreement with Co-operative Group and Banking Group on 4 November 2013, which will regulate the basis of their on-going relationship and includes appropriate measures regarding the degree of control that Co-operative Group, Banking Group and their associates may exercise over the management of the Bank.

The principal terms of the Relationship Agreement will take effect on the Liability Management Exercise becoming unconditional and will continue for so long as the Co-operative Group (or any member of its group) remains a significant shareholder of the Bank. However, if Co-operative Group ceases to be a significant shareholder because Banking Group fails to satisfy the Undertaking to Pay (defined below) and is consequently forced to transfer its Ordinary Shares, the rights of Co-operative Group and Banking Group under the Relationship Agreement shall be waived, and the Relationship Agreement shall continue until the fifth anniversary of the Liability Management Exercise becoming unconditional. For these purposes a "significant shareholder" is any person (or persons acting jointly by agreement whether formal or otherwise) who is entitled to exercise, or to control the exercise of, 20 per cent. of the rights to vote at a general meeting of the Bank.

Under the Relationship Agreement, Co-operative Group undertakes that it will conduct transactions with the Bank on arm's length terms and not seek to influence the day-to-day running of the Bank. Amendments to existing contracts and arrangements in place between Co-operative Group and the Bank will require the approval of a majority of independent directors. The Relationship Agreement contains provisions on conflicts and related party transactions.

Co-operative Group also undertakes that neither it, nor any member of its group, shall without the prior written consent of the Bank (i) operate, establish or acquire any undertaking which constitutes a competing business for a period of the later of the third anniversary of the Liability Management Exercise becoming unconditional and three years from the date of termination of the Relationship Agreement (although Co-operative Group is permitted to carry on business activities carried on at the date when the Liability Management Exercise becomes unconditional), or (ii) solicit for employment any of the directors (or their respective direct reports) or senior managers of the Bank for the same time period as applies in (i) above. For a period of two years after termination of the Relationship Agreement or seven years after the Liability Management Exercise becomes unconditional, whichever is the later, Co-operative Group has agreed to: (i) use the Bank as exclusive financial services provider in respect of clearing and certain other services (excluding lending) that are currently provided by the Bank to the Co-operative Group on an exclusive basis; (ii) use the Bank as principal financial services provider in respect of certain services (excluding lending) that have been provided by Bank to Co-operative Group at any time during the 12 month period prior to the date of the Relationship Agreement to the extent the Bank has the capacity to provide such services; (iii) promote the Bank's banking business and facilitate and encourage Co-operative Group's customers and members to hold bank accounts with, and otherwise use the services of, the Bank; and (iv) support (which, for the avoidance of doubt, shall not include any obligation on the Co-operative Group to make any financial contribution to the Bank in this regard) the enhancement and rejuvenation of the Co-op brand and franchise.

The Bank will have a Values and Ethics Committee which shall recommend to the Board for approval and adoption the co-operative and ethical policies of the Bank and shall represent, monitor and advise the Board concerning the interests of customers, suppliers, employees and other stakeholders in their dealings with the Bank. The terms of reference of the Values and Ethics Committee are set out in the agreement. The Values and Ethics Committee shall prepare an annual report on its activities which, subject to approval by the Board, shall be included in the annual report and accounts of the Bank and shareholders will be able to question the Values and Ethics Committee at the annual general meetings of the Bank. Further details on the Values and Ethics Committee are in paragraph 2 titled "*Corporate Governance*" in Section 9 (*Directors, Senior Management, Employees and Corporate Governance*).

In recognition of the mutual benefits derived by the Co-operative Group and the Bank from ensuring an appropriate alignment of their respective business strategies, the Bank has agreed to include in its Articles of Association a requirement to promote and conduct its business to the extent practicable in a manner informed by the established values of the co-operative movement having regard to:

(a) how it relates to, communicates with, balances the interests of, and otherwise deals with its stakeholders; and

(b) how it applies the profits of the Company, in accordance with the dividend policy set out in its Articles of Association.

Subject to certain conditions, the Relationship Agreement also provides a mechanism for the appointment of up to two persons (in each case, after having been identified for such purpose by the Purchasers): (i) nominated by the holders of the Dated Notes at or around the time of the Scheme Meeting; or (ii) to the extent the holders of the Dated Notes have not so nominated, approved by the shareholders other than Co-operative Group or Banking Group (and for these purposes, a person is ‘approved’ if less than 25 per cent. of relevant votes disapprove of the relevant person within a specified timeframe).

For as long as the Ordinary Shares are not admitted to the premium listing segment of the Official List, the Bank has agreed to use its reasonable endeavours to procure, and the Banking Group and Co-operative Group have agreed to exercise all of their respective powers of control to procure, that the Bank shall comply with the UK Corporate Governance Code as if it were in the FTSE 350 (as well as comply with the related provisions of LR 9.8.6R(5) and LR 9.8.6R(6) of the FCA’s Listing Rules, as if they applied to the Bank). In addition, for as long as the Ordinary Shares are not admitted to the premium listing segment of the Official List, the Company has agreed to comply with certain of the continuing obligations for a premium listed company under the FCA’s Listing Rules (and to the extent the Bank does not have a standard listing, only to the extent reasonably practicable, and in accordance with the spirit of those obligations). Analogous provisions are also contained in the Articles of Association, further details of which are set out in the sub-paragraphs 12.22 and 12.23 entitled “*Corporate Governance*” and “*Significant Transactions, Related Party Transactions, Circulars etc.*” respectively in Section 20 (*Additional Information*).

Co-operative Group has agreed to provide Bank with reasonable assistance to obtain a listing on the premium segment of the Official List within 12 months following the Liability Management Exercise becoming unconditional (although there can be no guarantee that the Bank will be able to satisfy the necessary eligibility criteria in to do so) and has agreed not to transfer the shares held directly or indirectly by Co-operative Group outside its group (subject to certain limited exceptions) for a period of five years from the date the Liability Management Exercise becomes unconditional unless the agreement has been terminated prior to such sale.

Provisions are included in the Relationship Agreement concerning the fact that Co-operative Group and Bank share many of the same customers and it is therefore necessary to mitigate risks and deal with practical issues concerning the processing of data.

The Bank has agreed to restrict non-pre-emptive share issuances (other than in certain specified exceptions) without the consent of the Co-operative Group for up to a maximum period of 36 months after the Liability Management Exercise becomes unconditional. Additionally, it will limit rights issues and other pre-emptive offers to an aggregate of £200 million for 12 months after the Liability Management Exercise becomes unconditional or until admission to listing, whichever is the earlier.

The Board believes that the terms of the Relationship Agreement will ensure that (subject to other existing contractual arrangements with Co-operative Group as at the date the Liability Management Exercise becomes unconditional) all transactions and relationships between the Bank and Co-operative Group and its affiliates are, and will be, at arm’s length and on a normal commercial basis and that the Bank will be able to carry on with its business with only limited and appropriate levels of control or influence from Co-operative Group.

20.4 2014 Commitment Agreement

On 4 November 2013, Banking Group entered into a legally binding and irrevocable commitment with the Bank (the **2014 Commitment Agreement**), conditional upon the Scheme having been implemented in accordance with its terms (including the completion of the subscription of the Additional New Ordinary Shares Offer to Holders of Dated Notes in accordance with the Scheme) and each of the Exchange Offers having become unconditional in accordance with their respective terms (the **Condition**), to subscribe for 54,058,442 New Ordinary Shares (the **Group Shares**) in consideration for an irrevocable undertaking to pay the sum of £333 million (the **Undertaking to Pay**), such amount being the amount of the 2014 Commitment. The other parties to the 2014 Commitment Agreement are the Co-operative Group and the Bank.

The Group Shares will be issued by Bank to Banking Group immediately following the satisfaction of the Condition. In the 2014 Commitment Agreement, the parties have agreed that the New Ordinary Shares issued in consideration for the Undertaking to Pay will be fully paid up for the purposes of the

Companies Act and will be freely transferable (subject to the certain lock-up restrictions, which shall be superseded by the lock-up restrictions contained in the Relationship Agreement once this comes into force and as described in paragraph 20.3 above) and fungible with all other Ordinary Shares. The New Ordinary Shares issued against the Undertaking to Pay will be issued at the effective subscription price of £6.16 per New Ordinary Share, as calculated in the manner set out in the Offering Memorandum. The New Ordinary Shares issued to Banking Group under the 2014 Commitment Agreement will represent 21.6 per cent. of the Ordinary Shares in issue on completion of the Liability Management Exercise.

The Undertaking to Pay does not generate Common Equity Tier 1 Capital of the Bank until such time as the cash proceeds of the undertaking are received by the Bank. The PRA has stipulated that the 2014 Commitment must be satisfied in two tranches, with £170 million payable by 30 June 2014 and £163 million payable after 30 June 2014 but not later than 31 December 2014. In the 2014 Commitment Agreement, Banking Group has agreed to contribute the 2014 Commitment and satisfy the Undertaking to Pay in a number of tranches, with (i) £20 million payable by no later than 31 December 2013; (ii) £50 million by no later than 31 January 2014; (iii) £100 million by no later than 30 June 2014; and (iv) £163 million by no later than 31 December 2014. In addition, following receipt by Banking Group of the Co-operative Life Insurance and Asset Management Deferred Consideration or the net proceeds of the disposal of CIS General Insurance, Banking Group is required to apply such proceeds as soon as reasonably practicable following receipt of such proceeds in satisfaction of the Undertaking to Pay (in part or in full as the case may be).

To support Banking Group's obligations under the 2014 Commitment, Banking Group has entered into an intra-group loan facility (the **Intra-group Loan**) with Co-operative Group, which entitles Banking Group to draw down under the Intra-group Loan in the event that the Insurance Proceeds are not available at the point in time required to satisfy the 2014 Commitment. The 2014 Commitment Agreement stipulates that any monies drawn down under the Intra-group Loan shall only be repaid by Banking Group after the Undertaking to Pay has been fully discharged. The Intra-group Loan is described in further detail in paragraph 20.6 below.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan in the event that the Insurance Proceeds are not sufficient to satisfy the 2014 Commitment or otherwise not received in time to satisfy the PRA's required timing for the satisfaction of the 2014 Commitment. See the risk factor entitled "*The commitment by Banking Group to contribute £333 million during 2014, in addition to being solely conditional upon the successful completion of the Liability Management Exercise, is subject to the ability of Banking Group and/or Co-operative Group to fund the commitment, which is dependent on certain actions, some of which are partially outside the control of Co-operative Group*" in Section 2 (*Risk Factors*).

In the event that Banking Group breaches its obligations under the Undertaking to Pay:

(a) Banking Group has agreed to a default interest at a rate of 9 per cent. per annum on the outstanding amount under the Undertaking to Pay accruing on a daily basis, from and including the due date for payment (provided that, for the avoidance of doubt, the amount of the Undertaking to Pay will not increase by such default interest);

(b) Banking Group has agreed to waive all rights that it has in respect of the Group Shares, including rights to dividend, capital and voting;

(c) Banking Group and Co-operative Group have agreed to waive all their respective rights that they may have under the Relationship Agreement;

(d) Banking Group has agreed to procure the immediate resignation of nominee directors appointed by it or by Co-operative Group from the Board, failing which, the Bank may remove such Nominee Directors;

(e) the Bank may exercise or direct the security trustee to exercise any of its rights, remedies, powers or discretions under the Intra-group Loan and the associated security agreement in connection with the Intra-group Loan; and

(f) the Banking Group shall, at the request of the Bank, transfer all, or some of its Group Shares (i) to a third party as directed by Bank (a **Third Party Transfer**) or (ii) to the Bank for nil consideration.

In respect of any transfer pursuant to sub-paragraph (f) above the Bank shall:

(a) use reasonable endeavours (acting in good faith) to ensure that any Third Party Transfer is on terms as close to arms' length as possible, and use any amount received from the relevant third party to reduce any amount outstanding to the Bank from Banking Group;

(b) where the Bank determines to require the transfer of Group Shares to it pursuant to clause 8.2(f)(ii), the Bank may require the transfer of:

    (i) such proportion of the Group Shares as is equal to the outstanding amount of the Undertaking to Pay plus any amount in respect of default interest (at the time of the relevant breach of the obligation under the Undertaking to Pay) as a proportion of the subscription amount (being £333 million) and the Undertaking to Pay plus any amount in respect of default interest shall, following such transfer, be discharged in its entirety; or

    (ii) such other number of Group Shares as the Bank shall specify (the Specified Shares), provided that the Specified Shares and shall have a value no greater than the aggregate amount outstanding under the Undertaking to Pay and any Default Interest, and shall reduce such amount by the lower of:

        (A) the fair market value of the Group Shares so transferred to the Bank; and

        (B) where the Group Shares are retained or cancelled by the Bank, the aggregate amount that a third party (or third parties, as the case may be) pay to the Bank in consideration (including any deferred consideration) for the issuance by the Bank of such number of ordinary shares in the Bank as is equal to the number of Group Shares transferred pursuant to sub-paragraph (f)(ii) above, whether or not such shares are issued at a discount to their fair market value and provided that such ordinary shares are issued on or before the six month anniversary of the transfer of such Group Shares to the Bank pursuant to sub-paragraph (f)(ii),

    provided further that if such lower amount exceeds the Undertaking to Pay, the Bank shall account to Banking Group for the difference.

With effect from the Subscription Date and to the fullest extent permitted by law, Bank (for itself and for each subsidiary and subsidiary undertaking of Bank together with all directors and employees of each such subsidiary and subsidiary undertaking of Bank) and Co-operative Group (for itself and each other member of the Co-operative Group together with its subsidiary undertaking and all directors and employees of each member of the Co-operative Group and its subsidiary undertakings), have agreed to waive each and every claim which they may have against the other in relation to or in connection with or in any way arising out of the preparation, negotiation or implementation of the Liability Management Exercise or the recapitalisation of the Bank and/or the circumstances which gave rise to the requirement for a recapitalisation of the Bank (provided that this does not preclude any such persons from enforcing any rights under any of the transaction documentation entered into in connection with the Recapitalisation Plan).

In connection with a notice of extraordinary general meeting sent to the shareholders of the Bank on or around 4 November 2013 (the **Notice**) convening an extraordinary general meeting of the Bank, to be held on or around 15 November 2013 (the **EGM**), each of Co-operative Group and Banking Group have irrevocably undertaken and agreed:

(a) to vote in favour of each and every resolution to be proposed at the EGM in respect of all the ordinary shares in Bank they each hold as at the date of the EGM, including resolution (1) contained in the Notice, adopting the new Articles of Association of the Bank in the agreed form; and

(b) to do to everything reasonably practicable to procure the adoption of the new Articles of Association of the Bank in the agreed form.

In addition, the 2014 Commitment Agreement also contains certain customary warranties. Banking Group has also agreed to pass all shareholder and other resolutions, and to do all such things and take all actions as may be reasonably required in order to give effect to the Recapitalisation Plan, including the Scheme and the Liability Management Exercise.

20.5 The Agreed Co-existence Principles

The Bank and Co-operative Group have agreed co-existence principles (the **Agreed Co-existence Principles**), to be expressed in a Co-existence Agreement on terms later agreed between the parties (the **Co-existence Agreement**). The Agreed Co-existence Principles govern the use of trade marks containing “Co-operative” or “Co-op” and other associated trademarks owned by both parties

The Agreed Co-existence Principles are as follows:

- Until a trigger event occurs, namely if the Bank removes or alters any of the provisions in its articles of association that entrench co-operative values and ethics without Co-operative Group consent, Co-operative Group cannot conduct any business under a brand that combines the words "Co-operative” or “Co-op” and “Bank”.

- After the Relationship Agreement ends (with a minimum lock up of five years) but before a trigger event, the Bank is free to continue using the terms “Co-operative” and “Co-op” provided it does so in a way that does not confuse the public into believing that the Bank is still a part of Co-operative Group. Where trade marks are required by the Bank for this, Co-operative Group will grant a non-exclusive royalty free licence until a trigger event occurs.

- After the expiry of the Non-Compete period (the minimum lock up of five years for the Relationship Agreement plus a further three years) Co-operative Group is free to conduct any financial services business under any of its brands, subject to the restriction placed on its use of “Co-operative” or “Co-op” with “Bank” as provided for above.

- Until the thirteenth anniversary of the ‘Effective Date’ (five years after the end of the Non-Compete period defined in the Relationship Agreement) Co-operative Group will not conduct any such business which competes with the Bank under a main business brand including the words “Co-operative” or “Co-op” but may include such words in supporting marketing and advertising materials to make it clear that the business is part of the Co-operative Group.

- The Bank and Co-operative Group each own various trade marks, some of which are predominantly used by the other party. There will be an exchange of trade mark registrations to ensure that at the outset of the Co-existence Agreement the trade marks are owned by the correctly entitled and utilising entity.

- The defined “banking” field of use for the purposes of the Agreed Co-existence Principles and the Co-existence Agreement must ensure that it is fair to both the Bank and Co-operative Group given each of their current and anticipated activities.

20.6 Intra-group Loan

The Bank, Banking Group and Co-operative Group have entered into an intra-group loan facility agreement dated 4 November 2013 (the **Intra-group Loan**) pursuant to which Co-operative Group will make available during 2014 to Banking Group a term loan facility to be utilised by way of advances. The term loan facility will mature no earlier than 27 July 2019 and, subject to Co-operative Group's existing syndicated facilities being repaid in full, all amounts outstanding under the Intra-group Loan will be automatically crystallised at maturity.

The Intra-group Loan has been entered into to support Banking Group's obligations under the 2014 Commitment. Banking Group is expecting to satisfy the 2014 Commitment from the net proceeds of the sale by Banking Group of Co-operative Life Insurance and Asset Management and the proposed sale of CIS General Insurance (the **Insurance Proceeds**). In the event that the Insurance Proceeds are not available at the point in time required to satisfy the 2014 Commitment, or are insufficient to do so, Banking Group is entitled to draw down under the Intra-group Loan. The 2014 Commitment is further described in paragraph 20.4 "*2014 Commitment Agreement*" in this Section 20 ("*Additional Information*").

The maximum amount which Banking Group can draw down is £313 million, which is £333 million less £20 million sourced from a proportion of net initial consideration already paid to Banking Group as a result of the disposal of Co-operative Life Insurance and Asset Management (such initial consideration which is scheduled to be paid to the Bank under the terms of the 2014 Commitment Agreement by 31 December 2013). This amount of £313 million is automatically reduced by the proceeds received by Banking Group from the sale of Co-operative Life Insurance and Asset Management and the sale of CIS General Insurance and applied in satisfaction of Banking Group's obligations under the 2014 Commitment. Any excess Insurance Proceeds which are not required to satisfy Banking Group's 2014 Commitment will be applied in mandatory prepayment of the loans.

The Bank may deliver draw down requests on behalf of Banking Group. Any draw down made by Banking Group pursuant to the Intra-group Loan is to be paid directly to the Bank in satisfaction of Banking Group's obligations under the 2014 Commitment. If any loan proceeds are provided to Banking Group under the Intra-group Loan, they must be held on trust for the Bank and Banking Group must promptly pay them to the Bank. Banking Group also holds on trust for the Bank its right to submit a drawdown request under the Intra-group Loan.

Banking Group has assigned to the Bank its rights in respect of any claims Banking Group may have against Co-operative Group in the event that Co-operative Group fails to provide Banking Group with a loan it is required to make pursuant to the terms of the Intra-group Loan.

A security assignment in respect of the Insurance Proceeds has been entered into between Banking Group and Co-operative Group as security trustee for itself and the Bank to secure Banking Group's obligations to the Bank in respect of the 2014 Commitment and Banking Group's obligations as borrower to Co-operative Group as lender under the Intra-group Loan.

Co-operative Group has informed the Bank that it has appropriate arrangements in place to satisfy the discharge of its obligations under the Intra-group Loan in the event that the Insurance Proceeds are not sufficient or otherwise not received in time for Banking Group to satisfy the 2014 Commitment. Based on the information provided by Co-operative Group and on investigations made by and on behalf of the Bank, the Bank believes these arrangements are appropriate.

20.7 Dealer Manager Agreement

The Bank, Co-operative Group, UBS and HSBC (UBS and HSBC taken together, for the purposes of this paragraph 20.7, the **Joint Dealer Managers**) have entered into a dealer manager agreement on 4 November 2013 (the **DMA**) whereby the Bank has appointed the Joint Dealer Managers as the exclusive dealer managers (and HSBC as adviser) in connection with the Liability Management Exercise.

The Joint Dealer Managers are appointed on a several and not joint basis. Each Joint Dealer Manager will perform certain services including:

(a) identifying and contacting holders of the Existing Securities and presenting the Liability Management Exercise to them on behalf of the Bank;

(b) making available employees to answer queries from, and provide additional information to, holders of the Existing Securities in connection with the Liability Management Exercise;

(c) providing assistance as and when requested by the Bank in relation to any decision to re-open, amend, terminate, shorten or extend the Liability Management Exercise;

(d) making or arranging for the making of such announcements as are agreed between the parties on behalf of the Bank in connection with the Liability Management Exercise; and

(e) providing such other assistance and undertaking such other duties as are agreed in writing between the parties to the Dealer Manager Agreement from time to time.

UBS's fee is payable by Co-operative Group while the Bank is to pay HSBC's fee.

The Bank and Co-operative Group have each given certain representations, warranties and undertakings to the Joint Dealer Managers.

The DMA also contains certain indemnities given by the Bank, failing which Co-operative Group, in favour of the Joint Dealer Managers in respect of, inter alia, claims made against or losses suffered or incurred by the Joint Dealer Managers in connection with the services rendered under the DMA.

Under the DMA each Joint Dealer Manager may terminate its obligations under the DMA in certain specified circumstances, including circumstances where any warranties are found to be untrue or inaccurate.

20.8 Lock-up Agreement

On or around the date of this Prospectus, Bank expects to enter into lock-up agreements with a number of Holders of Dated Notes.

Each lock-up agreement will provide that the relevant Holder will agree, amongst other things and subject to certain conditions, to cast all of its votes in respect of its Dated Notes that are subject to its lock-up agreement in favour of the Scheme.

The lock-up agreement includes various undertakings by the Bank in connection with the Scheme and, in certain circumstances, will terminate either automatically, or (depending on the circumstance) at the election of either the relevant Holder or the Bank. The lock-up agreement will terminate automatically (i) at a scheme meeting at which a vote takes place, if the Scheme is not approved by the requisite majorities, (ii) on the earlier of the Scheme Settlement Date and the 31 December 2013, (iii) if the Bank gives any Holder of Dated Notes written notice of an intention either not to proceed with the Scheme, or to proceed with a scheme of arrangement on terms that are different to the Scheme in any material respect, (iv) if the Holder of Dated Notes transfers all its Dated Notes that are subject to the lock-up agreement, or (v) if the Holders of the 5.5555% Bonds vote against the relevant proposals at the 5.5555% Meeting or the Holders of the 13% Bonds vote against the relevant proposals at the 13% Meeting or the Preference Shareholders vote against the relevant proposals at the Preference Shareholder meeting. The Bank may enter into lock-up agreements or similar arrangements in connection with the Scheme with other Holders of Dated Notes after the date of this Prospectus.

20.9 Purchase Agreement

The Bank has entered into a purchase agreement with certain Holders of the Dated Notes as listed in the purchase agreement (the **Purchasers**) on 4 November 2013 (the **Purchase Agreement**).

Pursuant to the Scheme, 62,500,000 Additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription.

To the extent that the amount received by 13 December 2013 from the Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than £125 million, the Purchasers have severally agreed to subscribe for the remaining Additional New Ordinary Shares in accordance with the proportions set out in the Purchase Agreement (the **Subscription**).

However, if, as a result of the Subscription, a Purchaser was obliged to subscribe for an amount of Additional New Ordinary Shares that would result in it holding more than 9.99 per cent. of the total issued share capital of the Bank (the **Threshold Amount**) (the **Excess Shares**), it is in relation to the shares which are in excess of the Threshold Amount (the **Excess Shares**), may satisfy its undertaking to subscribe for the Excess Shares by paying the amount in respect of such shares and directing that they be issued to a non-affiliated third party (who cannot be an associate of the relevant Purchaser). If no such third-party is nominated, the Purchaser will subscribe for the Excess Shares so long as either (1) the subscription for such Excess Shares would not cause it to hold more than the Threshold Amount; or (2) it receives approval from the PRA to hold such Excess Shares.

Subject to the satisfaction of the conditions of the Purchase Agreement, the Purchasers under the Purchase Agreement will be entitled to receive a commission for agreeing to subscribe for Additional New Ordinary Shares in accordance with the Purchase Agreement. The maximum aggregate amount of such commissions that may be paid to the Purchasers is equal to four per cent. of £125 million (the **Purchaser Premium**). The Bank will also pay certain costs and fees incurred in connection with the Purchase Agreement (whether or not the Purchaser's obligations under the Purchase Agreement became unconditional or are terminated).

All Holders of Dated Notes will be entitled to participate in a sub-purchase of the Purchase Agreement (the **Sub-Purchase Offer** and the sub-purchase of the Purchase Agreement, the **Sub-Purchase**). The Sub-Purchase Offer will be available to all Holders of Dated Notes, including the Purchasers. To participate in the sub-purchase a Holder of Dated Notes (the **Sub-Purchaser**) will be entitled to nominate the commitment that Holder is prepared to sub-purchase, subject to a maximum commitment of £125 million and a minimum commitment of £100,000. The allocation of sub-purchase commitment to a Holder of Dated Notes that wishes to participate in the Sub-Purchase Offer will, in the case of aggregate nominations being less than £125million, be the amount of Sub-Purchasers' nominations and, in the case of nominations in aggregate exceeding £125million, be pro rata based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Record Date) who have elected to participate in the Sub-Purchase Offer, subject to (i) a minimum commitment of £100,000 and (ii) a maximum commitment equal to the amount of the sub-purchase commitment elected for by that Holder (the **Sub-Purchase Commitment**), provided always that the aggregate amount of all Sub-Purchase Commitments allocated to all Holders of Dated Notes that participate in the Sub-Purchase is no greater than £125 million.

The Sub-Purchasers will be required to enter into an agreement with Bank on or around the date of the Scheme Meeting (the **Sub-Purchase Agreement**). The Bank will pay each Sub-Purchase a fee equal to 2 per cent. of their Sub-Purchase Commitment, provided that they comply with their obligations under the Sub-Purchase Agreement (the **Sub-Purchase Fee**). The aggregate Purchaser Premium payable to the Purchasers will be reduced in an amount equal to the aggregate Sub-Purchase Fees paid to the Sub-Purchasers, such reduction to be allocated among the Purchasers based on their subscription commitment as set out in the Purchase Agreement.

To the extent that the aggregate allocation of Additional New Ordinary Shares to all Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than 62,500,000 Additional New Ordinary Shares, the Sub-Purchasers pursuant to the Sub-Purchase Agreement will be required to subscribe for such number of remaining Additional New Ordinary Shares up to their Sub-Purchase Commitments. If there are still Additional New Ordinary Shares to be issued, the Purchasers under the Purchase Agreement will be required to subscribe for the remaining Additional New Ordinary Shares. Furthermore, if a Holder of Dated Notes elects to participate in the Additional

New Ordinary Shares Offer, or participates in the Sub-Purchase Offer, but, in either case, fails to fund the purchase of its allocation of Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, or the Sub-Purchase Commitment, as applicable, the Purchasers, under the Purchase Agreement, will also be required to subscribe for those Additional New Ordinary Shares.

The obligation of each Purchaser Purchase under the Purchase Agreement in respect of the Subscription are subject to certain conditions being satisfied or waived, including:

(a) the Bank having complied in all material respects with all its obligations under the Purchase Agreement, the Scheme and the Exchange Offers and the warranties given by the Bank being true and accurate;

(b) an office copy of the sanction order of the Scheme must have been delivered to the Registrar of Companies at Companies House;

(c) there shall have been no change in the condition (financial or otherwise) or prospects of the Bank and no litigation or regulatory proceedings will have commenced which is likely to have a material adverse effect upon the Bank's compliance with the minimum regulatory capital requirements or solvency, or which is likely to trigger the regulators' resolution powers under the Banking Act; and

(d) all shareholder, and other, resolutions have been adopted to redesignate and buy-back the existing ordinary shares of the Bank as contemplated by the Recapitalisation Plan.

If the conditions are not satisfied by 31 December 2013 the Purchase Agreement will automatically cease to have effect.

The Bank has given certain representations, warranties and undertakings to the Purchasers under the Purchase Agreement.

20.10 Pensions Undertaking

On 4 November 2013 Co-operative Group and the Bank entered into an undertaking pursuant to which Co-operative Group agreed with the Bank, subject to certain exceptions, not to require the Bank to cease to participate in Pace in connection with the Liability Management Exercise or any subsequent reduction in Co-operative Group's shareholding in the Bank (including to nil). Should either Co-operative Group or the Bank so request, the parties will enter into good faith discussions to agree on the separation of Pace, so that the scheme liability properly attributable to the Bank and an equivalent proportion of the scheme's assets would be transferred to a separate tax registered pension arrangement or a segregated section of the scheme. Neither the Co-operative Group nor the Bank is under an obligation to agree to any separation of the scheme that would result in a requirement to make material payments to or in respect of the scheme.

The undertaking also provides that Co-operative Group will agree with the Bank the proportion of the future service accrual contribution and the proportion of all other contributions due to Pace that the Bank will make. If Co-operative Group and the Bank are unable to agree the proportions payable by the Bank then the matter shall be referred to an independent third party chosen by both parties.

Co-operative Group also agrees to procure that, for so long as the principal employer of the Britannia Scheme is an entity outside of the Bank's group, such employer will not take any action in relation to the scheme without the Bank's prior agreement where such action would or might be expected to increase the liabilities of the Bank or contributions payable by the Bank in connection with the Britannia Scheme.

21. LITIGATION AND ARBITRATION

Save as disclosed in paragraph 21 of this Section 20 (*Additional Information*), there are no governmental, legal or arbitration proceedings which may have or have had in the 12 months prior to the date of this

Prospectus a significant effect on the financial position or profitability of the Bank and/or the Bank and its subsidiaries, nor, so far as the Bank is aware, are any such proceedings pending or threatened.

21.1 PPI

Provisions have been made in respect of potential customer compensation claims relating to past sales of PPI. Claims are investigated on an individual basis and, where appropriate, compensation payments are made. For a number of years, the Bank, along with many other financial services providers, sold PPI alongside mortgage and non-mortgage credit products. The Bank stopped selling non-mortgage PPI in January 2009 and stopped selling mortgage PPI in March 2012. However, products still exist within the Bank which will include an element of PPI from historic sales.

The FSA (as it was then known) issued a policy statement in August 2010 which amended the 'Disputes Resolution: Complaints' section of the Financial Services Handbook, setting out new rules for handling complaints, including complaints of PPI mis-selling. The Bank must comply with the policy statement which requires complainants to receive adequate redress and the Bank to complete a proactive review of all past business to identify mis-sold policies where no complaint has been made.

On 4 January 2013, the FSA fined the Bank £113,300 for failing to handle PPI complaints fairly during the period 21 January 2011 and 9 May 2011. During this period, the British Bankers Association unsuccessfully challenged the FSA measures (published in August 2010) designed to ensure all PPI complaints are treated fairly. The FSA found that during this period it was likely the Bank unfairly put on hold a significant proportion of 1,629 complaints, incorrectly deciding that they could not be determined because the outcome of the judicial review would have a bearing on the final decision.

In line with the rest of the banking industry, the Bank saw a continued increase in the volume of PPI complaints in 2012. As a result, an additional provision of £149.7 million (2011: £90.0 million) was recognised in 2012, in respect of the total expected cost to the Bank of carrying out this work and paying compensation, making total provisions raised of £244.0 million as at 31 December 2012 (2011: £94.3 million).

An additional provision of £53.0 million for redress relating to PPI has been recognised in the period 1 January 2013 to 30 June 2013 primarily to cover increased operating and ombudsman costs. This increases the total estimated cost to £297.0 million as at 30 June 2013 (31 December 2012: £244.0 million). As at 30 June 2013, £166.9 million of this PPI provision had been spent, with £130.1 million remaining. The number of inbound complaints has shown a significant decline in the six months to 30 June 2013, with the average weekly inbound volume being 25.2 per cent. lower than the levels seen in 2012.

This provision represents management's best estimate of the anticipated costs of related customer contact and redress, including administration expenses. The provision is based on the FSA's (as it was then known) policy statement and industry claims experience. Its calculation requires significant judgement by management in determining appropriate assumptions, which include the level of complaints, uphold rates, proactive contact and response rates, and Financial Ombudsman Service referral and uphold rates.

21.2 Interest rate hedging products (**IRHPs**) mis-selling claims

The Bank sold IRHPs to certain SME (non-sophisticated) customers.

On 29 June 2012 the FSA (as it was then known) announced the results of its thematic review of IRHP sales. The review found serious failings in the sale of such products by Barclays, HSBC, Lloyds and RBS to non-sophisticated customers. The FSA agreed a past business review (**PBR**) and redress exercise with these banks.

The FCA has not examined the Bank's sales of IRHPs and so has not made any finding of mis-selling. However, along with six other banks, in July 2012 the Bank volunteered to participate in the past business review (the **Bank's PBR**) and redress exercise, on the same basis as the PBR.

The Bank's PBR is on-going and involves an assessment of historic IRHP sales against eight sales standards (as agreed in collaboration with the FCA). The Bank's PBR population, as agreed with Grant Thornton (the Bank's skilled person as required by the FCA) and the FCA, includes approximately 64 business customers (a substantially smaller number than some banks), of which seven customers were part of an initial pilot scheme (that has now been finalised); redress is payable in two of the assessed pilot cases. Of the customers initially flagged for inclusion within the Bank's PBR, as at 23 October 2013 40 have opted to take part, 15 have opted out and two have yet to revert to the Bank.

The Bank's PBR will assess whether each sale complied with the sale standards. The potential outcomes of the Bank's review of each sale in the PBR are: (1) that the sale was fully compliant; (2) that the sale was not fully complaint but that no redress is payable; or (3) that the sale was not compliant and redress is due. Redress may involve inter alia switching the customer to an alternative product, or ripping up the existing IRHP and refunding payments made for the product. A provision of £10.0 million (2012: £nil) has been recognised for the six months ended 30 June 2013 in respect of the total expected cost to the Bank and the matter remains under review.

21.3 Third Party card protection

Between 1999 and 2012, the Bank introduced and/or sold third party card and identity protection products to its customers through a number of different third parties. In July 2013, the FCA contacted the Bank directly, confirming that it considered one of the third party's product offering to be defective (as customers could receive certain elements of the protection provided for free from their bank) and suggested that the Bank may be expected, moving forward, to offer redress to customers as a consequence of such failings.

A number of financial institutions (not including the Bank) have recently agreed, following discussions with the FCA, to repay substantial sums of redress to customers who took out card protection insurance products with Card Protection Plan Limited (**CPP**). Whilst the same approach would not necessarily be used by the FCA in relation to the third party, it is proposed (subject to creditor and court approval) that the CPP redress would be paid via a scheme of arrangement.

The Bank met with the FCA in September 2013 to discuss the FCA's concerns with the third party product. Further to this meeting, the Bank received a circular letter from the FCA on 15 October 2013 giving reasons why the FCA considers that the Bank is liable, together with the third party provider, to pay redress for sales of card protection products made between 14 January 2005 and 1 October 2012, and/or sold prior to 14 January 2005 and renewed before 1 October 2012. The Bank stopped actively advocating the third party product in February 2012. The FCA asked that the Bank cooperate with the FCA in the implementation of a customer redress process and the Bank is currently considering its position.

As at the date of this prospectus, it is difficult to estimate the cost, (if any), of the redress process to the Bank for the reasons stated above, and because the Bank has minimal data on sales and renewals of the third party product. Whilst the exact nature and extent of any redress is not fully clear at this stage, a precautionary provision of £26.0 million (2012: £nil) has been recognised for the six months ended 30 June 2013 in respect of the total expected cost to the Bank for potential customer redress relating to the above alleged failings.

21.4 ATM business rates

The Bank operates ATMs from a number of Co-operative food stores and other Co-operative society stores across the UK. The relationship between the Bank and the other Co-operative entities in relation to the service/functioning of such ATMs is governed by specific contractual provisions between the parties.

In mid-2013, correspondence was received from HMRC's Valuation Office, in relation to the rating assessments of the aforementioned ATMs. In this correspondence HMRC's Valuation Office has asserted that business rates will be payable in relation to the ATMs. The Bank has estimated that this will amount to approximately £12 million to £15 million.

This assertion continues to be disputed by the Bank. The future rating liability for the above ATMs is potentially in the region of £4 million per annum.

As the legal position is not clear, discussions are on-going with HMRC's Valuation Office as to whether business rates can be applied by the HMRC Valuation Office in the manner which has led them to seek this additional amount.

This is an issue which is common across the retail banking industry. A one-off provision of £13.9 million for the six months ended 30 June 2013 has been made in respect of this.

21.5 Platform and Mortgage Agency Services First Payment

The Bank is currently investigating an issue related to the first payment made by a significant number of current and former mortgage customers in relation to their capital and interest (repayment) mortgages. The Bank's practice had been to collect only the interest element of the first monthly mortgage payment; this with the intention of helping customers avoid falling into arrears immediately after their first monthly mortgage payment fell due. Whilst the 'welcome letter' sent to customers correctly identified that only interest was to be collected in the first payment, some of the further payment information in that letter did not fully correspond to information in the Offer Key Facts Illustration document. The Bank's investigations and consideration of the issue are evolving. It is believed that the issue affects all Platform advances, intermediary mortgage sales and all Mortgage Agency Services (**MAS**) further advances completed between 2002 and 17 March 2013. A number of Platform advances and MAS further advances completed prior to 2002 are also affected.

The Bank has raised this issue and is continuing to liaise with the FCA. As a matter of prudence, having regard to information that is known at the date of the Prospectus, a provision of £34 million was made.

22. RELATED PARTY TRANSACTIONS

Other than:

(i) as disclosed in note 37 of the Bank's consolidated audited financial statements for the financial years ended 31 December 2012, 2011, and 2010, such notes being incorporated by reference into this Prospectus;

(ii) Note 32 of the Interim Financial Information;

(iii) (a) the Existing IT Services Agreement and the proposed New IT Services Agreement (see paragraph 20.1(a) titled "*IT Services Agreement*" in this Section 20 (*Additional Information*")); (b) the Existing MSA and the proposed New MSA (both as defined in paragraph 20.1(b) titled "*MSA*" in this Section 20 (*Additional Information*)); (c) the CFSMS-Bank Framework Agreement (see paragraph 20.2 titled "*CFSMS-Bank Framework Agreement*" in this Section 20 (*Additional Information*)); (d) the Relationship Agreement (see paragraph 20.3 titled "*Relationship Agreement*" in this Section 20 (*Additional Information*)); (e) the 2014 Commitment Agreement (see paragraph 20.4 titled "*2014 Commitment Agreement*" in this Section 20 (*Additional Information*)); (f) the Agreed Co-existence Principles (see paragraph 20.5 titled "*The Agreed Co-existence Principles*" in this Section 20 (*Additional Information*)); (g) the Intra-group Loan (see paragraph 20.6 titled "*Intra-group Loan*" in this Section 20 (*Additional Information*)); and (h) the Dealer Manager Agreement (see paragraph 20.7 titled "*Dealer Manager Agreement*" in this Section 20 (*Additional Information*)); and

(iv) as disclosed in paragraphs 22.1 to 22.6 inclusive below,

neither the Bank nor any of its subsidiaries has entered into any related party transactions (which for these purposes are those set out in the standards adopted according to the Regulation (EC) No 1606/2002) with any related party during the financial years ended 31 December 2012, 2011 and

2010, during the six months ended 30 June 2013, and up to the latest practicable date prior to publication of this Prospectus.

22.1 The Bank entered into a services agreement with Co-operative Legal Services Limited (**CLS**) on 15 October 2013. This agreement replaces the pre-existing arrangements relating to the introduction of customers to CLS by the Bank. This is an arm's length agreement entered into in the ordinary course of business.

Under this agreement, the Bank will (a) promote the products and services of CLS through the Bank branch network by displaying materials produced by CLS which describe or promote the services they offer; (b) identify customers who have a need for the legal services of CLS and refer them to CLS; and (c) provide space in its premises for CLS staff to undertake pre-arranged appointments with customers who have been referred by the Bank. CLS retains an absolute and unfettered discretion to accept or decline any application to use its services in accordance with its normal practices and internal policies.

In return, CLS agrees to pay the Bank a quarterly marketing services charge. This payment is calculated on the basis of elements such as: (i) amount of time the Bank's colleagues spend discussing the products offered by CLS; and (ii) the amount of window space and leaflet dispensers in a premises of the Bank used to promote CLS' services. Banking Group is to provide this information to CLS and CLS will calculate the service charge payable. The first payment to be made under the agreement is not due until January 2014. It is not expected that this payment will exceed £45,000. CLS will also provide the Bank with the materials necessary for the promotional activity to take place, such as the leaflets. For the purposes of promotion, the parties agree to grant each other a royalty free non-exclusive licence to use, in the case of the CLS, the Bank logo and the following names: The Co-operative Bank and Co-operative Banking Group Limited, and, in the case of the Bank, the CLS logo and the following names: Co-operative Legal Services, The Co-operative Legal Services and Co-operative Legal Services Limited.

The services agreement has an initial term of three years from the date of the agreement and will continue thereafter unless terminated by either party on at least 12 months' notice. Either party may terminate the agreement if there is a change of control of the other party except where such change of control is for the purposes of solvent re-organisation or corporate arrangements, refinancing or mergers. If either party wishes to make an amendment to the marketing services charge they must propose it to the other at the joint management committee (**JMC**) which consists of senior management from both parties. If the parties fail to agree to the proposed change and the JMC cannot resolve the dispute, it shall be escalated to the managing director of CLS and the current Managing Director, Retail Bank, of the Bank. If the parties still fail to agree, either party may terminate on 30 days' written notice.

Each party's liability to the other party under the agreement is limited to £200,000 in the aggregate.

22.2 The Bank is proposing to enter into a services agreement with Funeral Services Limited (**FSL**) prior to the end of 2013. It will be an arm's length agreement entered into in the ordinary course of business.

Under this agreement, it is proposed that the Bank will (a) promote the products and services of FSL through the Bank branch network and (b) offer FSL funeral care planning products to its customers and potential customers. FSL retains an absolute and unfettered discretion to accept or decline any application to use its services in accordance with its normal practices and internal policies.

It is expected that this agreement will be entered into on terms similar to the agreement summarised in paragraph 22.1 above.

22.3 The Bank entered into a cash in transit services agreement dated 10 May 2012 with Sunwin Services Group (2010) Limited (**Sunwin**) (the **CITSA**). The CITSA is an arm's length agreement entered into in the ordinary course of business.

Under the CITSA, Sunwin agrees to provide the following services to the Bank: collection of cash, coin and cheques from the Bank's offices, branches, ATMs or corporate customers for the delivery of cash, coins and cheques, as applicable, to the Bank's chosen cheque-processing centre, the Bank's offices, branches, ATMs or corporate customers. Sunwin also agrees to perform collection and cash processing services (a) from Co-operative Group stores upon Jersey and Guernsey, and (b) to and from Banking Group's Guernsey branch.

In return, the Bank will pay Sunwin for the provision of the services. The amount to be paid varies depending upon how much the Bank utilises the services. The Bank paid approximately £1.2 million, inclusive of VAT, under the CITSA for the previous year.

The term of the CITSA began on 13 June 2011 and will end on termination of the CITSA. The Bank may terminate the CITSA immediately if continued association with Sunwin would, in the Bank's sole reasonable opinion, contravene the Bank's sustainable procurement and supplier policy. It may also terminate the CITSA if (i) Sunwin is subject to a change of control to which the Bank has not provided its consent or (ii) the Bank gives 12 months' written notice to Sunwin, such notice not to take effect prior to the fourth anniversary of the date of the agreement.

22.4 The Bank entered into an ATM cash replenishment agreement dated 24 October 2012 with Sunwin Services Group (2010) Limited (**Sunwin**) (the **CRA**). The CRA is an arm's length agreement entered into in the ordinary course of business.

Under the CRA, Sunwin agrees to provide to the Bank the following services: collection and return of ATM cash, cash replenishments, housekeeping of the ATMs and account management.

In return, the Bank will pay Sunwin for the provision of the services. The amount to be paid varies depending upon the how much the Bank utilises the services. It is expected that the Bank will pay between approximately £13 million and £15 million, inclusive of VAT, per annum for the services provided under the CRA. The CRA may be terminated, inter alia, by either party on 12 months' notice, provided that the notice period shall not expire earlier than five years from the date of the CRA. The Bank may terminate the CRA immediately if continued association with Sunwin would, in the Bank's sole reasonable opinion, contravene the Bank's sustainable procurement and supplier policy. The Bank may also terminate the CRA if Sunwin is subject to a change of control to which the Bank has not provided its consent.

22.5 The Bank entered into an agreement with Co-operative Group (CWS) Limited (now called Co-operative Group) (**CWS**) concerning the installation and operation of ATMs dated 1 January 2008 (the **ATMA**). The ATMA is an arm's length agreement entered into in the ordinary course of business.

Under the ATMA, CWS has granted a licence to the Bank to install and operate ATMs in CWS premises. The ATMs are to be installed in prominent locations in CWS premises by mutual agreement and the Bank has the right of first refusal to site ATMs at CWS premises. If the Bank declines a location offered, CWS has the right to install a third party's ATM at that location.

The ATMA is for an initial term of five years from the date of agreement, with automatic renewal on the same terms for 12 months' at a time unless either party gives two months' written notice to the other. Given the five year initial term has expired, the ATMA is continuing in force on the basis of the rolling 12 month notice period. On termination of the ATMA, all removal costs of the ATMs shall be shared equally by both parties.

The terms of the existing agreement are currently under review by the parties. As at the date of this Prospectus it is currently anticipated that a new agreement will be entered into prior to 2014. The new agreement is expected to provide greater detail on the operational arrangements required as well as clarifying aspects concerning the ownership of property, including the perfection of rights required to install and operate the ATM's, their ancillary plant and equipment and obligations and privileges for each ATM to operate without prejudice to the safety and operation of the building in which it is located and vice versa.

22.6 The Bank and CIS General Insurance have, for approximately three years, had a course of dealings which is undocumented by which the Bank (a) promotes the products and services of CIS General

Insurance through the Bank branch network by displaying materials produced by CIS General Insurance which describe or promote the services they offer; and (b) offers CIS General Insurance home insurance policies through the Bank's mortgage advisors. In return, CIS General Insurance pays the Bank a commission of £40 for every insurance policy sold. During the financial year to 31 December 2012, CIS General Insurance paid the Bank £849,180 in commissions.

As part of the sale of proposed CIS General Insurance it is proposed that a new agreement be entered into to document this arrangement.

23. DEPENDENCE UPON OTHER ENTITIES IN CO-OPERATIVE GROUP

The Bank is dependent on Co-operative Group for the provision of certain administrative services (such as finance, marketing, human resources, some risk functions and, in particular, IT) although the extent of this reliance is expected to be reduced following completion of the Liability Management Exercise as services are likely to be repatriated to the Bank. These arrangements may need to be renegotiated as a result of the successful implementation of the Liability Management Exercise. In addition the Bank is dependent on the strength of the wider Co-operative brand and its reputation with customers and potential customers of the Bank.

21
IMPORTANT LEGAL INFORMATION

This section contains some important legal information regarding the basis on which this Prospectus may be used and other matters.

IMPORTANT LEGAL INFORMATION

The Prospectus has been prepared on a basis that permits a public offer of the Notes that is not within an exemption from the requirement to publish a prospectus under Article 5.4 of Directive 2003/71/EC as amended (which includes the amendments made by Directive 2010/73/EU to the extent that such amendments have been implemented in a relevant Member State of the European Economic Area) in the United Kingdom.

Persons authorised to use this Prospectus

The Notes are being offered by the Issuer only. In addition, the offer is being made only to investors who hold the Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (the **2016 Notes**), the 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) (the **2019 Notes**), the 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) (the **April 2021 Notes**), the Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) (the **November 2021 Notes**), the 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) (the **2022 Notes**), the 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) (the **2024 Notes**), the 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (the **2033 Notes**) (together the **Dated Notes**), the 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the **5.5555% Bonds**) and other capital securities issued by the Bank of the Issuer which are currently outstanding, as part of the Liability Management Exercise being conducted by the Issuer and the Co-operative Group. Accordingly, the Issuer has not authorised any subsequent resale of the Notes through financial intermediaries.

The Dealer Managers and the Trustee

None of the Dealer Managers or the Trustee has independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealer Managers or the Trustee as to the accuracy or completeness of the information contained or incorporated in this Prospectus or any other information provided by the Issuer in connection with the offering of the Notes. Neither the Dealer Managers nor the Trustee accept any liability in relation to the information contained or incorporated by reference in this Prospectus or any other information provided by the Issuer in connection with the offering of the Notes or their distribution. Each Dealer Manager and the Trustee accordingly disclaims all and any liability whether arising in tort or in contract or otherwise which it might otherwise have in respect of this Prospectus.

No person is or has been authorised by the Issuer, the Dealer Managers or the Trustee to give any information, or to make any representation, not contained in, or not consistent with, this Prospectus or any other information supplied in connection with the offering of the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer, the Dealer Managers or the Trustee.

Neither this Prospectus nor any other information supplied in connection with the offering of the Notes (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Dealer Managers or the Trustee that any recipient of this Prospectus or any other information supplied in connection with the offering of the Notes should participate in the Liability Management Exercise or invest in the Notes. Each investor contemplating participating in the Liability Management Exercise or investing in the Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Prospectus nor any other information supplied in connection with the offering of the Notes constitutes an offer or invitation by or on behalf of the Issuer, the Dealer Managers or the Trustee to any person to subscribe for or to purchase any Notes.

Neither the delivery of this Prospectus nor the offering, sale or delivery of the Notes shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the offering of the Notes is correct as of any time subsequent to the date indicated in the document containing the same. The Dealer Managers and the Trustee expressly do not undertake to review the financial condition or affairs of the Issuer during the life of the Notes or to advise any investor in the Notes of any information coming to their attention.

Each of HSBC Bank plc and UBS Limited are authorised by the PRA and regulated by the PRA and the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of either Dealer Manager (within the meaning of the FCA's rules) by virtue of receipt of this Prospectus or participation in the Liability Management Exercise or any component part thereof. The Dealer Managers are acting on their own account in relation to the Liability Management Exercise and, to the fullest extent permitted by applicable law and regulation, will not be responsible to any other person for providing the protections which would be afforded to clients of either Dealer Manager or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Offer and distribution restrictions

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the **Securities Act**). Holders who wish to participate in the Exchange Offers will be required to represent that they will not resell or otherwise transfer the Notes during the 40 day period commencing on the Settlement Date except outside of the United States in a transaction complying with Rule 903 or 904 of Regulation S.

This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy the Notes in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Prospectus and the offer or sale of Notes may be restricted by law in certain jurisdictions. The Issuer, the Dealer Managers and the Trustee do not represent that this Prospectus may be lawfully distributed, or that the Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, except as indicated in Section F "*Offer Restrictions*" in the Offer Memorandum set out in Appendix C to this Prospectus, no action has been taken by the Issuer, the Dealer Managers or the Trustee which is intended to permit a public offering of the Notes or the distribution of this Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Prospectus or any Notes may come must inform themselves about, and observe, any such restrictions on the distribution of this Prospectus and the offering and sale of Notes. In particular, there are restrictions on the distribution of this Prospectus and the offer or sale of Notes in the United States and the United Kingdom, see Section F "*Offer Restrictions*" in the Offer Memorandum set out in Appendix C to this Prospectus.

PRESENTATION OF FINANCIAL INFORMATION

The financial information contained in this Prospectus has been prepared for the Bank. Prospective investors should consult their own professional advisers to gain an understanding of the financial information contained in the Prospectus. An overview of the basis for presentation of financial information in this Prospectus is set out below.

Save as set out below, financial information presented or incorporated by reference in this Prospectus: (i) comprises information for the Bank for the financial years ended 31 December 2012, 2011 and 2010 and the six months ended 30 June 2013 and 2012; and (ii) has been extracted without material adjustment from the audited consolidated financial statements of the Bank for the years ended 31 December 2012, 2011 and 2010 and the interim financial information of the Bank for the six months ended 30 June 2013 (**Interim Financial Information**).

The consolidated financial statements of the Bank for the years ended 31 December 2012, 2011 and 2010 and the Interim Financial Information have been audited by KPMG Audit Plc, independent auditors, in accordance with applicable law and the International Standards on Auditing (UK & Ireland) issued by the Auditing Practices Board in the UK. They have been prepared in accordance with the requirements of the

Prospectus Directive and the UK Listing Rules and in accordance with IFRS, as adopted by the EU. The consolidated financial statements of the Bank for the years ended 31 December 2012, 2011 and 2010 have been incorporated by reference, as detailed in Section 18 (*Information Incorporated by Reference*). The Interim Financial Information is set out at Part B of Section 16 (*Financial Information*). In the financial year ended 31 December 2011 the Bank reported its operating segments as 'Retail', 'Corporate and Business Banking' and 'Other' and in the financial year December 2010 the Bank reported its operating segments as 'Retail', 'Corporate and Markets' and 'Other', based on differences in products and services. In 2012 the Bank refined the 'Corporate and Business Banking' into core and non-core and moved the Platform portfolio from 'Corporate and Business Banking' to the 'Retail' business. The Bank reported on this refined basis in the financial year ended 31 December 2012 and the Interim Financial Information. The comparatives for the six months ended 30 June 2012 are also reported on this basis.

In 2013, as the strategy of the Bank developed and as part of the Bank's plan to simplify and reshape itself as announced on 17 June 2013, the core and non-core business activities constituted in 2012 were redefined as:

(i) Retail and SME Banking (the **Core Business**); and

(ii) Co-operative Asset Management (the **Non-core Business**).

The Core Business represents lines of business that are consistent with the Bank's strategy and risk appetite. The Non-core Business includes those businesses and assets which are not consistent with the Bank's business strategy, are managed to achieve the most appropriate asset value on an individual portfolio basis or are targeted for run down or exit, and contain the majority of the Bank's impairment risk. These include the Optimum portfolio (a closed book of predominantly interest only, intermediary and acquired mortgage book assets), the Illius portfolio of investment properties and non-core corporate banking assets, in particular the commercial real estate portfolio.

Save as set out below, the historical financial information of the Bank for the financial years ended 2012, 2011 and 2010 and the six months ended 30 June 2013 and 2012 incorporated by reference into or included in this Prospectus, notably Section 10 (*Capitalisation and Indebtedness*), Section 11 (*Selected Financial Information*), Section 12 (*Operating and Financial Review*) and Section 16 (*Financial Information*), reflects the segments of the business in place during the relevant reporting periods including, for the financial statements for the year ended 31 December 2012 and the six months ended 30 June 2013, the core and non-core business segments as constituted in 2012.

The historical financial information of the Bank for the six months ended 30 June 2013 as set out in Section 8 (*Description of the Bank*) and Section 15 (*Segmented Financial and Other Information*) reflects the divisions of the Bank as now managed, i.e. the Core Business and Non-core Business. This financial information is unaudited and has been extracted from the Bank's internal management systems for the six months ended 30 June 2013.

The Accountant's Report on the Bank's Interim Financial Information for the six months ended 30 June 2013 also includes an emphasis of matter paragraph relating to note 2 to the Interim Financial Information.

IFRS and generally accepted accounting procedures in the United Kingdom (**UK GAAP**) differ from each other in certain significant respects. The Bank's financial statements and interim reports have not been reconciled to UK GAAP. The Bank has not prepared any financial information in accordance with UK GAAP nor a reconciliation or quantification of differences between IFRS and UK GAAP.

CURRENCIES

Unless otherwise indicated, in this Prospectus, all references to:

(i) **US dollars, dollars, USD, US$** or **cents** are to the lawful currency of the United States;

(ii) **euro** or **€** are to the lawful currency of the European Union (as adopted by certain member states); and

(iii) **British pounds sterling, Sterling, pounds sterling** or **£** are to the lawful currency of the UK.

Unless otherwise indicated, the financial information contained in this Prospectus has been expressed in pounds sterling. The Bank's functional currency is pounds sterling and the Bank prepares its financial statements in pounds sterling.

FORWARD-LOOKING STATEMENTS

Certain information contained or incorporated by reference in this Prospectus including any information as to the Bank's strategy, plans or future financial or operating performance constitute "forward-looking statements". These forward-looking statements can be identified by the use of forward-looking terminology, including the terms "believes", "estimates", "anticipates", "projects", "expects", "intends", "aims", "plans", "predicts", "may", "will", "seeks" or "should" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Prospectus and include statements regarding the intentions, beliefs or current expectations of the Directors concerning, amongst other things, the Bank's results of operations, financial condition, prospects, growth, strategies and the industry in which the Bank operates.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. Forward-looking statements are not guarantees of future performance. The Bank's actual results of operations, financial condition, and the development of the financial services industry in which the Bank operates, may differ materially from those suggested by the forward-looking statements contained in this Prospectus. In addition, even if the Bank's results of operations, financial condition, and the development of the financial services industry are consistent with the forward-looking statements contained in this Prospectus, those results or developments may not be indicative of results or developments in subsequent periods.

Prospective investors are advised to read, in particular, Section 2 (*Risk Factors*) and Section 8 (*Description of the Bank*) for a more complete discussion of the factors that could affect the Bank's future performance and the financial services industry. In light of these risks, uncertainties and assumptions, the events described in the forward-looking statements in this Prospectus may not occur.

The forward-looking statements contained in this Prospectus speak only as of the date of this Prospectus. The Bank, the Dealer Managers and the Trustee expressly disclaim any obligation or undertaking to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, unless required to do so by applicable law, the Prospectus Rules, the Listing Rules, or the Disclosure and Transparency Rules of the FCA. All subsequent written and oral forward-looking statements attributable to the Bank or individuals acting on behalf of the Bank are expressly qualified in their entirety by this paragraph.

MARKET, ECONOMIC AND INDUSTRY DATA

The Prospectus contains information regarding Bank's business and the industry in which it operates and competes, which the Bank has obtained from third-party sources.

Bank and other institutions operating in the financial services industry make available a wide range of financial and operational information to regulatory and market bodies, including the Bank of England and the CML. These bodies use certain of the data supplied to publish market share statistics relating to retail mortgage lending and savings, among other matters. However, no assurance can be made that the information reported to these bodies by different market participants is, in all cases, directly comparable.

In some cases, independently determined industry data is not available. In these cases, any Bank market share included in this Prospectus is referred to as having been estimated. All such estimates have been made by the Bank using its own information and other market information which is publicly available. All such estimations have been made in good faith based on the information available and Bank's knowledge of the market within which it operates.

Where third-party information has been used in this Prospectus, the source of such information has been identified. In the case of the presented economic and statistical information, similar information may be obtainable from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source.

The Bank confirms that all information extracted from third party sources has been accurately reproduced and, as far as the Bank is aware and has been able to ascertain from information published by those sources, no facts have been omitted which would render the reproduced information inaccurate or misleading. Where third party information has been used in this Prospectus, the source of such information has been identified.

Where information has not been independently sourced, it is the Bank's own information.

DEFINITIONS

Certain capitalised and other terms used in this Prospectus are defined in Appendix A (*Defined Terms*).

ROUNDING

Certain data in this Prospectus has been rounded. As a result of such rounding, the totals of data presented in tables or narrative descriptions in this Prospectus may vary slightly from the arithmetic totals of such data.

CREDIT RATING AGENCIES

This prospectus contains references to Moody's, Fitch and S&P.

Each of Moody's, Fitch and S&P are established in the European Union and are registered under the CRA Regulation. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

NO INCORPORATION OF WEBSITE INFORMATION

The Bank's website is www.co-operativebank.co.uk. The information on this website or any website mentioned in this Prospectus or any website directly or indirectly linked to these websites has not been verified and is not incorporated by reference into this Prospectus and investors should not rely on it.

All references in this document to times are to UK time unless otherwise stated.

A
APPENDIX A
DEFINED TERMS

This Appendix sets out the meaning of certain defined terms used in this Prospectus or indicates the location in this Prospectus where such meaning can be found.

The following definitions apply throughout this Prospectus unless the context requires otherwise:

Terms and expressions defined in Appendix C (*Consent and Exchange Offer Memorandum*) shall have the same meanings in this Prospectus, except where the context otherwise requires or unless otherwise stated.

13% Bonds	13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201)
5.5555% Bonds	5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45)
2014 Commitment	the commitment by Banking Group made pursuant to a legally binding and irrevocable commitment with the Bank on 4 November 2013 (conditional upon the Scheme having been implemented in accordance with its terms (including the subscription of Additional New Ordinary Shares Offer to Holders of Dated Notes in accordance with the Scheme)), to contribute £333 million Common Equity Tier 1 Capital to the Bank during 2014, as agreed with the PRA
2014 Commitment Agreement	the agreement between the Banks and Banking Group which is further described in paragraph 20.4, titled "*2014 Commitment Agreement*" in Section 20 (*Additional Information*)
2016 Notes	Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998)
2019 Notes	5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942)
2022 Notes	7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868)
2024 Notes	5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183)
2033 Notes	5.875% Subordinated Notes due 2033 (ISIN: XS0145065602)
Accrual Date	As defined in Appendix B (*Conditions of the Notes*)
Additional New Ordinary Shares	means 62,500,000 ordinary shares to be issued by the Bank for an aggregate consideration equal to £125 million pursuant to the Additional New Ordinary Shares Offer
Additional New Ordinary Shares Offer	the offer to subscribe for Additional New Ordinary Shares in accordance with the terms of the Scheme
Additional Preference Shares	as defined in Section 6 (*Details of the Liability Management Exercise*)
Additional Tier 1 or **ATI**	at any time has the meaning ascribed thereto in Basel III
ALCO	Bank Asset and Liability Committee
Approved Persons	persons approved by either or both of the FCA or the PRA under section 59 of FSMA
April 2021 Notes	9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902)
Authorities	HM Treasury, the Bank of England, the FCA and/or the PRA

B2.5	refers to amendments made to the Basel II framework under the following three papers published by the Basel Committee in July 2009: (a) Enhancements to the Basel II framework (BCBS157); (b) Revisions to the Basel II market risk framework (BCBS158); and (c) Guidelines for computing capital for incremental risk in the trading book (BCBS159)
BACB	the Bank's core business and commercial banking business as further described in paragraph 5 "*Business Overview*" in Section 8 (*Description of the Bank*)
Bank	The Co-operative Bank p.l.c. and its subsidiaries, depending on the context
Bank T2 Notes	new 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853; SEDOL: BFXW085), which may be issued by the Bank pursuant to the Liability Management Exercise
Banking Act	the Banking Act 2009
Banking Group	Co-operative Banking Group Limited, or Co-operative Banking Group Limited and its subsidiaries, depending on the context
Banking Reform Bill	Financial Services (Banking Reform) Bill
Barclays	Barclays Bank PLC, a public limited company organised under the laws of England and Wales, registered with Companies House under number 01026167
Basel II or **B2**	the international capital requirements framework as set out in the Basel Committee's document: *International Convergence of Capital Measurements and Capital Standards: a Revised Framework* (revised in November 2005)
Basel III or **B3**	the reforms to enter new international capital and liquidity requirements as set out in the Basel Committee's document Basel III: *A global regulatory framework for more resilient banks and banking systems dated December 2010* (revised in June 2011), together with the Basel Committee's 13 January 2011 press release entitled *Basel Committee issues final elements of the reforms to raise the quality of regulatory capital*
Basel III Tier 1 Capital	the highest quality regulatory capital under Basel III, as implemented in the European Union through CRD IV, which is divided into common equity tier 1 and additional tier 1 (each as defined in Basel III)
Basel Accord	the current risk-adjusted capital guidelines promulgated by the Basel Committee
Basel Committee	means the Bank for International Settlements' Basel Committee on Banking Supervision
BIPRU	the Prudential sourcebook for Banks, Building Societies and Investment Firms as set out in the Financial Services Handbooks
BRC	the Board Risk Committee of the Bank

Britannia	Britannia Building Society
Britannia Scheme	the Britannia Pension Scheme as further described in paragraph 17 titled "*Pension Schemes*" in Section 20 (*Additional Information*)
British pounds sterling, pounds sterling, Sterling or **£**	pounds sterling, the lawful currency of the United Kingdom
CABB	the Bank's legacy 'corporate and business banking' division which was constituted in 2011 and redefined in 2012
CCA	Consumer Credit Act 1974, as amended
CEO	Chief Executive Officer
Certificate	a certificate issued to each Noteholder that holds their Notes in certificated form, in respect of their registered holding of Notes
CFSMS	CFS Management Services Limited
CFSMS-Bank 2006 Agreement	agreement dated 16 February 2006 in relation to the provision of assets and personnel to the Bank by CFSMS
CFSMS-Bank Framework Agreement	the proposed draft amendment to the CFSMS-Bank 2006 Agreement contemplated for the 17 June Plan and which is further described in paragraph 20.2 titled "*CFSMS-Bank Framework Agreement*" in Section 20 (*Additional Information*)
CIS General Insurance	CIS General Insurance Limited, an industrial and provident society with registration number IP29999R with its registered office address at CIS Building, Miller Street, Manchester M60 0AL
Clearstream, Luxembourg	Clearstream Banking, *société anonyme*
CML	Council of Mortgage Lenders
CoAM or **Co-operative Asset Management**	the function established by the Bank to oversee the proactive management, disposal and run-off of the Non-core Assets
Common Equity Tier 1	at any time, has the meaning ascribed thereto (or to any equivalent term) at such time in CRD IV
Common Equity Tier 1 Capital	capital meeting the definition of Common Equity Tier 1
Companies Act	the Companies Act 2006, as amended
Conditions	the conditions of the Notes as set out in Appendix B (*Conditions of the Notes*)
Co-operative Group	Co-operative Group Limited, or Co-operative Group Limited and its subsidiaries, depending on the context
Co-operative Life Insurance and Asset Management	Royal London (CIS) Limited (formerly known as Co-operative Insurance Society Limited) and Royal London Asset Management (CIS) Limited (formerly known as The Co-operative Asset Management Limited)
Core Business	the division of the Bank comprising the of core business activities as constituted in 2012 and redefined in 2013 consisting of: (i) Retail Banking business;

	(ii) BACB business; and
	(iii) Treasury/other
Core Tier 1 Capital	means the highest quality regulatory capital under Basel II
CRA Regulation	Regulation (EC) No 1060/2009 on credit rating agencies, as amended
CRD IV	the EU's implementation of Basel III via the PRD and the PRR
CRE	commercial real estate
Credit Guarantee Scheme	the HM Treasury's credit guarantee scheme introduced in October 2008 (and closed to new issuance on 28 February 2010) for the purpose of assisting the funding of the UK banking sector and support the stability of the financial system
CREST	the relevant system (as defined in the Uncertificated Securities Regulations) in respect of which Euroclear UK & Ireland Limited (previously CRESTCo Limited) is the operator (as defined in the CREST Regulations)
CRO	Chief Risk Officer
Dated Notes	the following lower tier 2 bonds issued by the Bank: • the 2016 Notes • the 2019 Notes • the April 2021 Notes • the November 2021 Notes • the 2022 Notes • the 2024 Notes • the 2033 Notes
Dealer Managers	HSBC Bank plc and UBS Limited
Deposit Guarantee Scheme	the deposit guarantee scheme created pursuant to the DGSD
DGSD	Directive 94/19/EC (the **EU Deposit Guarantee Scheme Directive**)
Directors or **Board**	the Executive and Non-Executive Directors of the Bank
Disclosure and Transparency Rules	the disclosure and transparency rules made by the FCA under Part VI of FSMA
Discount Window Facility or **DWF**	bilateral facility offered by the Bank of England designed to address short-term liquidity shocks
Early Participation Deadline	4.30 p.m. (London time) on 29 November 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders)
Early Participation Threshold	has the meaning given to that term in the Offer Memorandum
EBA	European Banking Authority
EEA	European Economic Area

Eligible Holders	a Holder that is eligible to participate in the Liability Management Exercise, or the relevant component part thereof, in accordance with the Offer Restrictions (and **Holder** shall be construed accordingly unless the context otherwise admits)
ERC	Executive Risk Committee
EU	the European Union
euro or **€**	the lawful currency of the Member States that adopt the single currency in accordance with the Treaty establishing the European Community (signed in Rome on 25 March 1957), as amended by the Treaty on European Union (signed in Maastricht on 7 February 1992), the Treaty of Amsterdam (signed in Amsterdam on 2 October 1997) and the Treaty of Nice (signed in Nice on 26 February 2001)
Euroclear	Euroclear Bank S.A./N.V.
Eurozone	those Member States which have adopted the euro
EU Savings Directive	EC Council Directive 2003/48/EC on the taxation of savings income
Exchange Agent	Lucid Issuer Services Limited, in its capacity as exchange agent in respect of the Offers
Exchange Instruction	has the meaning given to that term in the Offer Memorandum
Exchange Offers	the invitations described in the Offer Memorandum by the Bank and Co-operative Group (as applicable) to Eligible Holders to offer to exchange or sell their Preference Shares and Perpetual Subordinated Bonds for certain New Securities or cash payable in instalments (represented by certain New Securities) (and the offer in respect of each series of Perpetual Subordinated Bonds and the Preference Shares each being an **Exchange Offer**)
Executive Directors	Niall Booker and Rodney Jensen Bulmer
Existing IT Services Agreement	the agreement dated 5 July 2012 (as amended and restated from time to time and including most recently on 22 May 2013) between the Bank, Co-operative Group and CFSMS, pursuant to which Co-operative Group provides members of Banking Group, including the Bank, and Co-operative Insurance Society Limited, with a wide range of IT services
Existing MSA	the agreement dated 14 February 2013 (as amended from time to time) between the Bank, Co-operative Group and CFSMS, pursuant to which Co-operative Group provides the Bank with certain services
Existing Securities	Preference Shares, Perpetual Subordinated Bonds and Dated Notes
Explanatory Statement	the explanatory statement made available or to be made available to Holders of Dated Notes in connection with the Scheme
Extraordinary Resolutions	in respect of the Preference Shares and each series of Perpetual Subordinated Bonds, the extraordinary resolution to be proposed at the relevant Meeting of Holders of such securities
FATCA	US Internal Revenue Code of 1986
FCA	the UK Financial Conduct Authority

Final Repayment Notes	11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630; SEDOL: BFXW063) which may be issued by Co-operative Group pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of Co-operative Group's subsidiaries
Financial Services Compensation Scheme or **FSCS**	the UK compensation fund of last resort for customers of financial services firms authorised under FSMA, such fund being established under FSMA
Financial Services Handbooks	the FCA Handbook and the PRA Handbook issued under FSMA
Fitch	Fitch Ratings Limited
FPC	Financial Policy Committee
FSA	the Financial Services Authority as succeeded by the FCA or the PRA, as applicable
FSMA	the Financial Services and Markets Act 2000, as amended
Funding for Lending Scheme	the Bank of England and HM Treasury scheme launched on 31 July 2012 to encourage banks and building societies to increase their lending to UK households and non-financial companies
GENPRU	the General Prudential sourcebook as set out in the Financial Services Handbooks
Government	the Government of the United Kingdom
Group Notes	the Final Repayment Notes and/or the Instalment Repayment Notes, as the context admits
Group Notes Prospectus	the prospectus dated 4 November 2013 and issued by Co-operative Group in connection with the issue, offer and listing and admission to trading of the Group Notes, including any supplement(s) thereto (if any) which may be issued after that date
HMRC	HM Revenue & Customs
Holders	the holders of the Existing Securities
Holding Period Trustee	Lucid Issuer Services Limited, as holding period trustee in connection with the Scheme
HSBC	HSBC Bank plc, public limited company organised under the laws of England and Wales, registered with Companies House under number 00014259
IFRS	International Financial Reporting Standards
Illius	a portfolio of repossessed properties managed through Co-operative Group Property with the Non-core Business as further described in Section 8 (*Description of the Bank*)
Information Agent	Lucid Issuer Services Limited, as information agent in connection with the Scheme
Instalment Repayment Notes	Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29; SEDOL: BFXWHQ2), having their last payment in 2025, which may be issued by Co-operative Group

	pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of Co-operative Group's subsidiaries
Insurance Proceeds	proceeds of the sale by Co-operative Group of Co-operative Life Insurance and Asset Management and the proposed sale of CIS General Insurance
Interest Payment Date	as defined in Appendix B (*Conditions of the Notes*)
Interim Financial Information	the historical financial information for the Bank for the six months ended 30 June 2013, as set out in "*Part A*" in Section 16 (*Financial Information*)
IRB	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 the permission of the appropriate regulator; in the case of the Bank, the appropriate regulator is the PRA
ISIN	International Securities Identification Number
Issue Date	the date of issue of the first tranche of the Notes
Issuer	The Co-operative Bank p.l.c.
Issuer Agreement	the announcement by the Bank and Co-operative Group on 17 June 2013 that, following the conclusion of the Bank's review of its capital position and discussion with the PRA, the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion
June Announcement	the announcement by the Bank and Co-operative Group on 17 June 2013 that following the Bank's review of its capital position and discussions with the PRA, the Bank required additional aggregate Common Equity Tier 1 Capital of £1.5 billion
Junior Securities	as defined in Appendix B (*Conditions of the Notes*)
KPMG	KPMG Audit Plc, a public limited company organised under the laws of England and Wales, registered with Companies House under number 03110745
Liability Management Exercise or **LME**	the liability management exercise of the Bank and Co-operative Group, including the Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds, the Scheme in respect of the Dated Notes and the Additional New Ordinary Shares Offer
LIBOR	London Interbank Offered Rate – the interest rate participating banks offer to other banks for loans on the London market
Liikanen Group	the group set up in November 2011 constituting a high-level expert group on structural aspects of the EU banking sector
Listing Rules	the listing rules of the FCA relating to admission to the Official List made in accordance with section 73A(2) of FSMA

Lloyds or **Lloyds Banking Group**	Lloyds Banking Group plc, a public limited company organised under the laws of Scotland, registered with Companies House under number SC095000
Lock-up Arrangements	as defined in Section 6 (*Details of the Liability Management Exercise*)
London Stock Exchange	London Stock Exchange plc
Maturity Date	the tenth anniversary of the Issue Date
Meeting	in respect of the Preference Shares and each series of Perpetual Subordinated Bonds, the meeting of Holders of such securities convened to consider the relevant Extraordinary Resolution (and any adjournment thereof)
Member State	a member state of the EU
Moody's	Moody's Investors Service Limited
New IT Services Agreement	the proposed draft amendment and restatement of the Existing IT Services Agreement contemplated for the 17 June Plan
New MSA	the proposed draft amendment and restatement of the existing MSA contemplated for the 17 June Plan
New Ordinary Shares	112,500,000 ordinary shares to be issued by the Bank in exchange for the Dated Notes pursuant to the Scheme
New Securities	The New Ordinary Shares, the Final Repayment Notes, the Instalment Repayment Notes and/or the Bank T2 Notes, as the context admits
Non-core Assets	the asset classes of the Non-core Business of the Bank that are not consistent with the Bank's Core Business strategy. Further details are contained in Section 8 (*Description of the Bank*)
Non-core Business	a division of the Bank comprising of non-core business activities as constituted in 2012 and redefined in 2013 consisting of asset classes of the Bank that are not consistent with the Core Business of the Bank
Non-Executive Directors	John Richard Coates, Anne Margaret Gunther, Richard Graeme Barclay Hardie, Merlyn Vivienne Lowther, Richard Pym, Euan Angus Sutherland, Bennett Lyle Edward Reid and William Gennydd Thomas
Noteholder	the holders of the Notes
Notes	new 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853; SEDOL: BFXW085), which may be issued by the Bank pursuant to the Liability Management Exercise
November 2021 Notes	Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984)
Offers	The Exchange Offers and the Proposals
Offer Memorandum	the Consent and Exchange Offer Memorandum attached to this Prospectus as Appendix C (*Consent and Exchange Offer Memorandum*)

Offer Record Date	Expected to be 11 December 2013, unless any Meeting is required to be adjourned for want of a quorum (in which case the Offer Record Date is expected to be on or around 27 December 2013). The Offer Record Date is the last date on which Preference Shares, 13% Bonds and 5.5555% Bond can be traded
Offer Restrictions	the offer restrictions as set out in the Offer Memorandum (in respect of the Exchange Offers) and the offer restrictions set out in the Explanatory Statement (in respect of the Scheme)
Official List	the Official List maintained by the Financial Conduct Authority
Optimum or **Optimum portfolio**	the Optimum closed book mortgage portfolio, as further described in Section 8 (*Description of the Bank*)
Ordinary Shares	the ordinary shares in the Bank's share capital following completion of the Liability Management Exercise from time to time
Pace	The Co-operative Pension Scheme (Pace)
Parity Securities	as defined in Appendix B (Conditions of the Notes)
Paying Agent	Computershare Investor Services PLC
Payment Card Industry Data Security Standard	the Payment Card Industry Data Security Standard issued by the Payment Card Industry Security Standards Council, as amended from time to time
Payment Card Industry Security Standards Council	a council formed on 7 September 2006 for the purpose of issuing and managing the Payment Card Industry Data Security Standard
Pension Protection Fund	a statutory fund run by the Board of the Pension Protection Fund, a statutory corporation established under the provisions of the Pensions Act 2004
Pensions Regulator	the UK regulator of work-based pension schemes, as established under the Pensions Act 2004
Perpetual Subordinated Bonds	the 13% Bonds and the 5.5555% Bonds
Pillar 1 Requirement	the minimum amount of capital resources that the Bank is required to maintain at all times under GENPRU 2.1.40R and 2.1.41R
Platform	the Bank's brand of residential mortgage loans sold through mortgage intermediaries
PPI	payment protection insurance
PRA	the UK Prudential Regulation Authority
PRD	Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC
Preference Shares	the Bank's 9.25 per cent. Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516)
Project Unity	the project whereby between 2011 and 2013 the Bank transferred a number of functions to Co-operative Group and entered into

	arrangements pursuant to which Co-operative Group would provide certain services to the Bank as further described in Section 8 (*Description of the Bank*)
Proposals	the proposals inviting Holders of Preference Shares and Perpetual Subordinated Bonds to vote on the Extraordinary Resolutions at the meetings, in order to approve modifications to the terms and conditions of the relevant series (and each proposal being a **Proposal**)
Prospectus Directive	Directive 2003/71/EC (and amendments thereto, including the Directive 2010/73/EU to the extent implemented in the Member State of the EEA that has implemented the Prospectus Directive (**relevant Member State**)) and includes any relevant implementing measure in each relevant Member State
Prospectus Directive Regulation	means Commission Regulation (EC) no. 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements
Prospectus Rules	the prospectus rules of the FCA made under Part VI of FSMA relating to offers of securities to the public and admission of securities to trading on a regulated market
PRR	Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 Text with EEA relevance
Purchase Agreement	the agreement between the Bank and those Holders of the Dated Notes listed in the agreement as described in paragraph 20.9 "*Purchase Agreement*" in Section 20 (*Additional Information*)
Purchasers	the purchasers under the Purchase Agreement
RBS	The Royal Bank of Scotland plc, a public limited company incorporated in Scotland with registered number SC090312
Recapitalisation Plan	taken together, the Liability Management Exercise, the 2014 Commitment and any capital generated from interest savings on the Bank's Existing Securities surrendered in the Liability Management Exercise
Registrar Agreement	the Principal Registrar Agreement dated the Issue Date as amended and/or supplemented and/or restated from time to time, made between the Issuer, the Registrar and the Paying Agent (including the agreement supplement to the Principal Registrar Agreement dated the Issue Date between the Issuer, the Registrar, the Paying Agent and the Trustee)
Registrar	Computershare Investor Services PLC (in respect of the Notes)
Registrars	Computershare Investor Services PLC (in respect of the Preference Shares) and Equiniti Limited (in respect of each series of Perpetual Subordinated Bonds), and references to the **relevant Registrar** shall be construed accordingly

Regulatory Event	as defined in Appendix B (*Conditions of the Notes*)
Relationship Agreement	the relationship agreement between the Bank, Co-operative Group, and Banking Group as described in paragraph 20.3 "*Relationship Agreement*" in Section 20 (*Additional Information*)
Relevant Authority	the Prudential Regulation Authority or such other authority (whether in the United Kingdom or elsewhere) having primary responsibility for prudential supervision of the Issuer
Relevant Date	as defined in Appendix B (*Conditions of the Notes*)
Resolution Authorities	the Bank of England and HM Treasury
Retail Banking	the core retail banking business, which trades as the "The Co-operative Bank", "Britannia" and "smile", together with the Bank's intermediary brand "Platform", and includes retail secured and unsecured lending, as further described in paragraph 5 "*Business Overview*" in Section 8 (*Description of the Bank*)
RRD	the proposed Recovery Resolution Directive, being the Proposal for a Directive of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010
S&P	Standard & Poor's Credit Market Services Europe Limited
Scheme	the Bank's proposed scheme of arrangement in respect of the Dated Notes under Part 26 of the Companies Act
Scheme Claim	the claim of a Holder of Dated Notes in the Scheme, being an amount equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme Claim in respect of 2016 Notes (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of the Scheme FX Rate
Scheme FX Rate	as defined in Section 6 (*Details of the Liability Management Exercise*)
Scheme Creditors	the Holders of the Dated Notes and the common depositary and trustee in respect of each series of Dated Notes
Scheme Meeting	the meeting convened for Scheme Creditors for the purpose of considering and if thought fit, approving the Scheme
Scheme Record Date	10 December 2013
Scheme Settlement Date	the date on which the Scheme settles, currently expected to be 18 December 2013
Senior Creditors	as defined in Appendix B (*Conditions of the Notes*)

Senior Managers or the **Senior Management**	the persons named as members of the senior management in Section 9 (*Directors, Senior Management, Employees and Corporate Governance*)
Settlement Condition	the condition which must be satisfied in order for the Liability Management Exercise to settle, as more fully described in Section 6 (*Details of the Liability Management Exercise*) and in the Offer Memorandum
Settlement Date	the date on which the Liability Mangement Exercise settles, currently expected to be 18 December 2013 (subject to the right of the Bank and/or Co-operative Group to amend such date upon notice to Holders)
SME	small and medium-sized enterprises
smile	the Bank's brand of internet banking
SRR	the special resolution regime as set out in part 1 of the Banking Act
Sterling-Equivalent	as defined in Section 6 (*Details of the Liability Management Exercise*)
Tax Jurisdiction	as defined in Appendix B (*Conditions of the Notes*)
Treasury/other	the Bank's treasury division, as further described in paragraph 5 "*Business Overview*" in Section 8 (*Description of the Bank*) and Unity Trust Bank
Trust Deed	a Trust Deed dated the Issue Date constituting the Notes (as modified and/or supplemented and/or restated from time to time) between the Issuer and the Trustee
Trustee	Law Debenture Trustees Limited and its successors as trustee for the Noteholders
UBS or **UBS Investment Bank**	UBS Limited, a private limited company organised under the laws of England and Wales, registered with Companies House under number 02035362
UK Listing Authority	the FCA in its capacity as the competent authority for the purposes of Part VI of FSMA
Uncertificated Securities Regulations	the Uncertificated Securities Regulations 2001, including any modification or re-enactment thereof for the time being in force
United Kingdom or **UK**	the United Kingdom of Great Britain and Northern Ireland
United States, **US** or **U.S.**	the United States of America, its territories and possessions, any state of the United States of America and the District of Columbia
Unity Agreements	(i) the Existing IT Services Agreement, in relation to the provision by Co-operative Group of certain IT services to Banking Group and its subsidiaries and (ii) a Professional Services Master Services Agreement, dated 14 February 2013, pursuant to which the same parties entered into a number of individual service contracts in relation to the provision of certain other services by Co-operative Group to Banking Group and its subsidiaries

Unity Trust Bank	Unity Trust Bank plc, a public limited company organised under the laws of England and Wales, registered with Companies House under number 01713124
Verde Business	Lloyds TSB branches which formed the basis of a proposed acquisition by the Bank

B

APPENDIX B

CONDITIONS OF THE NOTES

This Appendix sets out the terms and conditions of the Notes in full. The terms and conditions describe the obligations of the Bank and the rights of the Noteholders under the Notes.

CONDITIONS OF THE NOTES

The following (other than text in italicised font, which is descriptive only) is the text of the Conditions of the Notes which (subject to modification) will be endorsed on each Certificate issued in respect of the Notes:

The 11 per cent. Subordinated Notes due 2023 (the **Notes**, which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 14 and forming a single series with the Notes) of The Co-operative Bank p.l.c. (the **Issuer**) are constituted by a trust deed (such trust deed as modified and/or supplemented and/or restated from time to time, the **Trust Deed**) dated the date of issue of the first tranche of the Notes (the **Issue Date**) and made between the Issuer and Law Debenture Trustees Limited (the **Trustee**, which expression shall include its successor(s)) as trustee for the Noteholders (as defined below).

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed, the registrar agreement dated the Issue Date (such Registrar Agreement as amended and/or supplemented and/or restated from time to time, the **Principal Registrar Agreement**) made between the Issuer and Computershare Investor Services PLC as registrar (the **Registrar**, which expression shall include any successor registrar appointed from time to time) and as paying agent (the **Paying Agent**, which expression shall include any successor paying agent appointed from time to time) and the agreement supplemental to the Principal Registrar Agreement dated the Issue Date made between the Issuer, the Registrar, the Paying Agent and the Trustee (together with the Principal Registrar Agreement, the **Registrar Agreement**) are available for inspection (by prior appointment) during normal business hours by the Noteholders at the registered office for the time being of the Trustee, being at the date of issue of the Notes at Fifth Floor, 100 Wood Street, London EC2V 7EX, United Kingdom. The Noteholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Registrar Agreement applicable to them.

1. FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Notes are issued in registered form in amounts of £10 (referred to as the **principal amount** of a Note) and may be held in either certificated form or uncertificated form in CREST. If held in certificated form, a note certificate (each a **Certificate**) may be issued free of charge at the request of a Noteholder in respect of its registered holding of Notes. Each Certificate will be numbered serially with an identifying number which will be recorded on the relevant Certificate and in the register of Noteholders which the Issuer will procure to be kept by the Registrar.

In the case of Notes held in uncertificated form, any references herein to "Certificates" (and related references) shall not be applicable to such Notes and (notwithstanding anything to the contrary contained in these Conditions) any transfers or payments shall be made or notices issued in accordance with the Uncertificated Securities Regulations, as further provided in the Trust Deed.

CREST means the relevant system (as defined in the Uncertificated Securities Regulations) in respect of which Euroclear UK & Ireland Limited (formerly known as CRESTCo Limited) (or any successor) is the operator (as defined in the Uncertificated Securities Regulations).

Uncertificated Securities Regulations means the Uncertificated Securities Regulations 2001, including any modification or re-enactment thereof for the time being in force.

1.2 Title

Title to the Notes passes only by registration in the register of Noteholders. The holder of any Note will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any interest or any writing on, or the theft or loss of, the Certificate issued in respect of it) and no person will be liable for so treating the holder. In these Conditions **Noteholder** and (in relation to a Note) **holder** means the person in whose name a Note is registered in the register of Noteholders (or, in the case of a joint holding, to the joint holder whose name appears first on the register of Noteholders in respect of such joint holding (the **representative joint Noteholder**).

2. TRANSFER OF NOTES AND ISSUE OF CERTIFICATES

2.1 Transfers

A Note may, subject to the Conditions below, be transferred by depositing the Certificate issued in respect of that Note, with the form of transfer duly completed and signed, at the specified office of the Registrar.

2.2 Delivery of new Certificates

Each new Certificate to be issued upon transfer of Notes will, within five business days of receipt by the Registrar of the duly completed form of transfer together with a valid Certificate, be mailed by uninsured mail at the risk of the holder entitled to the Note to the address specified in the form of transfer. For the purposes of this Condition, **business day** shall mean a day on which banks are open for business in the city in which the specified office of the Registrar with whom a Certificate is deposited in connection with a transfer is located.

Where some but not all of the Notes in respect of which a Certificate is issued are to be transferred, a new Certificate in respect of the Notes not so transferred will, within five business days of receipt by the Registrar of the original Certificate, be mailed by uninsured mail at the risk of the holder of the Notes not so transferred to the address of such holder appearing on the register of Noteholders or as specified in the form of transfer.

2.3 Formalities free of charge

Registration of transfer of Notes will be effected without charge by or on behalf of the Issuer or the Registrar but upon payment (or the giving of such indemnity as the Issuer or the Registrar may reasonably require) in respect of any tax or other governmental charges which may be imposed in relation to such transfer.

2.4 Closed Periods

No Noteholder may require the transfer of a Note to be registered during the period of 15 days ending on the due date for any payment of principal or interest on that Note.

2.5 Regulations

All transfers of Notes and entries on the register of Noteholders will be made subject to the detailed regulations concerning transfer of Notes scheduled to the Trust Deed. The regulations may be changed by the Issuer with the prior written approval of the Registrar and the Trustee. A copy of the current regulations will be mailed (free of charge) by the Registrar to any Noteholder who requests one.

3. STATUS AND SUBORDINATION OF THE NOTES

3.1 Status

The Notes are unsecured and, in accordance with Condition 3.2, subordinated obligations of the Issuer and rank *pari passu* without any preference among themselves.

3.2 Subordination

On a winding-up of the Issuer, claims against the Issuer in respect of or arising under the Notes (including any damages awarded for breach of any obligations in respect of the Notes) will be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors (as defined below) but shall rank:

(a) at least *pari passu* with all claims of holders of all other subordinated obligations of the Issuer which constitute, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which constitute, or (in either case) would but for any applicable limitation on the amount of such capital constitute, Tier 2 Capital and all obligations which rank, or are expressed to rank, *pari passu* therewith (**Parity Securities**); and

(b) in priority to the claims of holders of:

(i) all obligations of the Issuer which rank or are expressed to rank, and all claims relating to a guarantee or other like or similar undertaking or arrangement given or undertaken by the Issuer in respect of any obligations of any other person which rank or are expressed to rank, junior to the claims in respect of the Notes, including (without limitation) obligations which constitute, or would but for any applicable limitation on the amount of such capital constitute, Tier 1 Capital and all obligations which rank, or are expressed to rank, *pari passu* therewith; and

(ii) all classes of share capital of the Issuer,

(together, the **Junior Securities**).

In these Conditions:

Senior Creditors means creditors of the Issuer whose claims are admitted to proof in the winding-up of the Issuer and who are unsubordinated creditors of the Issuer;

Tier 1 Capital and Tier 2 Capital have the respective meanings given to such terms in the Applicable Banking Regulations from time to time;

Applicable Banking Regulations means at any time the laws, regulations, requirements, guidelines and policies relating to capital adequacy then in effect in the United Kingdom and applicable to the Issuer, including, without limitation to the generality of the foregoing, those regulations, requirements, guidelines and policies relating to capital adequacy then in effect of the Relevant Authority and/or any regulation, directive or other binding rules, standards or decisions adopted by the institutions of the European Union; and

Relevant Authority means the Prudential Regulation Authority or such other authority (whether in the United Kingdom or elsewhere) having primary responsibility for prudential supervision of the Issuer.

3.3 Set-Off

Subject to applicable law, neither any Noteholder nor the Trustee may exercise or claim any right of set-off in respect of any amount owed to it by the Issuer arising under or in connection with the Notes and each Noteholder shall, by virtue of its subscription, purchase or holding of any Note, be deemed to have waived all such rights of set-off.

4. INTEREST

4.1 Interest Rate and Interest Payment Dates

The Notes bear interest on their outstanding principal amount from and including the Issue Date at the rate of 11 per cent. per annum, payable quarterly in arrear on each three-month anniversary of the Issue Date up to (and including) the Maturity Date (each an **Interest Payment Date**). The **Maturity Date** means the tenth anniversary of the Issue Date.

By way of example, if the Issue Date is 18 December 2013 (as currently expected), the Interest Payment Dates will be 18 March, 18 June, 18 September and 18 December in each year and the Maturity Date will be 18 December 2023.

4.2 Interest Accrual

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal due in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment, in which event interest shall continue to accrue as provided in the Trust Deed.

4.3 Calculation of Interest

Interest shall be calculated on the basis of (i) the actual number of days in the period from and including the date from which interest begins to accrue (the **Accrual Date**) to but excluding the date on which it falls due divided by (ii) the actual number of days from and including the Accrual Date to but excluding the next following Interest Payment Date multiplied by four. Such day count fraction shall be applied to the product of 11 per cent. and the aggregate principal amount of Notes held by the relevant Noteholder, with the resultant figure rounded down to the nearest £0.01.

5. PAYMENTS

5.1 Payments in respect of Notes

All payments in respect of the Notes will be made by sterling cheque or warrant drawn on a bank or building society in the United Kingdom, posted no later than the Business Day immediately preceding the relevant due date and made payable to the Noteholder (in the case of a joint holding of Notes, the representative joint Noteholder) appearing in the register of Noteholders in respect of the Note of which he is the holder at the close of business on the fifteenth day before the relevant due date (the **Record Date**) at the addresses shown in the register of Noteholders on the Record Date. Payments of principal and payments of interest due otherwise than on an Interest Payment Date will only be made against surrender of the relevant Certificate at the specified office of the Registrar or any Paying Agent. Upon application of a Noteholder (or in the case of a joint holding of Notes, the representative joint Noteholder) to the Registrar, in the form from time to time prescribed by the Registrar, not less than ten days before the due date for any payment in respect of his Notes, the payment may be made by transfer on the due date or, if the due date is not a Business Day, on the immediately following Business Day to a sterling account with a bank or building society in the United Kingdom.

5.2 Payments subject to applicable laws

Payments in respect of principal and interest on Notes are subject in all cases to (i) any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 7 and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the U.S. Internal Revenue Code of 1986 (the **Code**) or otherwise imposed pursuant to Sections 1471 through 1474 (inclusive) of the Code, any regulations or agreements thereunder, any official interpretations thereof, or (without prejudice to the provisions of Condition 7) any law implementing an intergovernmental approach thereto.

5.3 No commissions

No commissions or expenses shall be charged by the Issuer, the Registrar or any Paying Agent to the Noteholders in respect of any payments made in accordance with this Condition.

5.4 Payments on Business Days

Where payment of any principal and/or interest is to be made by transfer to a registered account, payment instructions (for value the due date or, if that is not a Business Day (as defined below), for value the first following day which is a Business Day) will be initiated, and where payment is to be made by cheque, the cheque will be mailed, on the Business Day preceding the due date for payment or, in the case of a payment of principal or a payment of interest due otherwise than on an Interest Payment Date, if later, on the Business Day on which the relevant Certificate is surrendered at the specified office of the Registrar or any Paying Agent.

Noteholders will not be entitled to any interest or other payment for any delay after the due date in receiving the amount due if the due date is not a Business Day, if the Noteholder is late in surrendering its Certificate (if required to do so) or if a cheque mailed in accordance with this Condition arrives after the due date for payment.

In these Conditions, **Business Day** means a day (other than a Saturday or Sunday) on which commercial banks are open for business in London, and in the case of presentation of a Certificate, in the place in which the Certificate is presented.

5.5 Partial payments

If the amount of principal or interest which is due on the Notes is not paid in full, the Registrar will annotate the register of Noteholders with a record of the amount of principal or interest in fact paid.

5.6 Interpretation of Principal and Interest

Any reference in these Terms and Conditions to principal in respect of the Notes shall be deemed to include any additional amounts which may be payable with respect to principal under Condition 7 or pursuant to any undertakings given in addition thereto or in substitution therefor pursuant to the Trust Deed.

Any reference in these Terms and Conditions to interest in respect of the Notes shall be deemed to include any additional amounts which may be payable with respect to interest under Condition 7 or pursuant to any undertakings given in addition thereto or in substitution therefore pursuant to the Trust Deed.

6. REDEMPTION AND PURCHASE

6.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as specified below, the Notes will be redeemed by the Issuer at their principal amount on the Maturity Date.

6.2 Redemption for Tax Reasons

Subject to Condition 6.6 below, the Notes may be redeemed at the option of the Issuer, in whole but not in part, at an amount equal to 101 per cent. of their principal amount together with unpaid interest accrued to (but excluding) the date of redemption, at any time on the Issuer giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable), if the Issuer satisfies the Trustee immediately before the giving of the aforementioned notice that:

(a) on the occasion of the next payment due under the Notes, the Issuer has or will become obliged either to pay additional amounts as provided or referred to in Condition 7 or to account to any taxing authority in the Tax Jurisdiction for any amount (other than tax withheld or deducted from interest payable on such Notes) in respect of such payment in each case as a result of any change in, or amendment to, the laws or regulations of the Tax Jurisdiction or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the Issue Date; or

(b) interest payments under or with respect to the Notes are no longer (partly or fully) deductible for UK corporation tax purposes as a result of any change in, or amendment to, the laws or regulations of the Tax Jurisdiction or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the Issue Date,

and (in either case) such obligation cannot be avoided by the Issuer taking reasonable measures available to it (each a **Tax Event**), provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts or make a payment in respect of which it would be obliged to account to any taxing authority as aforesaid were a payment in respect of the Notes then due.

Tax Jurisdiction means the United Kingdom or any political subdivision or any authority thereof or therein having power to tax.

Prior to the publication of any notice of redemption pursuant to this Condition 6.2, the Issuer shall deliver to the Trustee to make available for inspection (by prior appointment) at its specified office to the Noteholders (i) a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred, and (ii) an opinion of independent legal or tax advisers of recognised standing to the effect either that such a circumstance does exist or that, upon a change in or amendment to the laws (including any regulations thereunder) or in the interpretation or administration thereof, of the Tax Jurisdiction which at the date of such certificate is proposed to be made and in the opinion of such independent legal or tax advisers and the Issuer (based on such opinion) is reasonably expected to become effective on or prior to the date when the relevant payment in respect of such Notes would otherwise be made, becoming so effective, such circumstances would exist. The Trustee shall be entitled to accept and rely upon the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders.

6.3 Regulatory Event Redemption

Subject to Condition 6.6 below, the Notes may be redeemed at the option of the Issuer, in whole but not in part, at an amount equal to 101 per cent. of their principal amount together with unpaid interest accrued to (but excluding) the date of redemption, at any time on the Issuer giving not less than 30 nor more than 60 days' notice to the Noteholders (which notice shall be irrevocable), if, at any time after the Issue Date, the Issuer determines that as a result of a change in English law or Applicable Banking Regulations or any change in the official application or interpretation thereof (including as a result of the implementation or applicability thereof in the United Kingdom on or after the Issue Date) the Notes are (or will, within the following 90 days, be) fully excluded from Tier 2 Capital for the purposes of Applicable Banking Regulations (a **Regulatory Event**).

6.4 Purchases

Subject to Condition 6.6 below, the Issuer or any of its subsidiaries may at any time purchase Notes at any price in the open market or otherwise. Such Notes may be held, reissued, resold or, at the option of the Issuer, surrendered to the Registrar or any Paying Agent for cancellation.

6.5 Cancellation

All Notes which are redeemed, and any Notes which are purchased and surrendered for cancellation pursuant to Condition 6.4, shall be immediately cancelled and cannot be reissued or resold.

6.6 Redemption and Purchase Conditions

The Issuer shall not be permitted to redeem or purchase the Notes prior to the Maturity Date unless the following conditions (in each case, if and to the extent then required by Applicable Banking Regulations) are satisfied:

(a) the Issuer has given any requisite notice to the Relevant Authority and has obtained the Relevant Authority's prior permission or non-objection to the redemption or purchase (as the case may be) of the Notes;

(b) such redemption or purchase (as the case may be) complies with Applicable Banking Regulations, including (if then required) that either (i) not later than the redemption or purchase date, the Issuer replaces the Notes so redeemed or purchased with new Tier 2 Capital (or higher quality capital) or (ii) the Issuer has demonstrated to the satisfaction of the Relevant Authority that, both at the time of and immediately following the redemption or purchase (as the case may be) of the Notes, it meets and will continue to meet, or exceed by such margin as the Relevant Authority shall consider necessary, any capital resources requirement (which may include minimum capital requirements and/or combined buffer capital requirements) then applicable to it under Applicable Banking Regulations;

(c) in the case of any redemption of Notes upon the occurrence of a Tax Event or a Regulatory Event, the Issuer has demonstrated to the satisfaction of the Relevant Authority (i) that the circumstances giving rise to the Tax Event or, as the case may be, the Regulatory Event were not reasonably foreseeable as at the Issue Date and, (ii) in the case of a Tax Event only, that the change in the applicable tax treatment is material or, in the case of a Regulatory Event only, that the change in the applicable regulatory classification is sufficiently certain; and

(d) Notes may be purchased by the Issuer prior to the fifth anniversary of the Issue Date only if then permitted by Applicable Banking Regulations or if otherwise authorised by the Relevant Authority.

7. TAXATION

All payments of principal and interest in respect of the Notes by the Issuer will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of the Tax Jurisdiction (as defined in Condition 6.2), unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Notes after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes, in the absence of such withholding or deduction, except that no such additional amounts shall be payable with respect to any Note:

(a) the holder of which is liable for such taxes or duties in respect of such Note by reason of its having some connection with the Tax Jurisdiction other than the mere holding of such Note; or

(b) presented for payment (where presentation is required) more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day; or

(c) presented for payment (where presentation is required) in the United Kingdom; or

(d) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(e) presented for payment (where presentation is required) by or on behalf of a Noteholder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a Member State of the European Union.

As used herein, the **Relevant Date** means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by a Paying Agent or the Trustee on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Noteholders in accordance with Condition 12.

8. PRESCRIPTION

The Notes will become void unless claims in respect of principal and/or interest are made within a period of ten years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 7) therefor.

9. EVENTS OF DEFAULT AND ENFORCEMENT

9.1 If default is made in the payment of any principal or interest due on the Notes or any of them on the due date and such default continues in the case of principal for a period of 7 days and in the case of interest for a period of 15 days, the Trustee may, subject as provided below, at its discretion and without further notice, institute proceedings for the winding-up of the Issuer, but may take no other action in respect of such default.

9.2 If, otherwise than for the purposes of a reconstruction or amalgamation on terms previously approved in writing by the Trustee, an order is made or an effective resolution is passed for winding-up the Issuer, the Trustee may, and, if so requested in writing by the holders of at least one-fifth in nominal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the holders of the Notes shall (subject in each case to being indemnified and/or secured and/or pre-funded to its satisfaction), give notice to the Issuer that the Notes are, and they shall thereby become, immediately due and repayable at their principal amount, together with accrued interest as provided in the Trust Deed. In such event the Trustee shall be entitled to prove in the winding-up of the Issuer and shall have no other remedy against the Issuer.

9.3 Without prejudice to Condition 9.1, if the Issuer fails to perform, observe or comply with any obligation, condition or provision relating to such Notes binding on it under these Conditions (other than any payment obligations of the Issuer arising from the Notes or the Trust Deed including, without limitation, payment of principal or interest in respect of the Notes and any damages awarded for breach of obligations) the Trustee may, subject as provided below, at its discretion and without further notice, institute such proceedings against the Issuer as it may think fit to enforce such obligation, condition or provision provided that the Issuer shall not as a consequence of such proceeding be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

9.4 The Trustee shall not be bound to take the action referred to in Condition 9.1 or Condition 9.3 unless (i) it shall have been so directed by an Extraordinary Resolution of the Noteholders or so requested in writing by the holders of at least one-fifth in nominal amount of the Notes outstanding and (ii) it shall have been indemnified and/or secured and/or pre-funded to its satisfaction.

9.5 No remedy against the Issuer, other than the institution of proceedings by the Trustee for the winding-up of the Issuer and/or proving in the winding-up of the Issuer, shall be available to the Trustee or the Noteholders for the recovery of amounts owing in respect of the Notes as aforesaid (including damages awarded for breach of any obligations) and no holder of a Note shall be entitled to institute proceedings for the winding-up of the Issuer or to prove in such winding-up unless the Trustee, having become bound so to proceed in accordance with Condition 9.4, fails to do so or fails to prove in such winding-up, in each case within a reasonable time and such failure shall be continuing.

10. REPLACEMENT OF CERTIFICATES

Should any Certificate be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Registrar upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Certificates must be surrendered before replacements will be issued.

11. REGISTRAR AND PAYING AGENTS

The names of the initial Registrar and Paying Agent and their initial specified offices are set out below.

The Issuer is, with the prior written approval of the Trustee, entitled to vary or terminate the appointment of the Registrar and/or any Paying Agent and/or appoint additional or other Registrars and/or Paying Agents and/or approve any change in the specified office through which any Registrar and/or Paying Agent acts, provided that:

(a) so long as the Notes are listed on any stock exchange, there will at all times be a Paying Agent with a specified office in such place as may be required by the rules and regulations of the relevant stock exchange (or any other relevant authority);

(b) there will at all times be a Paying Agent with a specified office in a European city (which may be London) approved in writing by the Trustee;

(c) there will at all times be a Paying Agent and a Registrar; and

(d) there will at all times be a Paying Agent in a European Union Member State (if any) that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 12.

In acting under the Registrar Agreement, subject as provided therein, the Registrar and the Paying Agent will act solely as agents of the Issuer, and will not assume any obligations or relationships of agency or trust to or with the Noteholders, except that (without affecting the obligations of the Issuer to the Noteholders to repay the Notes and to pay interest thereon) funds received by the Paying Agent for the payment of any sums due in respect of the Notes shall be held by them on behalf of the Noteholders until the expiry of the relevant period of prescription under Condition 8. The Registrar Agreement contains provisions for the indemnification of the Registrar.

12. NOTICES

All notices to the Noteholders will be valid if mailed to them at their respective addresses in the register of Noteholders maintained by the Registrar. The Issuer shall also ensure that notices are duly given or published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Notes are for the time being listed. Any notice shall be deemed to have been given on the second day after being so mailed or on the date of publication or, if so published more than once or on different dates, on the date of the first publication.

13. MEETINGS OF NOTEHOLDERS, MODIFICATION AND WAIVER

13.1 Meetings of Noteholders

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Notes or certain provisions of the Trust Deed. Such a meeting may be convened by the Issuer, the Trustee or by Noteholders holding not less than 10 per cent. in nominal amount of the Notes for the time being remaining outstanding. The quorum at any such meeting for passing an Extraordinary Resolution is one or more persons holding or representing a clear majority in nominal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons being or representing Noteholders whatever the nominal amount of the Notes so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Notes (including modifying the date of maturity of the Notes or any date for payment of interest thereon, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Notes or altering the currency of payment of the Notes) or certain of the provisions of the Trust Deed, the necessary quorum for passing an Extraordinary Resolution will be one or more persons holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, in nominal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders shall be binding on all the Noteholders, whether or not they are present at the meeting.

13.2 Modification and Waiver

The Trust Deed provides that the Trustee may agree, without the consent of the Noteholders, to any modification (subject to certain exceptions as provided in the Trust Deed) of, or to any waiver or authorisation of any breach or proposed breach of, any of these Terms and Conditions or any of the provisions of the Trust Deed, or may determine that any condition, event or act which, but for such determination, would constitute an event giving rise to the right of the Trustee described in Condition 9, shall not be treated as such which in any such case, in the opinion of the Trustee, is not materially prejudicial to the interests of the Noteholders or to any modification of any of these Terms and Conditions or any of the provisions of the Trust Deed or the Registrar Agreement which is, in the opinion of the Trustee, of a formal, minor or technical nature, which is made to correct a manifest error or which, in the opinion of the Trustee, is not materially prejudicial to the interests of Noteholders. Any such modification, waiver, authorisation or determination shall be binding on the Noteholders and, unless the Trustee agrees otherwise, any such modification shall be notified to the Noteholders as soon as practicable thereafter in accordance with Condition 12.

13.3 Rights of Trustee

In connection with the exercise by it of any of its trusts, powers, authorities or discretions (including, but without limitation, any modification, waiver, authorisation or substitution), the Trustee shall have regard to the interests of the Noteholders as a class and, in particular, but without limitation, shall not have regard to the consequences of such exercise for individual Noteholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory and the Trustee shall not be entitled to require, nor shall any Noteholder be entitled to claim, from the Issuer or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders except to the extent already provided for in Condition 7 and/or any undertaking given in addition to, or in substitution for, Condition 7 pursuant to the Trust Deed.

13.4 Compliance with Applicable Banking Regulations

The Issuer shall comply with Applicable Banking Regulations in connection with any modification or proposed modification of these Terms and Conditions.

14. FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Noteholders to create and issue further notes having terms and conditions the same as the Notes or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single series with the outstanding Notes.

15. SUBSTITUTION

The Trustee may, without the consent of the Noteholders, agree with the Issuer to the substitution in place of the Issuer (or of any previous substitute under this Condition) as the principal debtor under the Notes and the Trust Deed of the Holding Company of the Issuer, a Successor in Business or any Subsidiary of the Issuer (each as defined in the Trust Deed), subject to (i) in the case of a substitution of any Subsidiary of the Issuer, the Notes being unconditionally and irrevocably guaranteed by the Issuer and so that the obligations of the Issuer under such guarantee shall be subordinated on a basis considered by the Trustee to be equivalent to that in respect of the Issuer's obligations in respect of the Notes, (ii) the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced by the substitution, (iii) the obligations of such Holding Company of the Issuer or Successor in Business or, in the case of substitution of a Subsidiary of the Issuer, the obligations of the Issuer under its guarantee, being subordinated on a basis considered by the Trustee to be equivalent to that in respect of the Issuer's obligations as principal debtor in respect of the Notes, and (iv) certain other conditions set out in the Trust Deed being complied with. In making any such determination of equivalence of subordination for the purposes of paragraphs (i) and (iii) above, the Trustee shall be entitled to request that the Issuer, and the Issuer shall be obliged to, procure an opinion of independent legal advisers of recognised standing and the Trustee shall be entitled to accept the provision of and rely upon such opinion in satisfaction of its making such determination.

The Issuer shall comply with Applicable Banking Regulations in connection with any substitution of the Issuer (or any previous substitute) under this Condition.

16. INDEMNIFICATION OF THE TRUSTEE

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility in certain circumstances including provisions relieving it from instituting proceedings to enforce repayment or exercise any powers, duties, authorities or discretions unless indemnified and/or secured and/or pre-funded to its satisfaction.

The Trustee may rely without liability to Noteholders on a report, confirmation or certificate or any advice or any accountants, financial advisers, financial institution or any other expert, whether or not addressed to it and whether their liability in relation thereto is limited (by its terms or by any engagement letter relating thereto entered into by the Trustee or in any other manner) by reference to a monetary cap, methodology or otherwise. The Trustee may accept and shall be entitled to rely on any such report, confirmation or certificate or advice and such report, confirmation or certificate or advice shall be binding on the Issuer, the Trustee and the Noteholders.

The Trustee is not responsible for monitoring or supervising the performance by the Registrar, the Paying Agent and/or any other person of its obligations to the Issuer and may assume these are being performed unless and until it has actual knowledge to the contrary.

17. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

18. GOVERNING LAW

The Trust Deed, the Registrar Agreement, the Notes and any non-contractual obligations arising out of or in connection with the Trust Deed, the Registrar Agreement and the Notes are governed by, and shall be construed in accordance with, English law.

C

APPENDIX C

CONSENT AND EXCHANGE OFFER MEMORANDUM

This Appendix is the Offer Memorandum which sets out the full terms of the Liability Management Exercise.

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt as to the action you should take, you are recommended to seek your own personal financial advice immediately from your stockbroker, bank, solicitor, accountant, fund manager or other appropriate financial adviser, who is authorised under the Financial Services and Markets Act 2000 if you are in the United Kingdom or, if not, from another appropriately authorised financial adviser.

IF YOU ARE A U.S. PERSON (WHEREVER LOCATED) OR ARE LOCATED IN THE UNITED STATES, YOU WILL BE ELIGIBLE TO RECEIVE THIS DOCUMENT AND TO PARTICIPATE IN THE SCHEME AND THE MEETINGS DESCRIBED HEREIN BUT YOU WILL NOT BE ELIGIBLE TO PARTICIPATE IN THE EXCHANGE OFFERS DESCRIBED HEREIN. THIS DOCUMENT IS NOT FOR GENERAL RELEASE, PUBLICATION OR DISTRIBUTION IN OR INTO ANY JURISDICTION WHERE TO DO SO WOULD CONSTITUTE A VIOLATION OF THE RELEVANT LAWS OF SUCH JURISDICTION.

This Consent and Exchange Offer Memorandum (the "Offer Memorandum") does not constitute an offer to buy or a solicitation of an offer to sell Existing Securities or New Securities (each as defined herein) in any jurisdiction in which, or to or from any person to or from whom, it is unlawful to make such offer or solicitation under applicable securities laws or otherwise. The offers of the securities referred to in this Offer Memorandum have not been and will not be registered under the United States Securities Act of 1933. In particular, the Exchange Offers are not being made to any person who is a U.S. person (as defined in Regulation S ("Regulation S") under the United States Securities Act of 1933) or who is located in the United States. The New Securities (as defined herein) may not be offered or sold in the United States or to U.S. persons unless an exemption from the registration requirements of the Securities Act is available. Holders who wish to participate in the Exchange Offers will be required to represent that they will not resell or otherwise transfer the New Securities during the 40 day period commencing on the Settlement Date for the Exchange Offers except outside of the United States in a transaction complying with Rule 903 or 904 of Regulation S. Persons into whose possession this Offer Memorandum comes are required by each of the Bank, the Group, the Dealer Managers, the Exchange Agent, the Information Agent and the Registrars (each as defined herein) to inform themselves about, and to observe, any such restrictions.

CONSENT AND EXCHANGE OFFER MEMORANDUM dated 4 November 2013

The co-operative bank The co-operative

Invitations by

The Co-operative Bank p.l.c.

(incorporated with limited liability in England with registered number 990937)

and

Co-operative Group Limited

(incorporated and registered in England under the Industrial and Provident Societies Act 1965 to 2003 with registered number IP525R)

to the holders of the securities listed in the table below, in each case issued by The Co-operative Bank p.l.c.

(together, the "**Existing Securities**")

to participate (as applicable) in

the Exchange Offers, the Proposals and the Scheme

(as defined in this document)

Description of the Securities	*ISIN*	*Outstanding Principal Amount*
Preference Shares:		
9.25% Non-Cumulative Irredeemable Preference Shares	GB0002224516	£60,000,000
Perpetual Subordinated Bonds:		
13% Perpetual Subordinated Bonds*	GB00B3VH4201	£110,000,000
5.5555% Perpetual Subordinated Bonds*	GB00B3VMBW45	£200,000,000
Dated Notes:		
Floating Rate Callable Step-up Dated Subordinated Notes due 2016**	XS0254625998	€34,980,000
5.875% Subordinated Callable Notes due 2019	XS0189539942	£37,775,000
9.25% Subordinated Notes due 28 April 2021	XS0620315902	£275,000,000
Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984	£8,747,000
7.875% Subordinated Notes due 19 December 2022	XS0864253868	£235,402,000
5.75% Dated Callable Step-up Subordinated Notes due 2024**	XS0188218183	£200,000,000
5.875% Subordinated Notes due 2033**	XS0145065602	£150,000,000

* Issued by the Bank in replacement of Britannia Building Society permanent interest bearing shares on its merger with Britannia on 1 August 2009
** Originally issued by Britannia Building Society and assumed by the Bank at the time of its merger with Britannia on 1 August 2009

AN OVERVIEW OF THE CONSIDERATION TO BE DELIVERED IN EXCHANGE FOR THE ABOVE SECURITIES IS SET OUT IN THE TABLE IN SECTION B OF THIS DOCUMENT

THE EARLY PARTICIPATION DEADLINE IS 4.30 P.M. (LONDON TIME) ON 29 NOVEMBER 2013 AND THE EXPIRATION DEADLINE IS 4.30 P.M. (LONDON TIME) ON 6 DECEMBER 2013, UNLESS IN EACH CASE EXTENDED, RE-OPENED OR TERMINATED AS PROVIDED IN THIS OFFER MEMORANDUM.

THE DEADLINES SET BY ANY INTERMEDIARY OR CLEARING SYSTEM WILL BE EARLIER THAN THESE DEADLINES.

Dealer Managers

HSBC **UBS Investment Bank**

INTRODUCTION TO THIS DOCUMENT

<u>What is this document?</u>

This document (the "**Offer Memorandum**"), which forms part of the Prospectus to which it is appended, contains the details of the liability management exercise being conducted by The Co-operative Bank p.l.c. ("**Co-operative Bank**" or the "**Bank**") and Co-operative Group Limited ("**Co-operative Group**" or the "**Group**").

<u>Is this document relevant to me?</u>

This document will be relevant to you if you hold any of the following securities issued by the Bank:

The "**Preference Shares**":

- 9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516)

The "**Perpetual Subordinated Bonds**"[1]:

- 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) (the "**13% Bonds**")
- 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (the "**5.5555% Bonds**")

The "**Dated Notes**":

- Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN XS0254625998)
- 5.875% Subordinated Callable Notes due 2019 (ISIN XS0189539942)
- 9.25% Subordinated Notes due 28 April 2021 (ISIN XS0620315902)
- Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN XS0274155984)
- 7.875% Subordinated Notes due 19 December 2022 (ISIN XS0864253868)
- 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN XS0188218183)
- 5.875% Subordinated Notes due 2033 (ISIN XS0145065602)

The Preference Shares, the Perpetual Subordinated Bonds and the Dated Notes are together referred to in this document as the "**Existing Securities**".

<u>I hold some of these Existing Securities. Where do I start?</u>

This document contains detailed information on what the Liability Management Exercise means for you. It is important that you read it carefully in full.

However, holders of Preference Shares, 13% Bonds and 5.5555% Bonds are encouraged to first read the key messages on the following pages.

1. The Perpetual Subordinated Bonds were issued by the Bank at the time of the merger with the Britannia Building Society on 1 August 2009. They replaced the permanent interest bearing shares originally issued by Britannia Building Society.

Key messages for holders of the 9.25% Preference Shares

How do I know if I own Preference Shares?

- You will either have a share certificate (if you own the Preference Shares directly) or, if you have invested through a broker, your account statements should reference the Co-operative Bank 9.25% Non-Cumulative Irredeemable Preference Shares. Their ISIN number is GB0002224516

What decisions do I need to take?

- You need to decide whether you wish to participate in the *Exchange Offer* for the Preference Shares. By participating in the *Exchange Offer*, you will vote in favour of a *Proposal* that will enable Co-operative Group to acquire mandatorily all Preference Shares. If the *Proposal* is approved, and the *Liability Management Exercise* is successful, what you will receive in return for your Preference Shares is explained below
- If you choose not to participate in the *Exchange Offer* you are free to vote against the *Proposal* if you wish. However, if the *Proposal* is approved and implemented, Co-operative Group will mandatorily acquire your Preference Shares on the same economic terms as if you had participated in the *Exchange Offer*

Do I have to participate?

- You do not have to participate. However, you are strongly encouraged to do so. If the *Liability Management Exercise* does not succeed, the Co-operative Bank believes that it would be subject to a formal 'resolution' procedure under the UK Banking Act 2009. The Co-operative Bank believes that success of the *Liability Management Exercise* will be substantially more beneficial to holders of Preference Shares than resolution of the Co-operative Bank

Do I have a choice of what I receive if I do decide to participate in the Exchange Offer?

- Yes. If you decide to participate in the *Exchange Offer*, you must choose what to receive in return for your Preference Shares. You have two alternatives. You must choose between them:
  - If you wish to preserve your level of income from the Preference Shares for the next twelve years you may choose the *Instalment Repayment Notes*. If, for example, you own £1,000 of Preference Shares, then by choosing the *Instalment Repayment Notes* option you would only receive £92.50* each year (payable in one yearly instalment) up to 2025. **You will not be entitled to any further payments after 2025**
  - If you wish to preserve some of your capital instead, you may choose the *Final Repayment Notes*. These pay interest at 11% each year, but you will receive less *Final Repayment Notes* than you currently have Preference Shares. If, for example, you own £1,000 of Preference Shares, then you would receive £601* of *Final Repayment Notes*. You would receive £66.11* of interest each year (payable in one yearly instalment) up to 2025, plus repayment of the £601* capital in 2025. **You will not be entitled to any further payments after 2025**

* *Please note that these amounts will be approximately 8% lower if not enough holders of Preference Shares, 13% Bonds and 5.5555% Bonds participate by 29 November 2013*

Who is responsible for making payments on the Instalment Repayment Notes and Final Repayment Notes?

- Co-operative Group will be responsible for making these payments

When do I have to take action?

- If you wish to participate in the *Exchange Offer*, you should do so by **29 November 2013** at the latest. Whilst it is possible to participate up to 6 December 2013, the terms of the *Exchange Offer* are more favourable for all holders of Preference Shares if enough investors participate by the earlier date

How do I participate?

- If you have a share certificate, you will receive a letter enclosing the relevant forms to complete and return. If you have invested through a broker, please contact your broker

What next?

- Please read the rest of this Prospectus, including this Offer Memorandum, carefully. It contains detailed information on the *Exchange Offer* and the Proposal to help you make your decision
- We expect to announce the results of the *Liability Management Exercise* on 12 December 2013

Key messages for holders of the 13% Perpetual Subordinated Bonds

How do I know if I own 13% Bonds?

- You will either have a bond certificate (if you own the 13% Bonds directly) or, if you have invested through a broker, your account statements should reference the Co-operative Bank 13% Perpetual Subordinated Bonds. Their ISIN number is GB00B3VH4201

What decisions do I need to take?

- You need to decide whether you wish to participate in the *Exchange Offer* for the 13% Bonds. By participating in the *Exchange Offer*, you will vote in favour of a *Proposal* that will enable Co-operative Group to acquire mandatorily all 13% Bonds. If the *Proposal* is approved, and the *Liability Management Exercise* is successful, what you will receive in return for your 13% Bonds is explained below
- If you choose not to participate in the *Exchange Offer* you are free to vote against the *Proposal* if you wish. However, if the *Proposal* is approved and implemented, Co-operative Group will mandatorily acquire your 13% Bonds on the same economic terms as if you had participated in the *Exchange Offer*

Do I have to participate?

- You do not have to participate. However, you are strongly encouraged to do so. If the *Liability Management Exercise* does not succeed, the Co-operative Bank believes that it would be subject to a formal 'resolution' procedure under the UK Banking Act 2009. The Co-operative Bank believes that success of the *Liability Management Exercise* will be substantially more beneficial to holders of 13% Bonds than resolution of the Co-operative Bank

Do I have a choice of what I receive if I do decide to participate in the Exchange Offer?

- Yes. If you decide to participate in the *Exchange Offer*, you must choose what to receive in return for your 13% Bonds. You have two alternatives. You must choose between them:
    - If you wish to preserve your level of income from the 13% Bonds for the next twelve years you may choose the *Instalment Repayment Notes*. If, for example, you own £1,000 of 13% Bonds, then by choosing the *Instalment Repayment Notes* option you would only receive £130* each year (payable in one yearly instalment) up to 2025. **You will not be entitled to any further payments after 2025**
    - If you wish to preserve some of your capital instead, you may choose the *Final Repayment Notes*. These pay interest at 11% each year, but you will receive less *Final Repayment Notes* than you currently have 13% Bonds. If, for example, you own £1,000 of 13% Bonds, then you would receive £844* of *Final Repayment Notes*. You would receive £92.84* of interest each year (payable in one yearly instalment) up to 2025, plus repayment of the £844* capital in 2025. **You will not be entitled to any further payments after 2025**

* *Please note that these amounts will be approximately 6% lower if not enough holders of Preference Shares, 13% Bonds and 5.5555% Bonds participate by 29 November 2013*

Who is responsible for making payments on the Instalment Repayment Notes and Final Repayment Notes?

- Co-operative Group will be responsible for making these payments

When do I have to take action?

- If you wish to participate in the *Exchange Offer*, you should do so by **29 November 2013** at the latest. Whilst it is possible to participate up to 6 December 2013, the terms of the *Exchange Offer* are more favourable for all holders of 13% Bonds if enough investors participate by the earlier date

How do I participate?

- If you have a bond certificate, you will receive a letter enclosing the relevant forms to complete and return. If you have invested through a broker, please contact your broker

What next?

- Please read the rest of this Prospectus, including this Offer Memorandum, carefully. It contains detailed information on the *Exchange Offer* and the *Proposal* to help you make your decision
- We expect to announce the results of the *Liability Management Exercise* on 12 December 2013

Key messages for holders of the 5.5555% Perpetual Subordinated Bonds

How do I know if I own 5.5555% Bonds?

- You will either have a bond certificate (if you own the 5.5555% Bonds directly) or, if you have invested through a broker, your account statements should reference the Co-operative Bank 5.5555% Perpetual Subordinated Bonds. Their ISIN number is GB00B3VMBW45

What decisions do I need to take?

- You need to decide whether you wish to participate in the *Exchange Offer* for the 5.5555% Bonds. By participating in the *Exchange Offer*, you will vote in favour of a *Proposal* that will enable the Co-operative Bank to exchange mandatorily all 5.5555% Bonds. If the *Proposal* is approved, and the *Liability Management Exercise* is successful, what you will receive in return for your 5.5555% Bonds is explained below
- If you choose not to participate in the *Exchange Offer* you are free to vote against the *Proposal* if you wish. However, if the *Proposal* is approved and implemented, the Co-operative Bank will mandatorily exchange your 5.5555% Bonds on the same economic terms as if you had participated in the *Exchange Offer*

Do I have to participate?

- You do not have to participate. However, you are strongly encouraged to do so. If the *Liability Management Exercise* does not succeed, the Co-operative Bank believes that it would be subject to a formal 'resolution' procedure under the UK Banking Act 2009. The Co-operative Bank believes that success of the *Liability Management Exercise* will be substantially more beneficial to holders of 5.5555% Bonds than resolution of the Co-operative Bank

Do I have a choice of what I receive if I do decide to participate in the Exchange Offer?

- No. If you decide to participate in the *Exchange Offer*, you will receive *Bank T2 Notes* in exchange for your 5.5555% Bonds. If, for example, you own £1,000 of 5.5555% Bonds, then you will receive £530* of *Bank T2 Notes*. You will receive £58.28* of interest each year (payable in four instalments of £14.57* every three months) up to 2023, plus repayment of the £530* capital in 2023. **You will not be entitled to any further payments after 2023**

** Please note that these amounts will be approximately 9% lower if not enough holders of Preference Shares, 13% Bonds and 5.5555% Bonds participate by 29 November 2013*

Who is responsible for making payments on the Bank T2 Notes?

- The Co-operative Bank will be responsible for making these payments

When do I have to take action?

- If you wish to participate in the *Exchange Offer*, you should do so by **29 November 2013** at the latest. Whilst it is possible to participate up to 6 December 2013, the terms of the *Exchange Offer* are more favourable for all holders of 5.5555% Bonds if enough investors participate by the earlier date

How do I participate?

- If you have a bond certificate, you will receive a letter enclosing the relevant forms to complete and return. If you have invested through a broker, please contact your broker

What next?

- Please read the rest of this Prospectus, including this Offer Memorandum, carefully. It contains detailed information on the *Exchange Offer* and the *Proposal* to help you make your decision
- We expect to announce the results of the *Liability Management Exercise* on 12 December 2013

Key message for all holders - Resolution of the Co-operative Bank

<u>What happens if the Liability Management Exercise does not succeed?</u>

- If any one of the *Proposals* does not succeed, the *Liability Management Exercise* will fail
- If the *Liability Management Exercise* fails, the Co-operative Bank will not be able to meet the Prudential Regulation Authority's requirement to raise at least £1 billion of fresh common equity tier 1 capital by the end of 2013
- In consequence, the Co-operative Bank would be failing, or likely to fail, to satisfy the conditions which the Prudential Regulation Authority considers necessary for it to operate as a UK bank
- The Co-operative Bank believes that, in those circumstances, the only realistic alternative is *Resolution* of the Co-operative Bank under the UK Banking Act 2009
- *Resolution* would involve the UK resolution authorities (HM Treasury and the Bank of England) exercising very broad powers under the Banking Act in order to recapitalise the Co-operative Bank
- These powers are extensive, and the UK resolution authorities have a number of options available to them. However, such powers could potentially be used in a manner which would result in holders of Existing Securities losing some, or even all, of their investment in their Existing Securities
- The Co-operative Bank has prepared an analysis of what may occur under Resolution. For further information, see Section 4, Part C (*Potential consequences of Holders' failure to support the Liability Management Exercise*) of the Bank T2 Prospectus or Part 2 (*Risk Factors – Risks relating to the Liability Management Exercise*) of the Group Notes Prospectus
- That analysis is necessarily subject to a number of significant caveats and assumptions described within the analysis
- **However, having given careful consideration to the matter and subject to those caveats and assumptions, the Board of Directors of the Co-operative Bank believes that if the Co-operative Bank were to enter into a bank insolvency or administration procedure following Resolution, holders of Existing Securities would receive no recovery at all**
- **As a result, the Board of Directors of the Co-operative Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to holders of all classes of Existing Securities than resolution of the Co-operative Bank**

OVERVIEW OF THE LIABILITY MANAGEMENT EXERCISE

What is a "liability management exercise"?

A liability management exercise is where a company seeks to restructure some or all of its debts and other obligations. Companies conduct liability management exercises for a number of reasons. A number of banks in the United Kingdom and across the world have conducted liability management exercises in recent years as a means to strengthen their capital position in response to the global financial crisis and the resulting efforts by banking regulators worldwide to make the financial systems safer. The Bank and the Group are conducting their liability management exercise for similar reasons, as more fully described below under "*Why has the Liability Management Exercise been launched?*".

What does the Bank's and Group's liability management exercise involve?

The liability management exercise being conducted by the Bank and the Group involves invitations to holders of the Existing Securities to exchange their Existing Securities for new securities to be issued by the Bank and, in certain cases, the Group.

This Offer Memorandum sets out the terms upon which those invitations are being made and related proposals (the "**Proposals**") in respect of the Preference Shares and Perpetual Subordinated Bonds for holders of such securities to agree, amongst other things, to amend the terms of such securities in the manner described below.

The offers in respect of the Preference Shares and Perpetual Subordinated Bonds are being conducted by way of exchange offers (the "**Exchange Offers**" and each an "**Exchange Offer**") and the Proposals. The offer in respect of the Dated Notes is being conducted by way of a scheme of arrangement under Part 26 of the Companies Act 2006 (the "**Scheme**"). Pursuant to, and on the terms of, the Scheme, the holders of the Dated Notes will also be entitled to elect to subscribe for up to 62,500,000 of new ordinary shares in the Bank for an aggregate consideration equal to £125 million.

The Exchange Offers, the Proposals and the Scheme are collectively referred to in this document as the "**Liability Management Exercise**".

The offers in respect of the Preference Shares, the Perpetual Subordinated Bonds and the Dated Notes are summarised briefly below under "*What is being offered?*", but these descriptions are subject to the more detailed offer terms and conditions set out in this Offer Memorandum.

Why has the Liability Management Exercise been launched?

The Liability Management Exercise is being conducted as part of a required recapitalisation of the Bank and is an integral part of the comprehensive recapitalisation plan announced by the Bank and the Group to strengthen the Bank's capital base (the "**Recapitalisation Plan**").

On 17 June 2013, following the conclusion of the Bank's review of its capital position and discussions with the Prudential Regulation Authority (the United Kingdom banking regulator, part of the Bank of England) (the "**PRA**"), the Bank and the Group announced that the Bank required additional aggregate Common Equity Tier 1 capital of £1.5 billion. The Bank and the Group also announced initial details of the Recapitalisation Plan which was intended to address this capital requirement. The Recapitalisation Plan consists of the Liability Management Exercise, a £333 million contribution of Common Equity Tier 1 capital from the Group in 2014 (the "**2014 Commitment**") and any capital generated from interest savings on the Existing Securities surrendered in the Liability Management Exercise. The Liability Management Exercise, if successful, is expected to generate at least £1 billion of Common Equity Tier 1 capital in 2013 and, conditional on successful completion of the Liability Management Exercise, £333 million of Common Equity Tier 1 capital during 2014 pursuant to the 2014 Commitment (of which £170 million is to be contributed by 30 June 2014 (with £70 million of this contribution to be paid by 31 January 2014) and the remaining £163 million by 31 December 2014).

The contributions that a successful Liability Management Exercise will provide by the end of 2013 would increase the Bank's Common Equity Tier 1 capital ratio towards the upper end of previously announced guidance on 29 August 2013, of "below 9 per cent. but above the regulatory minimum requirement" by the end of 2013, including after taking into account the impact of the impairment charges of £496 million incurred for the six month period ended 30 June 2013 and any potential further impairment charges for the remainder of the Bank's financial year ending 31 December 2013.

Successful completion of the Liability Management Exercise is conditional upon the entire principal amount of all Existing Securities being exchanged pursuant to the Liability Management Exercise, as further described below.

On 17 June 2013, the PRA made the following statement:

> *"The PRA's current assessment is that the Co-operative Bank needs to generate an additional £1.5bn in Common Equity Tier One capital in order to absorb potential losses over coming years. We will hold the Co-operative to the delivery of its plans. In relation to the Co-operative Bank this action will deliver the Financial Policy Committee's recommendation to the PRA in March regarding the capital position of the banking system."*

On 29 August 2013, the PRA reconfirmed its assessment of the Bank's capital shortfall of £1.5 billion following the announcement by the Bank of its interim results for the six month period ended 30 June 2013. In addition, the PRA reconfirmed that the £1.5 billion Common Equity Tier 1 capital requirement remained unchanged following the announcement by the Bank on 21 October 2013 of an expectation of an increase in its overall provisions of approximately £103 million relating to customer redress.

What is Common Equity Tier 1 capital?

Common Equity Tier 1 capital is a form of capital which banks and other financial institutions are required to maintain to help absorb losses, including in times of financial distress. In the aftermath of the recent global financial crisis, the PRA is requiring UK banks to bolster their capital resources so that they (and the UK banking system generally) are better able to withstand future losses and financial shocks.

How will the Liability Management Exercise strengthen the Bank's capital base?

The Liability Management Exercise, if successful, will principally generate Common Equity Tier 1 capital in two ways. First, to the extent that the Bank exchanges Existing Securities for new ordinary shares and issues additional new ordinary shares pursuant to the Scheme, the amount of new ordinary shares issued will constitute Common Equity Tier 1 capital of the Bank. Second, to the extent that the amount of new securities issued in exchange for Existing Securities is less than the value ascribed to those Existing Securities in the Bank's accounts, the difference will also be recognisable as Common Equity Tier 1 capital of the Bank. This is similar to paying off a debt for less than the full amount of that debt.

Provided the Liability Management Exercise is successfully completed, the Liability Management Exercise will generate at least £1 billion of the required £1.5 billion of Common Equity Tier 1 capital.

What conditions must be satisfied in order for the Liability Management Exercise to be successfully completed?

The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise.

In order for that to happen, all of the following (in each case, as further described in this document) must occur:

(i) the Proposal in respect of the Preference Shares must be (A) approved by the holders of the Preference Shares at the meeting convened for such holders to vote on such Proposal (and a resolution in similar terms must also be approved at a general meeting of the shareholders of the Bank) and (B) capable of being implemented in accordance with the terms of that Proposal as set out in this document;

(ii) the Proposal in respect of the 13% Bonds must be (A) approved by the holders of the 13% Bonds at the meeting convened for such holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal as set out in this document;

(iii) the Proposal in respect of the 5.5555% Bonds must be (A) approved by the holders of the 5.5555% Bonds at the meeting convened for such holders to vote on such Proposal and (B) capable of being implemented in accordance with the terms of that Proposal as set out in this document; and

(iv) (A) the Scheme must be approved by the requisite majority of the holders of the Dated Notes at the scheme meeting and sanctioned by the Court; (B) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (C) the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition).

The requirements of paragraphs (i) to (iv) (inclusive) above are collectively referred to in this document as the "**Settlement Condition**".

If the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged pursuant to the Liability Management Exercise. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

Will Co-operative Group retain control of the Bank?

If the Liability Management Exercise is successfully completed, the Group will retain a 30 per cent. stake in the Bank. This stake will come only as a direct result of the Group's fresh capital injection into the Bank, which it is providing partly through the Liability Management Exercise and partly through the 2014 Commitment. The Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil upon successful implementation of the Liability Management Exercise, and a total of 250,000,000 new ordinary shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to the Group in consideration for its fresh capital contribution (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued in the Scheme to holders of the Dated Notes in exchange for their Dated Notes (such new ordinary shares will be distributed in the Scheme *pro rata* amongst the holders of the Dated Notes, based on the relative size of each holder's scheme claim) (representing, based on the total value of scheme claims and the number of new ordinary shares issued in the Scheme to holders of Dated Notes, an implied subscription price of approximately £7.77 per share); and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

What happens if the Liability Management Exercise does not succeed?

The Bank believes that there are only two realistic outcomes for the Bank following the launch of the Liability Management Exercise, either:

- its recapitalisation following successful implementation of the Liability Management Exercise; or
- its Resolution under the UK Banking Act 2009 (the "**Banking Act**") following failure of the Liability Management Exercise.

"**Resolution**" would involve the United Kingdom resolution authorities (HM Treasury and the Bank of England) exercising very broad stabilisation powers available to them under the Banking Act to impose one of several stabilisation options under a 'special resolution regime' on the Bank. These powers are extensive, and could potentially be used in a manner which would result in holders of Existing Securities losing some, or even all, of their investment in the Existing Securities.

Given the discretionary nature of the powers available to the UK resolution authorities under the Banking Act, the Bank is unable to predict with certainty the precise outcome for holders if the Liability Management Exercise is not successfully implemented during 2013. However, the Bank has no other source available to it to raise the required additional Common Equity Tier 1 capital. As stated in the historical interim financial information for the Bank for the six months ended 30 June 2013, if the Liability Management Exercise is not successfully completed, the Bank will cease to be a going concern and the Bank considers it is likely to fail to satisfy its threshold conditions for authorisation (within the meaning of Section 55B of the Financial Services and Markets Act 2000, as amended). In such circumstances, the UK resolution authorities may then exercise a stabilisation power under the Banking Act. These threshold conditions include a requirement that the PRA is satisfied, in particular, that the Bank has appropriate financial resources and structural arrangements, including that the Bank has made appropriate provisions for its liabilities. In addition, the UK resolution authorities may also exercise their powers to resolve the Bank even where it remains a going concern.

If the Liability Management Exercise is not successfully implemented on or before 31 December 2013, the Bank therefore considers that the PRA would have a basis for determining that the Bank is failing, or is likely to fail, to satisfy its threshold conditions; that the power of the UK resolution authorities to exercise stabilisation powers under the Banking Act had arisen; and that the Bank believes that the Bank would be subject to a resolution procedure under the Banking Act. The Bank therefore believes, as noted above, that there are only two realistic outcomes for the Bank, which are either its recapitalisation following successful implementation of the Liability Management Exercise or a failure of the Liability Management Exercise resulting in the Bank becoming subject to a resolution procedure under the Banking Act.

In the event that the Bank enters an insolvency procedure or administration following action taken by the UK resolution authorities under the Banking Act, and as further described in Section 4, Part C (*Potential consequences of Holders' failure to support the Liability Management Exercise*) of the Bank T2 Prospectus (as defined below) and in Part 2 (*Risk Factors – Risks relating to the Liability Management Exercise*) of the Group Notes Prospectus (as defined below), the Board of the Bank believes it likely that holders would not receive any recovery in any such insolvency proceedings or administration and would not be entitled to any compensation as a result of a bank insolvency procedure or administration of the Bank. The Bank also believes that there are fundamental uncertainties as to whether the Bank could be successfully resolved under the current terms of the Banking Act such that the Bank itself remained a going concern. The Board of the Bank therefore believes that the Recapitalisation Plan represents the only realistic opportunity for holders to recover any value in return for their investment in the Bank.

The Bank has prepared a Resolution analysis, which can be found in Part C of Section 4 of the Bank T2 Prospectus, to support this conclusion. This analysis is subject to a number of significant caveats and assumptions described within the analysis. Holders should read the analysis in that light. However, subject to those caveats and assumptions, the Bank believes that the return to the Bank's senior unsecured creditors from a bank insolvency procedure or administration of the Bank would be in the region of 91.5 per cent. and that holders of Existing Securities would receive no recovery at all in such a bank insolvency procedure or administration because their claims are subordinated to the claims of the senior unsecured creditors of the Bank. As a result, the Bank believes that implementation of the Liability Management Exercise is substantially more beneficial to holders of all classes of Existing Securities than resolution of the Bank.

Is there an early participation incentive?

Yes. With a view to incentivising holders of the Preference Shares, 13% Bonds and 5.5555% Bonds to participate in the Liability Management Exercise promptly, the Liability Management Exercise is designed such that if the Early Participation Threshold (as described below) is achieved by 4.30 p.m. (London time) on 29 November 2013 (the "Early Participation Deadline"), the amount of consideration which all holders will be eligible to receive upon the exchange or sale of their Preference Shares, 13% Bonds and 5.5555% Bonds in the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be higher than if the Early Participation Threshold is not achieved by the Early Participation Deadline.

The "**Early Participation Threshold**" will be achieved only if all of the following have occurred by the Early Participation Deadline:

(i) the aggregate nominal amount of Preference Shares which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the Preference Shares (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of Preference Shares outstanding;

(ii) the aggregate nominal amount of 13% Bonds which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 13% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 13% Bonds outstanding; and

(iii) the aggregate nominal amount of 5.5555% Bonds which have been (A) validly offered for exchange and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 5.5555% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 5.5555% Bonds outstanding.

If any one or more of the above is not achieved by the Early Participation Deadline, the Early Participation Threshold will not have been achieved, and the amount of consideration to be delivered in exchange for all Preference Shares, 13% Bonds and 5.5555% Bonds pursuant to the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be lower than if the Early Participation Threshold had been achieved by the Early Participation Deadline. The difference in the amount of consideration is further described below.

<u>What is being offered?</u>

The offers and proposals being made pursuant to the Liability Management Exercise are summarised briefly below, but these descriptions are subject to the more detailed offer terms and conditions set out in this Offer Memorandum.

Preference Shares Offer

Holders of the Preference Shares are being offered a choice of two options:

(1) to offer to transfer their Preference Shares to the Group in exchange for new sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) (the "**Final Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or

(2) to offer to sell their Preference Shares to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (the "**Instalment Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

The Final Repayment Notes and Instalment Repayment Notes are, together, referred to in this document as the "**Group Notes**".

Final Repayment Notes: The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

Instalment Repayment Notes: The Instalment Repayment Notes (representing instalments of the cash purchase price for the Preference Shares) will not bear interest. However, the principal amount of such Instalment Repayment Notes will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a holder will receive upon the sale of its Preference Shares to the Group will be equal to twelve times the annual dividend on those Preference Shares (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the holder, in each of those twelve years, an amount which is broadly equivalent to the amount of dividends which such holder would have received had it continued to hold those Preference Shares which it sells to the Group in the Liability Management Exercise.**

Final Repayment Notes vs Instalment Repayment Notes: Each holder shall be able to choose only one of the two options available.

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such holder will be whether it wishes to receive (i) the higher amounts payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of holders opting to exchange their Preference Shares for Final Repayment Notes will be different to the tax treatment of holders opting to sell their Preference Shares for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are recommended to consult their own professional advisers regarding the tax treatment applicable to their specific circumstances.

A table comparing certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes can be found at Section C, Part 6 of this Offer Memorandum.

Group Notes

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of Preference Shares (excluding the Additional Preference Shares referred to below) exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

If the holder elects the Final Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £601 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares exchanged; and
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £551 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares exchanged.

If, on the other hand, the holder elects the Instalment Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,110 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares sold to the Group; and

- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,060 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares sold to the Group.

The references above to £1,000 in nominal amount of Preference Shares are for illustrative purposes only. Holders of Preference Shares will be able to offer to exchange or sell their Preference Shares in any whole multiple of £1 (subject to a minimum of £2 if such holder elects the Final Repayment Notes option (being the minimum nominal amount of Preference Shares necessary to receive, based on the Late Consideration Amount, at least the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if the holder elects the Instalment Repayment Notes option).

Accrued dividends

An amount equal to accrued and unpaid dividends from (and including) 30 November 2013 to (but excluding) the date of settlement of the Liability Management Exercise (i.e. the date on which the Preference Shares are transferred to the Group and holders become eligible to receive Group Notes) will also be paid in cash in respect of those Preference Shares (other than Additional Preference Shares) which are exchanged or sold to the Group.

In addition, the next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 which is during the offer period for the Liability Management Exercise. Under the terms of the Preference Shares, the Bank will not be able to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each holder in lieu of cash payment ("**Additional Preference Shares**"). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday). If the Liability Management Exercise successfully completes, then upon transfer of those Additional Preference Shares to the Group the holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash equal to the cash dividend which the Bank would have paid on or around 29 November 2013 had it been able to do so under the terms of the Preference Shares.

Since the Additional Preference Shares will be fungible with (i.e. identical to) other Preference Shares such that it may not be possible to distinguish between them, for the purposes of the treatment of Additional Preference Shares in the Liability Management Exercise as described above, 6⅞ per cent. of the aggregate nominal amount of the Preference Shares outstanding will be deemed to be Additional Preference Shares for these purposes.

Proposal

A meeting of the holders of the Preference Shares is also being convened (the "**Preference Shareholders Meeting**"), in accordance with the Articles of Association of the Bank, in order for those holders to vote on proposed resolutions which, if passed and implemented, would result in amendments to the terms of the Preference Shares, as set out in the Bank's Articles of Association, to enable the Bank:

(i) to purchase and cancel any share capital of the Bank (which would include, without limitation, Preference Shares) from time to time, without the need for the further consent of the holders of the Preference Shares; and

(ii) to mandatorily effect the transfer to the Group of all (but not some only) of the Preference Shares, which are not exchanged or sold in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all holders of the Preference Shares (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their Preference Shares; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

A general meeting of all shareholders (both ordinary shareholders and preference shareholders) of the Bank must also approve a resolution, in similar terms to the resolution in (ii) above, in order to give effect to the above resolution (the "**General Meeting**"). By offering to exchange or sell its Preference Shares in the Liability Management Exercise, a holder will instruct both (i) the chairman of the Preference Shareholders Meeting to vote on such holder's behalf in favour of the resolution proposed at the Preference Shareholders Meeting and (ii) the chairman of the General Meeting to vote on such holder's behalf in favour of the resolution proposed at the General Meeting.

If a holder has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such holder's Preference Shares are mandatorily transferred to the Group following the successful implementation of the Proposal described above, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

13% Bonds Offer

Holders of the 13% Bonds are being offered a choice of two options:

(1) to offer to transfer their 13% Bonds to the Group in exchange for Final Repayment Notes (as defined above) to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or

(2) to offer to sell their 13% Bonds to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by Instalment Repayment Notes (as defined above) to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

Final Repayment Notes: The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

Instalment Repayment Notes: The Instalment Repayment Notes (representing instalments of the cash purchase price for the 13% Bonds) will not bear interest. However, the principal amount of such Instalment Repayment Notes will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a holder will receive upon the sale of its 13% Bonds to the Group will be equal to twelve times the annual interest on those 13% Bonds (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved**

by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the holder, in each of those twelve years, an amount which is broadly equivalent to the amount of interest which such holder would have received had it continued to hold those 13% Bonds which it sells to the Group in the Liability Management Exercise.

Final Repayment Notes vs Instalment Repayment Notes: Each holder shall be able to choose only one of the two options available.

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment on the twelfth anniversary, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of holders opting to exchange their 13% Bonds for Final Repayment Notes will be different to the tax treatment of holders opting to sell their 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are recommended to consult their own professional advisers regarding the tax treatment applicable to their specific circumstances.

A table comparing certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes can be found in Section C, Part 7 of this Offer Memorandum.

Group Notes

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of 13% Bonds exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

If the holder elects the Final Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive £844 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged; and
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive £794 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged.

If, on the other hand, the holder elects the Instalment Repayment Notes option, then:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,560 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group; and

- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive (subject to rounding) £1,510 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group.

The 13% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange or sale in nominal amounts of £1,000 or a whole multiple of £1,000.

Accrued interest

An amount equal to accrued and unpaid interest from (and including) 31 July 2013 to (but excluding) the date of settlement of the Liability Management Exercise (i.e. the date on which the 13% Bonds are transferred to the Group and holders become eligible to receive Group Notes) will also be paid in cash in respect of those 13% Bonds which are exchanged or sold to the Group.

In addition, as announced by the Bank on 12 July 2013, upon successful completion (i.e. settlement) of the Exchange Offer in respect of the 13% Bonds, the Bank will pay, in cash, to all investors in the 13% Bonds (whether or not participating in the Exchange Offer) the deferred interest payment originally scheduled for 31 July 2013.

Proposal

A meeting of the holders of the 13% Bonds is also being convened (the "**13% Bondholders Meeting**"), in accordance with the trust deed dated 1 August 2009 constituting the 13% Bonds, in order for those holders to vote on proposed resolutions which, if passed and implemented, would result in amendments to the terms of the 13% Bonds to enable the Bank to mandatorily effect the transfer to the Group of all (but not some only) of the 13% Bonds, which are not offered or sold in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer.

The proposed resolution also contains, on behalf of all holders of the 13% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 13% Bonds; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

By offering to exchange or sell its 13% Bonds in the Liability Management Exercise, a holder will also instruct the chairman of the 13% Bondholders Meeting to vote on such holder's behalf in favour of the resolution proposed at the 13% Bondholders Meeting.

If a holder has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such holder's 13% Bonds are mandatorily transferred to the Group following the successful implementation of the Proposal described above, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes; or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

5.5555% Bonds Offer

Holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank (the "**Bank T2 Notes**").

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly on each three-month anniversary of the issue date of the Bank T2 Notes up to (and including) the tenth anniversary. The Bank will be obliged to repay the principal amount of the Bank T2 Notes in full on the tenth anniversary of their issue date.

A table comparing certain key features of the 5.5555% Bonds and the Bank T2 Notes can be found at Section C, Part 8 of this Offer Memorandum.

Bank T2 Notes

The principal amount of Bank T2 Notes which a holder will (if the Liability Management Exercise is successfully completed) receive in exchange for every £1,000 in nominal amount of 5.5555% Bonds will depend upon whether or not the Early Participation Threshold is achieved by the Early Participation Deadline. Accordingly:

- if the Early Participation Threshold is achieved by the Early Participation Deadline, a holder will receive £530 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged.
- if the Early Participation Threshold is not achieved by the Early Participation Deadline, a holder will receive £480 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged.

The 5.5555% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange in nominal amounts of £1,000 or a whole multiple of £1,000.

Accrued interest

An amount equal to accrued and unpaid interest from (and including) 14 December 2013 to (but excluding) the date of settlement of the Liability Management Exercise (i.e. the date on which the 5.5555% Bonds are exchanged for Bank T2 Notes) will also be paid in cash in respect of those 5.5555% Bonds which are exchanged.

The next interest payment on the 5.5555% Bonds is scheduled for 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully settles, the Bank will pay the deferred interest to all investors in the 5.5555% Bonds, whether or not participating in the Exchange Offer, in cash upon settlement of the Liability Management Exercise.

Proposal

A meeting of the holders of the 5.5555% Bonds is also being convened (the "**5.5555% Bondholders Meeting**"), in accordance with the trust deed dated 1 August 2009 constituting the 5.5555% Bonds, in order for those holders to vote on a proposed resolution which, if passed and implemented, would result in amendments to the terms of the 5.5555% Bonds to enable the Bank to mandatorily effect the exchange of all (but not some only) of the 5.5555% Bonds, which are not exchanged in the Exchange Offer, for Bank T2 Notes on the same economic terms as 5.5555% Bonds are exchanged in the Exchange Offer.

The proposed resolution also contains, on behalf of all holders of the 5.5555% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 5.5555% Bonds; provided, however, that nothing in that resolution shall constitute a release of the

Bank or the Group from, or a waiver of the rights and entitlements of holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

By offering to exchange its 5.5555% Bonds in the Liability Management Exercise, a holder will also instruct the chairman of the 5.5555% Bondholders Meeting to vote on such holder's behalf in favour of the resolution proposed at the 5.5555% Bondholders Meeting.

Dated Notes Offers

Holders of the Dated Notes are being invited to vote on proposals under the Scheme to authorise the Bank to exchange all outstanding Dated Notes (including those held by holders who do not vote in favour of the proposals) for a combination of (i) new ordinary shares (ISIN: GB00BDW0BX87) to be issued by the Bank ("**New Ordinary Shares**") and (ii) Bank T2 Notes (as defined above under "*5.5555% Bonds Offer*").

Scheme Claims and accrued interest

A holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a holder's Scheme Claim in respect of any Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the sterling equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

For the purposes of determining a holder's Scheme Claim, the "**Scheme Record Date**" is currently expected to be 10 December 2013.

The amount of a holder's Scheme Claim will be used to determine the number of New Ordinary Shares and principal amount of Bank T2 Notes which such holder will be entitled to receive in exchange for its Dated Notes if the Scheme is settled, as further described below. For the avoidance of doubt, no accrued interest will be paid in cash pursuant to the Scheme.

The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled on the Scheme Settlement Date.

New Ordinary Shares and Bank T2 Notes

The number of New Ordinary Shares and the principal amount of Bank T2 Notes which a holder will (if the Liability Management Exercise is successfully completed) receive pursuant to the Scheme based on its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

A holder will receive 115 New Ordinary Shares and £102.63 in principal amount of Bank T2 Notes (in each case, subject to rounding) for every £1,000 of its Scheme Claim.

Lock-up Arrangements

Holders of Dated Notes will be invited to enter into lock-up arrangements ("**Lock-up Arrangements**") in accordance with the procedures set out in the Explanatory Statement relating to the Scheme. Such Lock-up Arrangements will result in such holders agreeing (amongst other things) to vote their full Scheme Claim in favour of the Scheme at the Scheme creditors meeting.

Offer of additional New Ordinary Shares for cash

The Scheme will also provide that 62,500,000 additional New Ordinary Shares will be made available to holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

What options are available to me?

Preference Shares Offer

Holders of Preference Shares have the following options available:

(i) offer to exchange (for Final Repayment Notes) or sell (for cash consideration payable in twelve equal instalments over twelve years, to be represented by Instalment Repayment Notes) some or all of their Preference Shares in the Preference Shares Exchange Offer (in which case such holders will also automatically vote those Preference Shares in favour of the resolutions proposed at the Preference Shareholders Meeting and the General Meeting);

(ii) vote some or all of their Preference Shares in favour of the resolutions proposed at the Preference Shareholders Meeting and the General Meeting without offering to exchange or sell their Preference Shares;

(iii) vote some or all of their Preference Shares against the resolutions proposed at the Preference Shareholders Meeting and/or the General Meeting (in which case such holders will not be able to offer to exchange or sell their Preference Shares in the Preference Shares Exchange Offer); or

(iv) do nothing.

Holders who take the action (or inaction) under (ii), (iii) or (iv) above should note that, if the resolutions proposed at the Preference Shareholders Meeting and the General Meeting are passed and implemented, such holders' Preference Shares will be mandatorily either (1) exchanged for Final Repayment Notes or (2) transferred to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as Preference Shares are exchanged or sold in the Exchange Offer. Holders are encouraged to elect whether, if their Preference Shares are subject to such mandatory arrangements, they would prefer to (1) exchange their Preference Shares for Final Repayment Notes or (2) sell their Preference Shares to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes.

13% Bonds Offer

Holders of 13% Bonds have the following options available:

(i) offer to exchange (for Final Repayment Notes) or sell (for cash consideration payable in twelve equal instalments over twelve years, to be represented by Instalment Repayment Notes) some or all of their 13% Bonds in the Exchange Offer (in which case such holders will also automatically vote those 13% Bonds in favour of the resolution proposed at the 13% Bondholders Meeting);

(ii) vote some or all of their 13% Bonds in favour of the resolution proposed at the 13% Bondholders Meeting without offering to exchange or sell their 13% Bonds;

(iii) vote some or all of their 13% Bonds against the resolution proposed at the 13% Bondholders Meeting (in which case such holders will not be able to offer to exchange or sell their 13% Bonds in the Exchange Offer); or

(iv) do nothing.

Holders who take the action (or inaction) under (ii), (iii) or (iv) above should note that, if the resolution proposed at the 13% Bondholders Meeting is passed and implemented, such holders' 13% Bonds will be mandatorily either (1) exchanged for Final Repayment Notes or (2) transferred to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as 13% Bonds are exchanged or sold in the Exchange Offer. Holders are encouraged to elect whether, if their 13% Bonds are subject to such mandatory arrangements, they would prefer to (1) exchange their 13% Bonds for Final Repayment Notes or (2) sell their 13% Bonds to the Group in return for the cash consideration payable over twelve years and represented by the Instalment Repayment Notes.

5.5555% Bonds Offer

Holders of 5.5555% Bonds have the following options available:

(i) offer to exchange some or all of their 5.5555% Bonds in the Exchange Offer (in which case such holders will also automatically vote those 5.5555% Bonds in favour of the resolution proposed at the 5.5555% Bondholders Meeting);

(ii) vote some or all of their 5.5555% Bonds in favour of the resolution proposed at the 5.5555% Bondholders Meeting without offering to exchange their 5.5555% Bonds;

(iii) vote some or all of their 5.5555% Bonds against the resolution proposed at the 5.5555% Bondholders Meeting (in which case such holders will not be able to offer to exchange their 5.5555% Bonds in the Exchange Offer); or

(iv) do nothing.

Holders who take the action (or inaction) under (ii), (iii) or (iv) above should note that, if the resolution proposed at the 5.5555% Bondholders Meeting is passed and implemented, such holders' 5.5555% Bonds will be mandatorily exchanged for Bank T2 Notes on the same economic terms as 5.5555% Bonds are exchanged in the Exchange Offer.

Dated Notes Offer

Holders of Dated Notes have the following options available:

(i) enter into Lock-up Arrangements pursuant to which they will agree, amongst other things, to vote in favour of the Scheme at the Scheme Meeting;

(ii) vote in favour of the Scheme at the Scheme Meeting without entering into a Lock-up Arrangement;

(iii) vote against the Scheme at the Scheme Meeting; or

(iv) do nothing.

Holders of Dated Notes will also be entitled to elect to subscribe for up to 62,500,000 additional New Ordinary Shares for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

Holders should note that, whatever action (or inaction) they take, if the Scheme is approved by the requisite majorities of the holders of Dated Notes and the Scheme is sanctioned by the High Court of Justice of England & Wales (the "**Court**") and implemented, all of the holders of Dated Notes will be bound by the Scheme and, accordingly, their Dated Notes will be mandatorily exchanged for New Ordinary Shares and Bank T2 Notes.

What documents do I need to read?

The Liability Management Exercise is being conducted on the basis of the following documents:

- the Final Repayment Notes and the Instalment Repayment Notes are being offered by the Group to holders of the Preference Shares and 13% Bonds on the basis of a Prospectus dated 4 November 2013 published by the Group and relating to the Group Notes (the "**Group Notes Prospectus**");

- the Bank T2 Notes are being offered by the Bank to holders of the 5.5555% Bonds on the basis of a Prospectus dated 4 November 2013 published by the Bank and relating to the Bank T2 Notes (the "**Bank T2 Prospectus**"); and

- the Scheme will be described in the explanatory statement relating to the Scheme (the "**Explanatory Statement**") and accompanying documents (together, the "**Scheme Documents**"), which will be made available to holders of the Dated Notes on or around 19 November 2013.

The Group Notes Prospectus and the Bank T2 Prospectus are together referred to in this document as the "**Prospectuses**", and each is a "**Prospectus**". This Offer Memorandum is appended to, and forms part of, each Prospectus.

Holders of Existing Securities are recommended to read the following documents, which are relevant for their purposes:

Preference Shares and 13% Bonds

Holders of the Preference Shares and 13% Bonds are recommended to read the Group Notes Prospectus, which contains this Offer Memorandum. The following sections of this Offer Memorandum are directly relevant to holders of Preference Shares and 13% Bonds:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section C: Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

5.5555% Bonds

Holders of the 5.5555% Bonds are recommended to read the Bank T2 Prospectus, which contains this Offer Memorandum. The following sections of this Offer Memorandum are directly relevant to holders of 5.5555% Bonds:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section C: Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

Dated Notes

Holders of the Dated Notes are recommended to read the Scheme Documents, which include the Bank T2 Prospectus and this Offer Memorandum. The following sections of this Offer Memorandum are directly relevant to holders of Dated Notes:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section D: Scheme of Arrangement in respect of the Dated Notes
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

<u>Where can I obtain the relevant documents?</u>

The Prospectuses and the Scheme Documents will be made available on the Bank's website at: *http://www.co-operative.coop/bondholders*. The Prospectuses are available from the date of their publication. The Scheme Documents will be available following the Court hearing for convening the Scheme (which is expected to be held on 18 November 2013).

The Prospectuses are also available on the Regulatory News Service (RNS) operated by the London Stock Exchange plc at *http://www.londonstockexchange.com/exchange/news/market-news/market-news-home.html*.

The Prospectuses and Scheme Documents may also be obtained from Lucid Issuer Services Limited (the "**Exchange Agent**" and the "**Information Agent**"), who can be contacted at the following email address: *co-op@lucid-is.com.*

<u>Am I eligible to participate in the Liability Management Exercise?</u>

All holders of Existing Securities will be eligible to participate in the Liability Management Exercise, subject only to applicable laws and regulations in the country where they are located.

Holders located in the United Kingdom

All holders of Existing Securities who are located in the United Kingdom (and who are not "U.S. persons" as defined in Section L of this Offer Memorandum) will be eligible to participate in the Exchange Offers, the Proposals and the Scheme.

Holders located in the United States and U.S. persons

Holders who are resident or located in the United States, or who are "U.S. persons" (as defined in Section L of this Offer Memorandum) wherever they are located, are not eligible to participate in the Exchange Offers.

However, they will be eligible to participate in the Preference Shareholders Meeting (and the General Meeting), 13% Bondholders Meeting and/or 5.5555% Bondholders Meeting (if they hold Preference Shares, 13% Bonds or 5.5555% Bonds, respectively). They will also be eligible to participate in the Scheme (if they hold Dated Notes).

Other countries

In countries other than the United Kingdom and the United States, whether or not holders of Existing Securities are able to participate in the Liability Management Exercise, or certain of its component parts, may be restricted by law. Holders are responsible for ensuring that they inform themselves about, and comply with, any such restrictions.

However, for the avoidance of doubt, all holders of Preference Shares, 13% Bonds and 5.5555% Bonds will be eligible to participate in the Preference Shareholders Meeting (and the General Meeting), 13% Bondholders Meeting and 5.5555% Bondholders Meeting, respectively, even if such holders are not eligible to participate in the Exchange Offers.

Should I support the Liability Management Exercise?

Each holder must make its own decision whether or not to support the Liability Management Exercise, and should consult its own professional advisers if it is unsure as to any action it should take. None of the Bank, the Group, the Dealer Managers or any other person named in this document is providing any advice or recommendation to any holder as to what action it should take in respect of the Liability Management Exercise.

The Bank has sought an independent opinion from Canaccord Genuity Limited ("**Canaccord Genuity**") on the fairness of the Liability Management Exercise from a financial value perspective to the holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds. Canaccord Genuity's opinions are set out in Section N of this document.

Holders should note that these opinions do not constitute financial or legal advice. By consenting to the inclusion of its opinions in this document, Canaccord Genuity is not providing any advice or recommendation to any holder as to what action it should take in respect of the Liability Management Exercise. Canaccord Genuity will not be responsible or liable to any holder for that holder's decisions in respect of the Liability Management Exercise.

How do I participate in the Liability Management Exercise?

Holders of Preference Shares, 13% Bonds and 5.5555% Bonds are referred to Section C Part 4 of this Offer Memorandum for information on how to participate in the Offers.

Holders of Dated Notes are referred to the Explanatory Statement for information on how to participate in the Scheme.

Holders who hold their Existing Securities through a custodian, broker or other financial intermediary are urged to contact that intermediary as a matter of priority to discuss their arrangements and to determine what instructions that intermediary will require in order for the relevant holder to participate in the Liability Management Exercise.

I want to participate in the Liability Management Exercise. When do I need to take action?

The earliest date on which a holder of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell its Existing Securities in the Exchange Offers is 4 November 2013.

The Early Participation Deadline for the Offers is **4.30 p.m. (London time) on 29 November 2013**. As noted above, if the Early Participation Threshold is achieved by the Early Participation Deadline, the amount of consideration to be delivered in exchange for all Preference Shares, 13% Bonds and 5.5555% Bonds which are exchanged or sold pursuant to the Liability Management Exercise will be higher than if (in circumstances where the Settlement Condition is ultimately satisfied) the Early Participation Threshold is not achieved by the Early Participation Deadline. **Therefore, holders of Preference Shares, 13% Bonds and 5.5555% Bonds are strongly urged to make appropriate arrangements to participate in the Liability Management Exercise before the Early Participation Deadline.**

The earliest date on which a holder of Dated Notes is able to submit an Account Holder Letter is expected to be 19 November 2013.

The offer period for each of the Offers expires at **4.30 p.m. (London time) on 6 December 2013** (the "**Expiration Deadline**"). That is also the voting instruction deadline (the "**Voting Instruction Deadline**") for holders of Dated Notes to make appropriate arrangements to vote in the Scheme.

Holders who hold their Existing Securities through a custodian, broker or other financial intermediary are urged to contact that intermediary as a matter of priority to discuss their arrangements and to determine when that intermediary will require instructions in order for the relevant holder to participate in the Liability Management Exercise by the Early Participation Deadline, the Expiration Deadline or (in the case of holders of Dated Notes) the Voting Instruction Deadline. These times will be earlier than the times specified above.

What are the risks associated with the Liability Management Exercise?

There are a number of risks and other considerations which may be relevant to a holder's decision whether or not to participate in the Liability Management Exercise, including risks relating to the Liability Management Exercise, risks relating to an investment in the Bank and the Group generally and risks relating to the particular nature of the Bank T2 Notes, the Group Notes and the New Ordinary Shares. Certain of these risks and other considerations have been described by the Bank and the Group (as applicable) in the Prospectuses they have prepared in connection with the offer of Bank T2 Notes and Group Notes pursuant to the Liability Management Exercise, and the Explanatory Statement prepared by the Bank in connection with the Scheme.

Holders of Existing Securities are urged to read carefully and consider those sections which are relevant to them. In particular:

Holders of the **Preference Shares** and **13% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Group Notes Prospectus

Holders of the **5.5555% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus

Holders of the **Dated Notes** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus
- Part C ("*Risk Factors*") of the Explanatory Statement

Use of defined terms in this Offer Memorandum

Capitalised terms used in this Offer Memorandum have the meanings given in Section L of this Offer Memorandum.

In addition, there are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of holders of Preference Shares or 13% Bonds who elect the Instalment Repayment Notes option, such expressions are used for the holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out above in the brief description of the invitations being made to holders of Preference Shares and 13% Bonds, holders who opt for Instalment Repayment Notes will actually be selling their Preference Shares or 13% Bonds (as the case may be) to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes.

Where can I find further information about the Liability Management Exercise?

Website

Certain information relating to the Liability Management Exercise is set out on the Bank's website at: http://www.co-operative.coop/bondholders.

Questions regarding the terms of the Liability Management Exercise

Questions about the terms of the Liability Management Exercise can be directed to the Dealer Managers at the following contact details:

HSBC Bank plc 8 Canada Square London E14 5HQ United Kingdom Telephone: +44 20 7992 6237 Attention: Liability Management Group Email: coop.exchange@hsbcib.com	**UBS Limited** 1 Finsbury Avenue London EC2M 2PP United Kingdom Telephone: +44 20 7567 0525 Attention: Liability Management Group Email: mark-t.watkins@ubs.com/ mahmoud.abdelaal@ubs.com

Questions regarding participation mechanics

Questions of a practical nature regarding how to participate in the Liability Management Exercise should be directed to the Exchange Agent and Information Agent at the following contact details:

Lucid Issuer Services Limited 436 Essex Road London N1 3QP United Kingdom Telephone: 0800 279 7346 (if calling from outside the UK: +44 20 7704 0880) Fax: +44 20 7067 9098 Attention: Sunjeeve Patel / David Shilson / Yves Theis Email: co-op@lucid-is.com

In addition, holders of the Preference Shares may contact Computershare as registrar for the Preference Shares, and holders of the 13% Bonds and 5.5555% Bonds may contact Equiniti as registrar for those bonds, at the following contact details:

Preference Shares	*13% Bonds and 5.5555% Bonds*
Computershare Investor Services PLC Corporate Actions Projects Bristol BS99 6AH United Kingdom Telephone: 0800 694 0470 (if calling from outside the UK: +44 117 902 7672)	**Equiniti Limited** Corporate Actions Aspect House Spencer Road Lancing West Sussex BN99 6DA United Kingdom Telephone: 0800 169 7006 (if calling from outside the UK: +44 121 415 0260)
Lines are open from 8.30 a.m. to 5.30 p.m. (London time) Monday to Friday (except UK public holidays). Calls from UK landlines to the "0800" numbers will not be chargeable. Calls from outside the UK will be charged at the applicable international rate. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. Please note that the telephone operators cannot provide advice on the merits of the Liability Management Exercise or any part of it, nor can they give financial, tax, investment or legal advice.	

No advice or recommendation

None of the Bank, the Group, the Dealer Managers, the Exchange Agent, the Information Agent, the Trustee (as defined in Section L of this Offer Memorandum) or the Registrars are able to, and they do not, express any opinion on the merits of the Liability Management Exercise or any component part of the Liability Management Exercise, or make any recommendation or offer any advice regarding whether or not a holder of Existing Securities should participate in the Liability Management Exercise. Each holder must carefully review the applicable documents in connection with the Liability Management Exercise and come to a decision, either on its own or with the assistance of its professional advisers, whether or not it wishes to participate in the Liability Management Exercise.

Any investor who does not fully understand any part of the Liability Management Exercise relevant to it, or any of the information relating to the relevant part of the Liability Management Exercise as set out in the relevant Prospectus(es), this Offer Memorandum or (in the case of the Dated Notes) the Scheme Documents, should seek independent advice from such financial, legal and/or other professional advisers as it considers appropriate.

Note to holders of Dated Notes who hold significant amounts of Dated Notes:

The Co-operative Bank p.l.c. is an authorised person, authorised and regulated by the Prudential Regulation Authority under the Financial Services and Markets Act 2000. In the United Kingdom, it is a criminal offence to acquire 10 per cent. or more of the shares or voting power in an authorised person without notifying the Prudential Regulation Authority or without obtaining the prior approval of the Prudential Regulation Authority. If any holder of Dated Notes considers that it may, as a result of the Liability Management Exercise, acquire 10 per cent. or more of the ordinary shares in the Bank, it is advised to seek independent legal advice.

TABLE OF CONTENTS

SECTION A

RATIONALE FOR THE LIABILITY MANAGEMENT EXERCISE

The Liability Management Exercise is being conducted as part of a required recapitalisation of the Bank and is an integral part of the Recapitalisation Plan.

Holders of the Preference Shares and 13% Bonds are referred to "*Risks relating to the Liability Management Exercise*" in Section 2 (*Risk Factors*) and "*Recent Developments – Capital Shortfall and Recapitalisation Plan*" in Section 8 (*Description of the Issuer*) of the Group Notes Prospectus.

Holders of the 5.5555% Bonds are referred to Section 4 (*Letter from the Chairman of the Bank, background to and reasons for the Recapitalisation Plan and potential consequences of Holders failing to support the Liability Management Exercise*) of the Bank T2 Prospectus.

Holders of the Dated Notes are referred to Section 4 (*Letter from the Chairman of the Bank, background to and reasons for the Recapitalisation Plan and potential consequences of Holders failing to support the Liability Management Exercise*) of the Bank T2 Prospectus (which forms part of the Scheme Documents).

SECTION B

OFFER CONSIDERATION – OVERVIEW TABLES

The tables in this section set out, in overview form, the consideration that holders of Existing Securities will be eligible to receive if their Existing Securities are exchanged or sold (as the case may be) pursuant to the Liability Management Exercise. The details of the offers for each series of the Existing Securities are set out later in this Offer Memorandum.

Offers in respect of the Preference Shares and the 13% Bonds

Existing Securities	ISIN	Early Consideration Amount[1] (per £1,000 nominal of Existing Securities)			Late Consideration Amount[1] (per £1,000 nominal of Existing Securities)		
		Final Repayment Notes[2]	OR[4]	Instalment Repayment Notes[3]	Final Repayment Notes[2]	OR[4]	Instalment Repayment Notes[3]
Preference Shares[5]	GB0002224516	£601		£1,110	£551		£1,060
13% Bonds	GB00B3VH4201	£844		£1,560	£794		£1,510

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group.

3 New sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (having their last instalment payment date in 2025) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group. The Instalment Repayment Notes represent the instalments of consideration to be received by Holders whose Preference Shares or 13% Bonds are sold to the Group in the Liability Management Exercise.

4 The amounts of Final Repayment Notes and Instalment Repayment Notes specified in the table above are alternative options. A holder will not receive both of these amounts. Holders will be able to elect (in accordance with the procedures set out in this document) either the Final Repayment Notes option or the Instalment Repayment Notes option only.

5 The Early Consideration Amount and Late Consideration Amount for the Preference Shares are presented in this table on a "per £1,000 in nominal amount" basis for ease of comparison with the 13% Bonds. Preference Shares can be offered for exchange or sale in any whole multiple of £1 (subject to a minimum of £2 if a holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a holder elects the Instalment Repayment Notes option).

Offer in respect of the 5.5555% Bonds

Existing Securities	ISIN	Early Consideration Amount[1] (per £1,000 nominal of Existing Securities)	Late Consideration Amount[1] (per £1,000 nominal of Existing Securities)
		Bank T2 Notes[2]	Bank T2 Notes[2]
5.5555% Bonds	GB00B3VMBW45	£530	£480

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

Scheme in respect of the Dated Notes

Existing Securities	ISIN	Consideration Amount[1,5] (per £1,000 of Scheme Claim[4])		New Ordinary Shares Conversion Price[5]
		Bank T2 Notes[2]	New Ordinary Shares[3]	
Floating Rate Callable Step-up Dated Subordinated Notes due 2016	XS0254625998	£102.63	£897.37	£7.7718292 per share
5.875% Subordinated Callable Notes due 2019	XS0189539942	£102.63	£897.37	
9.25% Subordinated Notes due 28 April 2021	XS0620315902	£102.63	£897.37	
Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984	£102.63	£897.37	
7.875% Subordinated Notes due 19 December 2022	XS0864253868	£102.63	£897.37	
5.75% Dated Callable Step-up Subordinated Notes due 2024	XS0188218183	£102.63	£897.37	
5.875% Subordinated Notes due 2033	XS0145065602	£102.63	£897.37	

Notes:

1 The number of New Ordinary Shares and principal amount of Bank T2 Notes which a holder of Dated Notes will be eligible to receive in respect of its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

3 New Ordinary Shares to be issued by the Bank. If the Liability Management Exercise is successfully completed, the Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 New Ordinary Shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to the Group in consideration for its fresh injection of capital into the Bank through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued to holders of the Dated Notes in the Scheme in exchange for their Dated Notes, to be distributed in the Scheme *pro rata* amongst such holders based on their respective Scheme Claims (representing, based on the total value of Scheme Claims and the number of New Ordinary Shares issued in the Scheme to holders of Dated Notes, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 112,500,000 New Ordinary Shares; and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

4 A Holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date (expected to be 10 December 2013), provided that a Holder's Scheme Claim in respect of Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

5 Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the Consideration Amounts and the New Ordinary Shares Conversion Price in this table are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016. For the purpose of the indicative figures above, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on 14 November 2013 and, once determined, the Bank will announce the final Consideration Amounts and New Ordinary Shares Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final Consideration Amounts and New Ordinary Shares Conversion Price are not expected to differ materially from the indicative Consideration Amounts and New Ordinary Shares Conversion Price specified above.

....

SECTION C

EXCHANGE OFFERS AND PROPOSALS IN RESPECT OF THE PREFERENCE SHARES AND THE PERPETUAL SUBORDINATED BONDS

Application of this Section C

This Section C applies to the following securities issued by the Bank:

9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516)
(the "**Preference Shares**")

13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201)
(the "**13% Bonds**")

and

5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45)
(the "**5.5555% Bonds**" and, together with the 13% Bonds, the "**Perpetual Subordinated Bonds**")

The Perpetual Subordinated Bonds were issued by the Bank at the time of the merger with the Britannia Building Society, in replacement of two series of Permanent Interest Bearing Shares originally issued by the Britannia Building Society.

Introduction to this Section C

This Section C describes the Exchange Offers and the Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds. References in this Section C to:

- the "**Exchange Offers**" are to the Exchange Offers in respect of the Preference Shares and the Perpetual Subordinated Bonds (the Preference Shares, the 13% Bonds and the 5.5555% Bonds are each subject to a separate Exchange Offer);
- the "**Proposals**" are to the Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds (the Preference Shares, the 13% Bonds and the 5.5555% Bonds are each subject to separate Proposals);
- the "**Offers**" are to the Exchange Offers and the Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds; and
- "**Eligible Holders**" are to holders of Preference Shares and holders of Perpetual Subordinated Bonds who are eligible to participate in the relevant Exchange Offer in accordance with the Offer Restrictions set out in Section F of this Offer Memorandum (and "**Holders**" shall be construed accordingly unless the context otherwise requires).

  All Holders who are located and resident in the United Kingdom (and who are not "U.S. persons" as defined in Section L of this Offer Memorandum) will be eligible to participate in the Exchange Offers.

  Further, and for the avoidance of doubt, all Holders of Preference Shares, 13% Bonds and 5.5555% Bonds will be eligible to participate in the Preference Shareholders Meeting (and General Meeting), 13% Bondholders Meeting and 5.5555% Bondholders Meeting, respectively, referred to in this section, even if such Holders are not eligible to participate in the Exchange Offers described in this section.

Other capitalised terms used in this Section are defined in Section L of this Offer Memorandum.

This Section is split into the following parts:

Part 1: Details of the Exchange Offers

Part 2: Details of the Proposals

Part 3: Indicative Timetable for the Offers

Part 4: Procedures for Participating in the Offers

Part 5: Representations, Warranties, Acknowledgements, Agreements and Undertakings

Part 6: Comparison of certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes and worked examples

Part 7: Comparison of certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes and worked examples

Part 8: Comparison of certain key features of the 5.5555% Bonds and the Bank T2 Notes and worked examples

Part 9: Form of Notice convening the Meeting in respect of the Preference Shares

Part 10: Form of Notice convening the Meeting in respect of the 13% Bonds

Part 11: Form of Notice convening the Meeting in respect of the 5.5555% Bonds

Other relevant information

Holders of Preference Shares and Perpetual Subordinated Bonds are also directed to the following Sections of this Offer Memorandum, which contain further information relevant to the Exchange Offers and Proposals:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section E: Amendment and Termination and Revocation Rights
- Section F: Offer Restrictions
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

In addition:

- holders of the Preference Shares and the 13% Bonds are recommended to read carefully the full Group Notes Prospectus; and
- holders of the 5.5555% Bonds are recommended to read carefully the full Bank T2 Prospectus.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 1

DETAILS OF THE EXCHANGE OFFERS

1. SUMMARY OFFERING TABLES

1.1 The following table summarises the consideration that Holders of Preference Shares and 13% Bonds will be eligible to receive if their Preference Shares and 13% Bonds (as applicable) are exchanged or sold pursuant to the Liability Management Exercise:

Existing Securities	**ISIN**	**Early Consideration Amount**[1] (per £1,000 nominal of Existing Securities)			**Late Consideration Amount**[1] (per £1,000 nominal of Existing Securities)		
		Final Repayment Notes[2]		**Instalment Repayment Notes**[3]	**Final Repayment Notes**[2]		**Instalment Repayment Notes**[3]
Preference Shares[5]	GB0002224516	£601	OR[4]	£1,110	£551	OR[4]	£1,060
13% Bonds	GB00B3VH4201	£844		£1,560	£794		£1,510

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all Preference Shares and 13% Bonds will be exchanged or sold at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group.

3 New sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (having their last instalment payment date in 2025) to be issued by the Group and guaranteed (on a subordinated basis) by certain subsidiaries of the Group. The Instalment Repayment Notes represent the instalments of consideration to be received by Holders whose Preference Shares or 13% Bonds are sold to the Group in the Liability Management Exercise.

4 The amounts of Final Repayment Notes and Instalment Repayment Notes specified in the table above are alternative options. A holder will not receive both of these amounts. Holders will be able to elect (in accordance with the procedures set out in this document) either the Final Repayment Notes option or the Instalment Repayment Notes option only.

5 The Early Consideration Amount and Late Consideration Amount for the Preference Shares are presented in this table on a "per £1,000 in nominal amount" basis for ease of comparison with the 13% Bonds. Preference Shares can be offered for exchange or sale in any whole multiple of £1 (subject to a minimum of £2 if a holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a holder elects the Instalment Repayment Notes option).

1.2 The following table summarises the consideration that Holders of 5.5555% Bonds will be eligible to receive if their 5.5555% Bonds are exchanged pursuant to the Liability Management Exercise:

Existing Securities	ISIN	**Early Consideration Amount**[1] (per £1,000 nominal of Existing Securities)	**Late Consideration Amount**[1] (per £1,000 nominal of Existing Securities)
		Bank T2 Notes[2]	**Bank T2 Notes**[2]
5.5555% Bonds	GB00B3VMBW45	£530	£480

Notes:

1 If the Early Participation Threshold is achieved by the Early Participation Deadline (4.30 p.m. (London time) on 29 November 2013) and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Early Consideration Amount. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise successfully completes, all 5.5555% Bonds will be exchanged at the Late Consideration Amount.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

2. INTRODUCTION TO THE EXCHANGE OFFERS

2.1 *The Exchange Offers*

(a) All Eligible Holders of Preference Shares are invited to either (1) offer to exchange any and all of their Preference Shares that are outstanding for Final Repayment Notes, or (2) offer to sell any and all of their Preference Shares that are outstanding to the Group for cash consideration payable in instalments over twelve years (represented by Instalment Repayment Notes), upon the terms and subject to the conditions described below.

(b) All Eligible Holders of 13% Bonds are invited to either (1) offer to exchange any and all of their 13% Bonds that are outstanding for Final Repayment Notes, or (2) offer to sell any and all of their 13% Bonds that are outstanding to the Group for cash consideration payable in instalments over twelve years (represented by Instalment Repayment Notes), upon the terms and subject to the conditions described below.

(c) All Eligible Holders of 5.5555% Bonds are invited to offer to exchange any and all of their 5.5555% Bonds that are outstanding for Bank T2 Notes, upon the terms and subject to the conditions described below.

2.2 *Key Dates and Times*

An indicative timetable for the Exchange Offers and Proposals is set out in Part 3 of this Section C. Certain key dates relevant to the Exchange Offers are set out below:

- the earliest date on which a Holder of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell its Existing Securities is 4 November 2013.
- the Early Participation Deadline is scheduled for 4.30 p.m. (London time) on 29 November 2013.
- the Expiration Deadline (the last time at which it is possible to participate in the Exchange Offers) is scheduled for 4.30 p.m. (London time) on 6 December 2013.
- the Settlement Date for the Exchange Offers is expected to occur on 18 December 2013.

The times and dates given above for the Early Participation Deadline, Expiration Deadline and Settlement Date are indicative only, and may be changed at the option of the Bank. If the Bank changes any scheduled dates in the Exchange Offers, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

A holder who holds Preference Shares or Perpetual Subordinated Bonds through a custodian, broker or other financial intermediary and/or who holds its Preference Shares or Perpetual Subordinated Bonds in CREST, Euroclear or Clearstream, Luxembourg should note that it will need to provide instructions to such intermediary and/or CREST, Euroclear or Clearstream, Luxembourg (as applicable) before the times and dates specified above in order to meet the relevant deadlines.

2.3 ***Procedures for participating in the Exchange Offers***

A description of the procedures to be followed in order to participate in the Exchange Offers is set out in Part 4 of this Section C. The procedures involve a Holder submitting (or arranging for the submission on its behalf of) a valid Exchange Instruction. The form of the Exchange Instruction depends upon how Holders hold their Preference Shares or Perpetual Subordinated Bonds, and is more fully described in Part 4 of this Section C.

A Holder's offer to exchange or sell Preference Shares will be deemed to be made at the time of receipt by Computershare of such Holder's valid Exchange Instruction.

A Holder's offer to exchange or (in the case of 13% Bonds where the Holder elects the Instalment Repayment Notes option) sell Perpetual Subordinated Bonds will be deemed to be made at the time of receipt by Equiniti of such Holder's valid Exchange Instruction.

2.4 ***Preference Shares and Perpetual Subordinated Bonds to be offered for exchange or sale in whole specified denominations***

The Preference Shares have a nominal amount of £1 each. Preference Shares may be offered for exchange or sale in any whole multiple of £1, subject to a minimum of £2 if a Holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if a Holder elects the Instalment Repayment Notes option.

The specified denomination of each Perpetual Subordinated Bond is £1,000. Accordingly, Perpetual Subordinated Bonds must be offered for exchange or (in the case of 13% Bonds where the Holder elects the Instalment Repayment Notes option) sale in principal amounts equal to £1,000 or a whole multiple of £1,000.

3. EARLY PARTICIPATION THRESHOLD, EARLY CONSIDERATION AMOUNT AND LATE CONSIDERATION AMOUNT

If the Early Participation Threshold (as defined below) is achieved by 4.30 p.m. (London time) on 29 November 2013 (the "**Early Participation Deadline**"), the amount of consideration which all Holders will be eligible to receive upon the exchange or sale of their Preference Shares, 13% Bonds and 5.5555% Bonds pursuant to the Liability Management Exercise (if the Liability Management Exercise is successfully completed) will be higher than if the Early Participation Threshold is not achieved by the Early Participation Deadline.

Accordingly, if the Early Participation Threshold is achieved by the Early Participation Deadline (and the Liability Management Exercise is successfully completed), the principal amount of Final Repayment Notes or Instalment Repayment Notes which a Holder will receive upon exchange or sale of its Preference Shares or 13% Bonds, and the principal amount of Bank T2 Notes which a Holder will receive in exchange for its 5.5555% Bonds, will be determined on the basis of the relevant figure in the "*Early Consideration Amount*" columns in the tables under paragraph 1 above. If the Early Participation Threshold is not achieved by the Early Participation Deadline and the Liability Management Exercise is successfully completed, the principal amount of Final Repayment Notes or Instalment Repayment Notes which a Holder will receive upon exchange or sale of its Preference

Shares or 13% Bonds, and the principal amount of Bank T2 Notes which a Holder will receive in exchange for its 5.5555% Bonds, will be determined on the basis of the relevant figure in the "*Late Consideration Amount*" columns in the tables under paragraph 1 above.

The "**Early Participation Threshold**" will be achieved only if all of the following have occurred by the Early Participation Deadline:

(i) the aggregate nominal amount of Preference Shares (including Additional Preference Shares) which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the Preference Shares (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of Preference Shares outstanding;

(ii) the aggregate nominal amount of 13% Bonds which have been (A) validly offered for exchange or sale in the Liability Management Exercise and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 13% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 13% Bonds outstanding; and

(iii) the aggregate nominal amount of 5.5555% Bonds which have been (A) validly offered for exchange and/or (B) otherwise validly voted in favour of the Extraordinary Resolution in respect of the 5.5555% Bonds (and, in each case, not validly revoked) must be equal to or greater than 75 per cent. of the aggregate nominal amount of 5.5555% Bonds outstanding.

If any one or more of the above is not achieved by the Early Participation Deadline, the Early Participation Threshold will not have been achieved.

The amount of consideration to be delivered in exchange for (i) Preference Shares is described further in paragraph 4 below; (ii) 13% Bonds is described further in paragraph 5 below; and (iii) 5.5555% Bonds is described further in paragraph 6 below.

4. PREFERENCE SHARES EXCHANGE OFFER

4.1 *Final Repayment Notes and Instalment Repayment Notes*

(a) *Exchange or sale*

Holders of the Preference Shares are being offered a choice of two options:

(i) to offer to transfer their Preference Shares to the Group in exchange for new sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) (the "**Final Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or

(ii) to offer to sell their Preference Shares to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (the "**Instalment Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

The Final Repayment Notes and the Instalment Repayment Notes are together referred to as the "**Group Notes**".

There are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of Holders of Preference Shares who elect the Instalment Repayment Notes option, such expressions are used for the Holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out above, Holders who opt for

Instalment Repayment Notes will actually be selling their Preference Shares to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes. Such cash consideration will be paid only in those twelve instalments over twelve years, and Holders will not be entitled to immediate payment of that cash consideration.

(b) *Final Repayment Notes*

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

(c) *Instalment Repayment Notes*

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the Preference Shares) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon the sale of its Preference Shares to the Group will be equal to twelve times the annual dividend on those Preference Shares (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of dividends which such Holder would have received had it continued to hold those Preference Shares which it sells to the Group in the Liability Management Exercise.**

(d) *Holders have a choice between Final Repayment Notes and Instalment Repayment Notes*

Each Holder of the Preference Shares will have the opportunity to choose one of the two options available.

A Holder should make its election in accordance with the procedures set out in paragraph 1.3 of Part 4 of this Section C.

If a Holder of Preference Shares fails to make a valid election in accordance with the procedures set out in this document but such Holder's Preference Shares are transferred to the Group pursuant to the Liability Management Exercise, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

(e) *Final Repayment Notes vs Instalment Repayment Notes*

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such

Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their Preference Shares for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their Preference Shares for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

(f) *Form of the Group Notes*

The Final Repayment Notes will have denominations of £1 each. The Instalment Repayment Notes will have denominations of £0.12 (12 pence) each.

Upon issue, some of the Group Notes will be held in dematerialised book-entry form in CREST and the remainder of the Group Notes will be held in certificated form outside CREST.

With respect to Group Notes held in certificated form outside CREST, Computershare (in its capacity as registrar for the Group Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Group Notes held in CREST, it will be possible to trade interests in such Group Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Group Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the Group Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Group, the guarantors, the Final Repayment Notes and the Instalment Repayment Notes, including the full terms and conditions of the Final Repayment Notes and the Instalment Repayment Notes and a description of certain risks relating to an investment in Final Repayment Notes or Instalment Repayment Notes, is set out in the Group Notes Prospectus.

The Group has, pursuant to the Group Notes Prospectus, made an application to the Financial Conduct Authority for the Final Repayment Notes and the Instalment Repayment Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Final Repayment Notes and the Instalment Repayment Notes to be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Settlement Date.

(g) *Comparisons of certain key features of the different securities*

A table comparing certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes is set out in Part 6 of this Section C.

4.2 ***Principal amount of Group Notes to be delivered upon exchange or sale of Preference Shares***

The principal amount of Group Notes which a holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of Preference Shares (excluding the Additional Preference Shares referred to in paragraph 4.4 below) exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its Preference Shares in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £601 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so exchanged by 60.1 per cent. and rounding the resulting figure down to the nearest whole multiple of £1 (being the minimum denomination of the Final Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £551 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) exchanged (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so exchanged by 55.1 per cent. and rounding the resulting figure down to the nearest whole multiple of £1 (being the minimum denomination of the Final Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its Preference Shares to the Group in the Exchange Offer under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,110 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so sold by 111.0 per cent. and rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,060 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of Preference Shares (excluding Additional Preference Shares) sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's Preference Shares (excluding Additional Preference Shares) so sold by 106.0 per cent. and rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)).

(c) *References to exchange or sale of £1,000 in nominal amount of Preference Shares*

The references above to an exchange or sale of £1,000 in nominal amount of Preference Shares are for illustrative purposes only. Holders of Preference Shares will be able to offer to exchange or sell (as the case may be) Preference Shares in any whole multiple of £1, subject to a minimum of £2 if such Holder elects the Final Repayment Notes option (being the minimum nominal amount of Preference Shares necessary to receive, based on the Late Consideration Amount, at least the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if such Holder elects the Instalment Repayment Notes option.

4.3 ***Accrued dividends***

In addition to Final Repayment Notes or Instalment Repayment Notes, a Holder whose Preference Shares are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid dividends on its Preference Shares (other than Additional Preference Shares) from (and including) 30 November 2013 to (but excluding) the Settlement Date, calculated on the basis of the terms of the Preference Shares as set out in the Bank's Articles of Association and on the assumption that dividends accrue from day-to-day on a non-compounding basis (the "**Accrued Dividends**").

4.4 ***Preference Share dividend instalment scheduled for 30 November / Additional Preference Shares***

The next instalment of the Preference Share dividend is, under the terms of the Preference Shares, scheduled to be paid on 30 November 2013 (which is during the offer period for the Liability Management Exercise).

Under the terms of the Preference Shares, the Bank will not be permitted to pay the dividend in cash, but will instead be required to allot additional Preference Shares to each holder in lieu of cash payment ("**Additional Preference Shares**"). The Bank expects to allot such Additional Preference Shares on 29 November 2013 (since 30 November is a Saturday). The allotment of additional Preference Shares in lieu of cash will satisfy the Bank's obligations in respect of such dividend instalment and, for the avoidance of doubt, Holders will not be entitled to any cash amount in respect of that dividend (whether on 29 November 2013 or at any other time).

However, if the Liability Management Exercise successfully completes, then upon exchange or sale to the Group of those Additional Preference Shares, the Holders will not receive Final Repayment Notes or Instalment Repayment Notes in respect thereof but rather will receive an amount in cash (in pounds sterling) equal to the cash dividend which the Bank would have paid on 29 November 2013 had it been able to do so under the terms of the Preference Shares.

Since the Additional Preference Shares will be fungible with (i.e. identical to) other Preference Shares such that it may not be possible to distinguish between them, for the purposes of the treatment of Additional Preference Shares in the Liability Management Exercise as described above, 6⅛ per cent. of the aggregate nominal amount of the Preference Shares outstanding will be deemed to be Additional Preference Shares for these purposes.

4.5 ***An offer to exchange or sell Preference Shares is also an offer to exchange or sell Additional Preference Shares***

By offering to exchange or sell Preference Shares on or before 28 November 2013 (which is the record date for determining the Holders of Preference Shares for the purpose of allotment of the Additional Preference Shares), a Holder will also be deemed (without the need for such Holder or the nominee referred to below to take any further action) to offer to exchange or sell (as the case may be), on the same terms, any such Additional Preference Shares to be allotted to it on 29 November 2013 (including instructing the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting to vote on such Holder's behalf at the Preference Shareholders Meeting and the General Meeting, respectively, to exercise the votes attaching to those Additional Preference Shares in favour of the resolution proposed at each such meeting). Accordingly, by submitting an Exchange Instruction in respect of Preference Shares on or prior to 28 November 2013, the Holder of those Preference Shares will:

(a) irrevocably direct the Bank to allot any Additional Preference Shares, which would otherwise be allotted to such Holder, to Computershare Investor Services PLC as nominee for such Holder; and

(b) irrevocably direct such nominee:

(i) if the Exchange Offers are settled, to deliver such Additional Preference Shares on behalf of such Holder to the Group on the Settlement Date in exchange for a cash payment equal to the cash dividend which would have been paid to such Holder on 29 November 2013 had the Bank been permitted, under the terms of the Preference Shares, to make payment in cash; or

(ii) if the Exchange Offers are not settled, to promptly deliver such Additional Preference Shares to such Holder.

4.6 ***Worked Examples***

Worked examples illustrating what a Holder of Preference Shares may receive upon the exchange or sale of its Preference Shares in the Liability Management Exercise are set out in Part 6 of this Section C.

5. 13% BONDS EXCHANGE OFFER

5.1 ***Final Repayment Notes and Instalment Repayment Notes***

(a) *Exchange or sale*

Holders of the 13% Bonds are being offered a choice of two options:

- to offer to transfer their 13% Bonds to the Group in exchange for new sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) (the "**Final Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; or
- to offer to sell their 13% Bonds to the Group in consideration for a cash amount which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) (the "**Instalment Repayment Notes**") to be issued by the Group and guaranteed (on a subordinated basis) by certain of its subsidiaries.

The Final Repayment Notes and the Instalment Repayment Notes are together referred to as the "**Group Notes**".

There are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the *context of Holders of 13% Bonds who elect the Instalment Repayment Notes option, such expressions are used for the Holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out above, Holders who opt for Instalment Repayment Notes will actually be selling their 13% Bonds to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes. Such cash consideration will be paid only in those twelve instalments over twelve years, and Holders will not be entitled to immediate payment of that cash consideration.*

(b) *Final Repayment Notes*

The Final Repayment Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid annually in arrear on each anniversary of the issue date of the Final Repayment Notes up to (and including) the twelfth anniversary. The Group will be obliged to repay the principal amount of the Final Repayment Notes in full on the twelfth anniversary of their issue date.

(c) *Instalment Repayment Notes*

The Instalment Repayment Notes will not bear interest. However, the principal amount of such Instalment Repayment Notes (representing instalments of the cash purchase price for the 13% Bonds) will be repaid in twelve equal instalments over twelve years. Those payments will be made on each anniversary of the issue date of the Instalment Repayment Notes, with the final payment falling on the twelfth anniversary of that issue date. If the Early Participation Threshold is achieved by the Early Participation Deadline, the principal amount of Instalment Repayment Notes which a Holder will receive upon sale of its 13% Bonds to the Group will be equal to twelve times the annual interest on those 13% Bonds (rounded down to the nearest £0.12 (12 pence), which is the minimum denomination of the Instalment Repayment Notes). **Accordingly, (in circumstances where the Early Participation Threshold is achieved by the Early Participation Deadline), by repaying those Instalment Repayment Notes in twelve equal instalments over twelve years, the Group will pay to the Holder, in each of those twelve years, an amount which is broadly equivalent to the amount of interest which such Holder would have received had it continued to hold those 13% Bonds which it sells to the Group in the Liability Management Exercise**.

(d) *Holders have a choice between Final Repayment Notes and Instalment Repayment Notes*

Each Holder of 13% Bonds will have the opportunity to choose one of the two options available.

A Holder should make its election in accordance with the procedures set out in paragraph 1.3 of Part 4 of this Section C.

If a Holder of 13% Bonds fails to make a valid election in accordance with the procedures set out in this document but such Holder's 13% Bonds are transferred to the Group pursuant to the Liability Management Exercise then (i) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

(e) *Final Repayment Notes vs Instalment Repayment Notes*

Since the Group will repay the principal of the Instalment Repayment Notes in equal instalments over twelve years, the amount payable to a Holder in each year if it elects the Instalment Repayment Notes option will be higher than the annual interest payment to such Holder if it elects the Final Repayment Notes option. However, the final payment on the Instalment Repayment Notes in 2025 will be significantly lower than the final payment under the Final Repayment Notes in 2025 (reflecting the fact that the principal on the Final Repayment Notes is repayable in a single payment in that twelfth year).

After the twelfth and final payment, both the Final Repayment Notes and the Instalment Repayment Notes will have been fully repaid, and the Holder will have no further entitlement to any amounts under whichever of those securities it elected to receive.

If a Holder intends to hold its Final Repayment Notes or Instalment Repayment Notes for the full twelve years, an important point of distinction for such Holder will be whether it wishes to receive (i) the higher amount payable each year (except the twelfth year) under the Instalment Repayment Notes, or (ii) the lower annual payments of interest under the Final Repayment Notes but a larger one-off payment in twelve years' time, in which latter case it should elect to receive the Final Repayment Notes.

The tax treatment of Holders opting to exchange their 13% Bonds for Final Repayment Notes will be different to the tax treatment of Holders opting to sell their 13% Bonds for a cash amount paid in instalments (represented by Instalment Repayment Notes). Holders are directed to section I (Taxation Considerations) and the section headed "Taxation" in the Group Notes Prospectus which contain further information relevant to the tax consequences of choosing one of the two options. Holders are advised to consult their own professional advisers regarding the differences for them in the tax treatment of the two options based on their own circumstances.

(f) *Form of the Group Notes*

The Final Repayment Notes will have denominations of £1 each. The Instalment Repayment Notes will have denominations of £0.12 (12 pence) each.

Upon issue, some of the Group Notes will be held in dematerialised book-entry form in CREST and the remainder of the Group Notes will be held in certificated form outside CREST.

With respect to Group Notes held in certificated form outside CREST, Computershare (in its capacity as registrar for the Group Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Group Notes held in CREST, it will be possible to trade interests in such Group Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Group Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the Group Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Group, the guarantors, the Final Repayment Notes and the Instalment Repayment Notes, including the full terms and conditions of the Final Repayment Notes and the Instalment Repayment Notes and a description of certain risks relating to an investment in Final Repayment Notes or Instalment Repayment Notes, is set out in the Group Notes Prospectus.

The Group has, pursuant to the Group Notes Prospectus, made an application to the Financial Conduct Authority for the Final Repayment Notes and the Instalment Repayment Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Final Repayment Notes and the Instalment Repayment Notes to be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Settlement Date.

(g) *Comparisons of certain key features of the different securities*

A table comparing certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes is set out in Part 7 of this Section C.

5.2 ***Principal amount of Group Notes to be delivered upon exchange or sale of 13% Bonds***

The principal amount of Group Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive for each £1,000 in nominal amount of 13% Bonds exchanged or sold to the Group will depend upon (i) whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option; and (ii) whether or not the Early Participation Threshold is achieved by the Early Participation Deadline:

(a) *Final Repayment Notes*

An Eligible Holder who validly offers to exchange its 13% Bonds in the Exchange Offer for Final Repayment Notes will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £844 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so exchanged by 84.4 per cent.); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £794 in principal amount of Final Repayment Notes for every £1,000 in nominal amount of 13% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so exchanged by 79.4 per cent.).

(b) *Instalment Repayment Notes*

An Eligible Holder who validly offers to sell its 13% Bonds to the Group in the Exchange Offer under the Instalment Repayment Notes option will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £1,560 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so sold by 156.0 per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £1,510 in principal amount of Instalment Repayment Notes for every £1,000 in nominal amount of 13% Bonds sold to the Group (calculated by multiplying the aggregate nominal amount of such Holder's 13% Bonds so sold by 151.0 per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £0.12 (being the minimum denomination of the Instalment Repayment Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof)).

(c) *References to exchange or sale of £1,000 in nominal amount of 13% Bonds*

The references above to an exchange or sale of £1,000 in nominal amount of 13% Bonds are for illustrative purposes only. The 13% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange or sale in nominal amounts of £1,000 or a whole multiple of £1,000.

5.3 ***Accrued interest***

In addition to Final Repayment Notes or Instalment Repayment Notes, a Holder whose 13% Bonds are exchanged or sold in the Liability Management Exercise will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 13% Bonds from (and including) 31 July 2013 to (but excluding) the Settlement Date, calculated in accordance with the terms of the 13% Bonds as set out in the trust deed dated 1 August 2009 constituting the 13% Bonds (the "**13% Bonds Accrued Interest**").

5.4 ***Deferred interest payment originally scheduled for 31 July 2013***

In addition, as announced by the Bank on 12 July 2013, upon successful completion of the Exchange Offer the Bank will pay to all Holders of the 13% Bonds (whether or not participating in the Exchange Offers) the deferred interest payment originally scheduled for 31 July 2013. Such payment will be made in cash on the Settlement Date.

5.5 ***Worked Examples***

Worked examples illustrating what a Holder of 13% Bonds may receive upon the exchange or sale of its 13% Bonds in the Liability Management Exercise are set out in Part 7 of this Section C.

6. 5.5555% BONDS EXCHANGE OFFER

6.1 ***Bank T2 Notes***

(a) *Exchange*

Holders of the 5.5555% Bonds are being invited to exchange their 5.5555% Bonds for new sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank

(b) *Bank T2 Notes*

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly in arrear on each three-month anniversary of the issue date of the Bank T2 Notes up to (and including) the tenth anniversary of the issue date. The Bank will be obliged to repay the principal amount of the Bank T2 Notes on the tenth anniversary of their issue date.

(c) *Form of the Bank T2 Notes*

The Bank T2 Notes will have denominations of £10 each.

Upon issue, some of the Bank T2 Notes will be held in dematerialised book-entry form in CREST and the remainder of the Bank T2 Notes will be held in certificated form outside CREST.

With respect to Bank T2 Notes held in certificated form outside CREST, Computershare (in its capacity as registrar for the Bank T2 Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Bank T2 Notes held in CREST, it will be possible to trade interests in such Bank T2 Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Bank T2 Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the Bank T2 Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Bank and the Bank T2 Notes, including the full terms and conditions of the Bank T2 Notes and a description of certain risks relating to an investment in Bank T2 Notes, is set out in the Bank T2 Prospectus.

The Bank has, pursuant to the Bank T2 Prospectus, made an application to the Financial Conduct Authority for the Bank T2 Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Bank T2 Notes to be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Settlement Date.

(d) *Comparisons of certain key features of the different securities*

A table comparing certain key features of the 5.5555% Bonds and the Bank T2 Notes is set out in Part 8 of this Section C.

6.2 ***Principal amount of Bank T2 Notes to be delivered in exchange for 5.5555% Bonds***

(a) *Principal amount of Bank T2 Notes to be delivered*

The principal amount of Bank T2 Notes which a Holder will (if the Liability Management Exercise is successfully completed) receive in exchange for every £1,000 in nominal amount of 5.5555% Bonds will depend upon whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

Accordingly, an Eligible Holder who validly offers to exchange its 5.5555% Bonds in the Exchange Offer will, if the Liability Management Exercise is successfully completed, be eligible to receive on the Settlement Date, either:

(i) if the Early Participation Threshold is achieved by the Early Participation Deadline, an amount equivalent to £530 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 5.5555% Bonds so exchanged by 53.0 per cent.); or

(ii) if the Early Participation Threshold is not achieved by the Early Participation Deadline, an amount equivalent to £480 in principal amount of Bank T2 Notes for every £1,000 in nominal amount of 5.5555% Bonds exchanged (calculated by multiplying the aggregate nominal amount of such Holder's 5.5555% Bonds so exchanged by 48.0 per cent.).

(b) *References to exchange of £1,000 in nominal amount of 5.5555% Bonds*

The references above to an exchange of £1,000 in nominal amount of 5.5555% Bonds are for illustrative purposes only. The 5.5555% Bonds have denominations of £1,000 each, and accordingly must be offered for exchange in nominal amounts of £1,000 or a whole multiple of £1,000.

6.3 ***Accrued interest***

In addition to Bank T2 Notes, a Holder whose 5.5555% Bonds are exchanged will also be eligible to receive a cash amount (paid in pounds sterling) equal to the accrued and unpaid interest on its 5.5555% Bonds from (and including) 14 December 2013 to (but excluding) the Settlement Date, calculated in accordance with the terms of the 5.5555% Bonds as set out in the trust deed dated 1 August 2009 constituting the 5.5555% Bonds (the "**5.5555% Bonds Accrued Interest**").

6.4 ***Interest payment scheduled for 14 December 2013***

The next scheduled interest payment date for the 5.5555% Bonds is 14 December 2013. The Bank intends to defer that interest payment (which it is entitled to do under the terms of the 5.5555% Bonds). If the Liability Management Exercise subsequently successfully settles, the Bank will (in addition to the 5.5555% Bonds Accrued Interest referred to above) pay the deferred interest payment originally scheduled for 14 December 2013 (to all investors in the 5.5555% Bonds, whether or not participating in the Exchange Offer) upon successful completion of the Liability Management Exercise. Such payment will be made in cash on the Settlement Date.

6.5 ***Worked Examples***

Worked examples illustrating what a Holder of 5.5555% Bonds may receive in exchange for its 5.5555% Bonds in the Liability Management Exercise are set out in Part 8 of this Section C.

7. DELIVERY OF GROUP NOTES AND BANK T2 NOTES AND PAYMENT OF THE ACCRUED DIVIDENDS AND ACCRUED INTEREST AND OTHER AMOUNTS

7.1 ***Delivery of Bank T2 Notes and Group Notes***

References in this section to "Group Notes" include both the Final Repayment Notes and the Instalment Repayment Notes, whichever is applicable to a Holder.

The manner of delivery of Bank T2 Notes or Group Notes to a Holder will depend upon whether the Holder offers to exchange or sell its Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) (1) in CREST, (2) in Euroclear or Clearstream, Luxembourg or (3) in certificated form outside the clearing systems.

(a) *Preference Shares and 13% Bonds held in CREST*

Holders who offer to exchange or sell their Preference Shares or 13% Bonds (as the case may be) in CREST will, if the Liability Management Exercise is successfully completed, receive their Group Notes in the same CREST account from which the Preference Shares or 13% Bonds (as the case may be) are offered for exchange or sale.

(b) *5.5555% Bonds held in CREST*

Holders who offer to exchange their 5.5555% Bonds in CREST will, if the Liability Management Exercise is successfully completed, receive their Bank T2 Notes in the same CREST account from which the 5.5555% Bonds are offered for exchange.

(c) *Preference Shares and 13% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who offer to exchange or sell their Preference Shares or 13% Bonds in Euroclear or Clearstream, Luxembourg will, if the Liability Management Exercise is successfully completed, receive interests in their Group Notes in the same Euroclear or Clearstream, Luxembourg account from which the Preference Shares or 13% Bonds (as applicable) are offered for exchange or sale.

(d) *5.5555% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who offer to exchange their 5.5555% Bonds in Euroclear or Clearstream, Luxembourg will, if the Liability Management Exercise is successfully completed, receive interests in their Bank T2 Notes in the same Euroclear or Clearstream, Luxembourg account from which the 5.5555% Bonds are offered for exchange.

(e) *Preference Shares and 13% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

Holders who hold their Preference Shares or 13% Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg and who offer to exchange or sell their Preference Shares or 13% Bonds (as applicable) will, if the Liability Management Exercise is successfully completed, hold their Group Notes in certificated form outside CREST, and will be eligible to receive a certificate evidencing such holding from Computershare (as registrar for the Group Notes). Such certificate will be sent to the address of such Holder appearing in the register for the Preference Shares or, as the case may be, 13% Bonds in exchange for which the Group Notes are delivered, unless such Holder specifies an alternative address in its Exchange Instruction in which case the certificate will be sent to such alternative address.

(f) *5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

Holders who hold their 5.5555% Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg and who offer to exchange their 5.5555% Bonds will, if such offer is accepted by the Bank, hold their Bank T2 Notes in certificated form outside CREST, and will be eligible to receive a certificate evidencing such holding of Bank T2 Notes from Computershare (as registrar for the Bank T2 Notes). Such certificate will be sent to the address of such Holder appearing in the register for the 5.5555% Bonds in exchange for which the Bank T2 Notes are delivered, unless such Holder specifies an alternative address in its Exchange Instruction in which case the certificates will be sent to such alternative address.

7.2 ***Payment of the Accrued Dividends, Accrued Interest and other amounts***

Payment of the Accrued Dividends in respect of the Preference Shares (and the cash amount to be paid in exchange for Additional Preference Shares) will be made in accordance with the usual procedures of Computershare (as registrar in respect of the Preference Shares) for the payment of dividends on the Preference Shares.

Payment of the Accrued Interest on the 13% Bonds and the 5.5555% Bonds (as well as the deferred interest payment on the 13% Bonds originally scheduled for 31 July 2013 and the deferred interest payment on the 5.5555% Bonds originally scheduled for 14 December 2013) will be made in accordance with the usual procedures of Equiniti (as registrar in respect of the Perpetual Subordinated Bonds) for the payment of interest on the relevant Perpetual Subordinated Bonds.

7.3 ***Delivery of the Preference Shares***

Any Preference Shares which are offered for exchange or sale will, if the Liability Management Exercise successfully completes, be transferred to the Group, which expects to surrender its economic rights under the Preference Shares (in order to generate Common Equity Tier 1 capital for the Bank) in consideration for the issue of ordinary shares by the Bank to the Group.

7.4 ***Delivery and cancellation of the 13% Bonds***

Any 13% Bonds which are offered for exchange or sale will, if the Liability Management Exercise successfully completes, be transferred to the Group, which expects to surrender those 13% Bonds to the Bank for cancellation in consideration for the issue of ordinary shares by the Bank to the Group.

7.5 ***Cancellation of the 5.5555% Bonds***

Any 5.5555% Bonds which are offered for exchange will, if the Liability Management Exercise successfully completes, be cancelled.

8. THE SETTLEMENT CONDITION

8.1 The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged or sold pursuant to the Liability Management Exercise.

8.2 In order for the entire principal amount of all Existing Securities to be exchanged or sold pursuant to the Liability Management Exercise, all of the following must occur:

(a) the Proposal in respect of the Preference Shares must be (i) approved by the Holders of the Preference Shares at the Preference Shareholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) (and substantially the same resolution must be approved at the General Meeting also) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(b) the Proposal in respect of the 13% Bonds must be (i) approved by the Holders of the 13% Bonds at the 13% Bondholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(c) the Proposal in respect of the 5.5555% Bonds must be (i) approved by the Holders of the 5.5555% Bonds at the 5.5555% Bondholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum; and

(d) (i) the Scheme (as further described in Section D of this Offer Memorandum) must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court; (ii) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (iii) the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition).

The requirements of sub-paragraphs (a) to (d) (inclusive) above are collectively referred to in this document as the "**Settlement Condition**".

8.3 The Exchange Offers will only settle, and the Proposals will only be implemented, if the Settlement Condition is satisfied. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

8.4 **The Settlement Condition is not capable of being waived**. Accordingly, if the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged or sold (and no New Securities will be issued) pursuant to the Liability Management Exercise.

8.5 The Bank undertakes that it shall not:

(a) accept any offers to exchange or sell Preference Shares or Perpetual Subordinated Bonds; or

(b) implement the Proposals or any of them (even if the relevant Extraordinary Resolutions are passed),

in each case unless the Settlement Condition is satisfied.

9. ACCEPTANCE OF OFFERS AND ACCEPTANCE CONDITIONS

9.1 The Exchange Offers are invitations to treat by the Bank and the Group, and any reference to an offer or invitation being made by the Bank and/or the Group as part of the Exchange Offers should be read accordingly. An offer to exchange or sell (as the case may be) Preference Shares or Perpetual Subordinated Bonds will be made by each Holder who submits (or arranges the submission on its behalf of) a valid Exchange Instruction in accordance with the terms of the Exchange Offers. All such offers will only be accepted by the Bank and the Group (if at all) upon, and at the time of, the announcement by the Bank and the Group of acceptance, such announcement to be made via the Regulatory News Service (RNS) operated by the London Stock Exchange.

9.2 The Bank and the Group undertake to accept all valid offers to exchange or sell Preference Shares and Perpetual Subordinated Bonds, subject to satisfaction of the Acceptance Conditions.

9.3 The Bank and the Group shall not accept any offer to exchange or sell Preference Shares or Perpetual Subordinated Bonds unless and until the Acceptance Conditions are satisfied. The "**Acceptance Conditions**" are:

(a) that the Settlement Condition has been satisfied; and

(b) that, between the time of conclusion of the Meeting for each Series of Perpetual Subordinated Bonds and the Preference Shares (including, if any such Meeting is adjourned and the Bank postpones settlement of the Exchange Offers until after the adjourned meeting, such adjourned meeting) and the time of announcement by the Bank and the Group as to whether or not any offers to exchange or sell Preference Shares and Perpetual Subordinated Bonds are accepted, there has been no material adverse change in the financial condition of the Bank or the Group which requires the publication of one or more supplements to the Prospectuses or any of them.

10. REPRESENTATIONS, WARRANTIES, ACKNOWLEDGEMENTS, AGREEMENTS AND UNDERTAKINGS

Holders submitting (or having submitted on their behalf) Exchange Instructions will be required to make and give, and will be deemed to have made and given, the representations, warranties, acknowledgements, agreements and undertakings set out in Part 5 of this Section C of this Offer Memorandum. Holders who have concerns about making or giving any such representations, warranties, acknowledgements, agreements and/or undertakings should contact Computershare (in the case of Holders of Preference Shares) or Equiniti (in the case of Holders of Perpetual Subordinated Bonds) immediately.

If the Bank and the Group amend the terms of the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

11. SEPARATE OFFERS

Each Series of Perpetual Subordinated Bonds and the Preference Shares is the subject of a separate Exchange Offer and a separate Proposal. As at the date of this Offer Memorandum, the Bank and the Group expect that the Offers in respect of each such Series will run to the same timetable. However, the Bank and the Group reserve the right to amend the timetable and/or terms of any one or more Exchange Offers and/or Proposals independently of any amendments which may (or may not) be made to the timetable and/or terms of any other Exchange Offer or Proposal.

If the Bank and the Group amend the terms of the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

12. RECEIPT OF NEW SECURITIES AND RELEVANT CASH PAYMENTS

12.1 If the Exchange Offers are settled, the Bank and the Group (as applicable) will procure the delivery of the Bank T2 Notes and the Group Notes to the Holders entitled thereto and the payment of the relevant Accrued Dividends and/or Accrued Interest (and other amounts due under the terms of the Exchange Offers), as applicable, on the Settlement Date for the relevant Exchange Offer.

12.2 The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (the "**Offer Record Date**"), is expected to be 11 December 2013 (unless any Meeting is required to be adjourned for want of a quorum, in which case the Offer Record Date is expected to be on or around 27 December 2013). The Offer Record Date is the last date on which (if the Liability Management Exercise successfully completes) Preference Shares, 13% Bonds and 5.5555% Bond can be traded. At close of business on the Offer Record Date, all holdings of Preference Shares, 13% Bonds and 5.5555% Bonds will be fixed, and the registered holders of the Preference Shares, 13% Bonds and 5.5555% Bonds at that time will be the persons entitled to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise on the Settlement Date.

12.3 Delivery of the Bank T2 Notes and Group Notes and payment of Accrued Dividends and Accrued Interest (and other amounts due under the terms of the Exchange Offers) will be effected in the manner described in paragraph 7 above.

12.4 With respect to Bank T2 Notes and Group Notes (or interests therein) which are to be delivered to accounts in CREST, Euroclear or Clearstream, Luxembourg, Holders should note that:

(a) the Bank and the Group (as applicable) will procure the issue of such Bank T2 Notes and Group Notes in CREST on the Settlement Date;

(b) CREST (and, where applicable, Euroclear and Clearstream, Luxembourg) will thereafter arrange for such Bank T2 Notes and Group Notes (or, where applicable, interests therein) to be delivered to the relevant accounts in CREST, Euroclear and Clearstream, Luxembourg. It is possible that this process may not be completed on the Settlement Date (and is expected to take up to ten working days), and accordingly the Holders entitled to such Bank T2 Notes and Group Notes may not receive their Bank T2 Notes and Group Notes (or, where applicable, interests therein) until after the Settlement Date;

(c) the issue of the Bank T2 Notes and Group Notes in CREST on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such Bank T2 Notes and Group Notes. Thereafter, the Holders entitled to such Bank T2 Notes and Group Notes must look to CREST, Euroclear and/or Clearstream, Luxembourg (as applicable) for receipt of such Bank T2 Notes and Group Notes (or, where applicable, interests therein); and

(d) provided that the Bank and the Group (as applicable) procure the issue of the Bank T2 Notes and the Group Notes in CREST on or before the Settlement Date, neither the Bank nor the Group (nor the Registrars) will be liable to pay any compensation or other additional amounts in the event that a Holder receives its entitlement to such Bank T2 Notes or Group Notes after the Settlement Date.

12.5 With respect to Bank T2 Notes and Group Notes which are to be held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, Holders should note that:

(a) the Bank and the Group will, on the Settlement Date, instruct Computershare (as registrar for the Bank T2 Notes and Group Notes) to prepare and mail the certificates evidencing the holdings of such Bank T2 Notes and Group Notes as soon as reasonably practicable;

(b) Computershare will thereafter arrange for such certificates to be prepared and mailed to the relevant addresses. Accordingly, the Holders entitled to such Bank T2 Notes and Group Notes will not receive their certificate(s) until after the Settlement Date (and may not receive them for up to ten working days);

(c) the instructions of the Bank and the Group to Computershare on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such certificate(s), and Holders should look to Computershare for such certificate(s); and

(d) provided that the Bank and the Group (as applicable), on or before the Settlement Date, instruct Computershare to prepare and mail the certificates, neither the Bank nor the Group will be liable to pay any compensation or other additional amounts in the event that a Holder receives its certificate(s) after the Settlement Date.

12.6 With respect to the payment of Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) and Accrued Interest (as well as the deferred interest payments on the 13% Bonds and the 5.5555% Bonds), Holders should note that:

(a) the Bank will pay, or procure the payment of, (i) an amount equal to all Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (and deferred interest payments) to Equiniti, in each case on or before the Settlement Date;

(b) Computershare and Equiniti (as applicable) will thereafter arrange for the payment of such Accrued Dividends, Accrued Interest and other amounts to the relevant Holders in accordance with their usual procedures for making payments of dividend and interest (as applicable) on such Preference Shares, 13% Bonds and 5.5555% Bonds. Accordingly, the Holders entitled to such Accrued Dividends and/or Accrued Interest (and such other amounts) may not receive such amounts until after the Settlement Date (and it is expected to take up to ten working days for such payments to be received);

(c) the payment by or on behalf of the Bank of (i) an amount equal to all Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (and deferred interest payments) to Equiniti, in each case on or before the Settlement Date, will discharge the Bank's obligations in respect of the payment of such Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) and Accrued Interest (and such deferred interest payments), and Holders should look to Computershare or Equiniti (as applicable) for their share of such amounts; and

(d) provided that the Bank pays, or procures the payment of, (i) an amount equal to all Accrued Dividends (and the cash amount to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (and deferred interest payments) to Equiniti, in each case on or before the Settlement Date, neither the Bank nor the Group (nor, provided that they make the relevant onward payments within ten working days, the Registrars) will be liable to pay any interest, compensation or other additional amounts in the event that a Holder receives such amounts after the Settlement Date.

13. ANNOUNCEMENTS

Unless stated otherwise, announcements in relation to the Offers will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent, the contact details for which are at the end of this Offer Memorandum.

14. IRREGULARITIES

All questions as to the validity, form and eligibility (including the time of receipt) of any Exchange Instruction or the withdrawal, revocation or revision thereof or delivery of Preference Shares or Perpetual Subordinated Bonds will be determined by the Bank and the Group (as applicable) in their sole and absolution discretion, which determination will be final and binding. The Bank and the Group reserve the absolute right to reject any and all Exchange Instructions not in proper form or for which any corresponding agreement by the Bank and/or the Group would, in the opinion of the Bank or the Group, be unlawful. The Bank and the Group also reserve the absolute right to waive any defects in any Exchange Instruction. None of the Bank, the Group, the Exchange Agent or the Registrars shall be under any duty to give notice to Holders, Direct Participants, CREST Participants or beneficial owners of any irregularities in Exchange Instructions.

15. RELEASE AND WAIVER

By offering to exchange (or, where applicable, sell) Existing Securities pursuant to any Exchange Offer, or by voting in favour of the relevant Extraordinary Resolution pursuant to the relevant Proposal, each Holder will, in respect of its Existing Securities which it offers for exchange or sale, or votes in favour (as applicable), be deemed to have:

(a) released, to the fullest extent permitted by law, the Bank, the Group, Co-operative Banking Group Limited, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives) from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise or any part thereof;

(b) waived, to the fullest extent permitted by law, all rights and entitlement it may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Bank, the Group, Co-operative Banking Group Limited, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives) in connection with the Liability Management Exercise and/or its Existing Securities; and

(c) (if its Existing Securities are exchanged (or sold) in the Liability Management Exercise) waived, to the fullest extent permitted by law, all its rights, title and interest to and claims in respect of such Existing Securities;

provided, however, that nothing in this paragraph 15 shall release the Bank or the Group from their respective obligations or liabilities as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

16. SCALING OF ENTITLEMENTS TO FINAL REPAYMENT NOTES

16.1 Notwithstanding any other term of the Offers, if, in respect of the Offers for the Preference Shares and the 13% Bonds, the number of Holders electing to exchange their Preference Shares and 13% Bonds for Final Repayment Notes would (but for this paragraph 16) require the Group to issue more than £117 million in principal amount of Final Repayment Notes pursuant to the Liability Management Exercise, then subject to paragraph 16.2 below:

(a) the entitlement of each relevant Holder to receive Final Repayment Notes will be scaled back *pro rata* by such amount (the "**Scale Back Amount**") as will result in the principal amount of Final Repayment Notes issued by the Group pursuant to the Liability Management Exercise being equal to (or as near as practicable to, but without exceeding) £117 million; and

(b) each such Holder will, in respect of the Scale Back Amount applicable to it, be entitled to receive (in lieu of Final Repayment Notes) consideration in the form of Instalment Repayment Notes.

16.2 If the Group, on or before the Settlement Date, obtains the consent of its Syndicated Lenders to issue up to £129 million of Final Repayment Notes pursuant to the Liability Management Exercise, there shall be no scaling of entitlements to receive Final Repayment Notes as described in paragraph 16.1 above, and each Holder who elected (or otherwise becomes entitled) to receive Final Repayment Notes will receive its full entitlement in the form of Final Repayment Notes. For these purposes, "**Syndicated Lenders**" means the lending banks under the Group's syndicated banking loan facility.

Explanation of this paragraph 16: *On 25 October 2013, the Group obtained certain required consents for the Liability Management Exercise from its Syndicated Lenders. Since that date, the Group has increased its offer to holders of the Preference Shares and 13% Bonds. As a result, the Group's agreement with its Syndicated Lenders as to the maximum amount of Final Repayment Notes which the Group is permitted to issue (£117 million) would be insufficient if (which the Group considers extremely unlikely) an overwhelming majority of Holders of the Preference Shares and 13% Bonds elect to receive Final Repayment Notes rather than Instalment Repayment Notes. The Group intends to enter into discussions with its Syndicated Lenders in early November to obtain their consent to issue up to £129 million Final Repayment Notes, which is the maximum amount of Final Repayment Notes which the Group would need to issue if all Holders of Preference Shares and 13% Bonds elect to exchange their Preference Shares and 13% Bonds for Final Repayment Notes. Given that such discussions will not be concluded ahead of launch of the Liability Management Exercise, this paragraph 16 has been included as a term of the Offer so that if the Group would otherwise be required to issue a greater principal amount of Final Repayment Notes than its current agreement with its Syndicated Lenders permits, it will not breach the terms of its agreement with its Syndicated Lenders. In such circumstances, Holders of Preference Shares and 13% Bonds who elect (or otherwise become entitled) to receive Final Repayment Notes would receive the substantial majority* *of their entitlement in the form of Final Repayment Notes, and the balance of their entitlement in the form of Instalment Repayment Notes.*

17. CALCULATIONS AND DETERMINATIONS BY THE BANK

The terms of the Offers provide for the Bank to make certain determinations and perform certain calculations in respect of the Offers. All such determinations and calculations by the Bank in good faith will, in the absence of manifest error, be conclusive and binding on the Bank, the Group and the Holders.

18. GOVERNING LAW AND SUBMISSION TO JURISDICTION

18.1 The terms of the Offers, including (without limitation) each Exchange Instruction, and any non-contractual obligations arising out of or in connection with the Offers, any such Exchange Instructions or any of them shall be governed by, and construed in accordance with, English law.

18.2 By submitting an Exchange Instruction, a Holder (and each Direct Participant or CREST Participant acting on the instructions of such Holder) irrevocably and unconditionally agrees for the benefit of the Bank, the Group, the Dealer Managers, the Exchange Agent and the Registrars that the courts of England are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Offers or any component part or parts thereof and that, accordingly, any suit, action or proceedings arising out of or in connection with the foregoing may be brought in such courts.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 2

DETAILS OF THE PROPOSALS

1. THE PROPOSALS

1.1 *Overview of the Proposals*

In conjunction with the Exchange Offers:

(a) all Holders of the Preference Shares are being invited to consent, by way of an Extraordinary Resolution to be proposed at a meeting of the Holders of the Preference Shares (the "**Preference Shareholders Meeting**") to the making of certain modifications to the terms of the Preference Shares as set out in the Bank's Articles of Association and to certain releases and waivers (the "**Preference Shares Proposal**");

(b) all Holders of the 13% Bonds are being invited to consent, by way of an Extraordinary Resolution to be proposed at a meeting of the Holders of the 13% Bonds (the "**13% Bondholders Meeting**") to the making of certain modifications to the terms of the 13% Bonds as set out in the trust deed dated 1 August 2009 constituting the 13% Bonds and to certain releases and waivers (the "**13% Bonds Proposal**"); and

(c) all Holders of the 5.5555% Bonds are being invited to consent, by way of an Extraordinary Resolution to be proposed at a meeting of the Holders of the 5.5555% Bonds (the "**5.5555% Bondholders Meeting**") to the making of certain modifications to the terms of the 5.5555% Bonds as set out in the trust deed dated 1 August 2009 constituting the 5.5555% Bonds and to certain releases and waivers (the "**5.5555% Bonds Proposal**").

The Preference Shareholders Meeting, the 13% Bondholders Meeting and the 5.5555% Bondholders Meeting are, together, referred to as the "**Meetings**" and each a "**Meeting**". The Preference Shares Proposal, the 13% Bonds Proposal and the 5.5555% Bonds Proposal are, together, referred to as the "**Proposals**" and each a "**Proposal**".

In addition, a general meeting (the "**General Meeting**") of all shareholders (both ordinary shareholders and preference shareholders) of the Bank must also approve a resolution in similar terms to that which is proposed at the Preference Shareholders Meeting, in order to give effect to that resolution.

1.2 *Proposed modifications to the terms of the Preference Shares and release and waiver arrangements*

The terms of the Extraordinary Resolution to be proposed at the Preference Shareholders Meeting are set out in full in the form of notice convening the meeting set out at Part 9 of this Section C of this Offer Memorandum. A resolution, in substantially the same terms, will also be considered at the General Meeting.

If both the Extraordinary Resolution is approved at the Preference Shareholders Meeting and the corresponding resolution is approved at the General Meeting, and such resolutions are implemented by the Bank, the effect of such resolutions will be to enable the Bank:

(a) to purchase and cancel any share capital of the Bank (which would include, without limitation, Preference Shares) from time to time, without the need for the further consent of the holders of the Preference Shares; and

(b) to mandatorily effect, at the Bank's option, the transfer to the Group of all (but not some only) of the Preference Shares, which are not offered for exchange or sale in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer for the Preference Shares (the "**Preference Shares Mandatory Exchange Option**").

The proposed Extraordinary Resolution also contains, on behalf of all Holders of the Preference Shares (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their Preference Shares; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of Holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

1.3 ***Proposed modifications to the terms of the 13% Bonds and release and waiver arrangements***

The terms of the Extraordinary Resolution to be proposed at the 13% Bondholders Meeting are set out in full in the form of notice convening the meeting set out at Part 10 of this Section C of this Offer Memorandum.

The effect of the Extraordinary Resolution, if approved at the 13% Bondholders Meeting and implemented by the Bank, will be to modify the terms and conditions of the 13% Bonds such that the Bank is able to mandatorily effect, at the Bank's option, the transfer to the Group of all (but not some only) of the 13% Bonds, which are not exchanged in the Exchange Offer, either (1) in exchange for Final Repayment Notes, or (2) in return for the cash consideration to be paid over twelve years and represented by the Instalment Repayment Notes, in either case on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer for the 13% Bonds (the "**13% Bonds Mandatory Exchange Option**").

The proposed Extraordinary Resolution also contains, on behalf of all Holders of the 13% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 13% Bonds; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of Holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

1.4 ***Proposed modifications to the terms of the 5.5555% Bonds and release and waiver arrangements***

The terms of the Extraordinary Resolution to be proposed at the 5.5555% Bondholders Meeting are set out in full in the form of notice convening the meeting set out at Part 11 of this Section C of this Offer Memorandum.

The effect of the Extraordinary Resolution, if approved at the 5.5555% Bondholders Meeting and implemented by the Bank, will be to modify the terms and conditions of the 5.5555% Bonds such that the Bank is able to mandatorily effect the exchange, at the Bank's option, of all (but not some only) of the 5.5555% Bonds, which are not exchanged in the Exchange Offer, for Bank T2 Notes, on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer for the 5.5555% Bonds (the "**5.5555% Bonds Mandatory Exchange Option**" and, together with the Preference Shares Mandatory Exchange Option and the 13% Bonds Mandatory Exchange Option, the "**Mandatory Exchange Options**" and each a "**Mandatory Exchange Option**").

The proposed Extraordinary Resolution also contains, on behalf of all Holders of the 5.5555% Bonds (i) a release, in favour of certain persons (including, amongst others, the Bank, the Group and their respective directors), from all liabilities in connection with the Liability Management Exercise and (ii) a waiver of all rights and entitlement which such Holders may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against any such persons in connection with the Liability Management Exercise or their 5.5555% Bonds; provided, however, that nothing in that resolution shall constitute a release of the Bank or the Group from, or a waiver of the rights and entitlements of Holders in respect of, the respective obligations or liabilities of the Bank and the Group in their capacity as persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively.

1.5 ***Connection between the Proposals and the Exchange Offers***

The submission of a valid Exchange Instruction pursuant to the Exchange Offers will also constitute the relevant Holder's instructions (i) to appoint the chairman of the relevant Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed; and (ii) (in the case of the Holders of Preference Shares only) to appoint the chairman of the General Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the corresponding resolution proposed.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) Exchange Instructions (and does not subsequently revoke such Exchange Instructions, in the limited circumstances in which such revocation is permitted) will not be able to attend the relevant Meeting itself, nor to vote against the Extraordinary Resolution proposed at such Meeting. If that Holder is a Holder of Preference Shares, it will also not be able to attend the General Meeting itself, nor to vote against the corresponding resolution proposed at such meeting.

1.6 ***Votes in respect of Additional Preference Shares***

In addition, by offering to exchange or sell Preference Shares in the Liability Management Exercise on or before 28 November 2013 (which is the record date for determining the Holders of the Preference Shares for the purposes of allotment of the Additional Preference Shares on 29 November 2013), a Holder will also be deemed to offer to exchange or sell (as the case may be), on the same terms, any such Additional Preference Shares to be allotted to it on 29 November 2013. This will automatically include instructing the proxies appointed to vote on such Holder's behalf at the Preference Shareholders Meeting and the General Meeting to exercise the votes attaching to those Additional Preference Shares in favour of the proposed Extraordinary Resolution at the Preference Shareholders Meeting and the corresponding resolution proposed at the General Meeting.

2. EXERCISE OF THE MANDATORY EXCHANGE OPTIONS

2.1 ***Undertaking to implement the Proposals and exercise the Mandatory Exchange Option***

If the Extraordinary Resolution at any Meeting is approved, the Bank (subject to satisfaction of the Settlement Condition and to paragraph 4.6 below) undertakes to implement the relevant Extraordinary Resolution promptly and to exercise the Mandatory Exchange Option which is the subject of such Extraordinary Resolution. The Bank expects that it would exercise the Mandatory Exchange Options in a manner that would result in the relevant Existing Securities being mandatorily transferred to the Group on the settlement date for the Exchange Offer in respect of such Series of Existing Securities (currently expected to be 18 December 2013). In the event that the Mandatory Exchange Option relating to the Preference Shares and/or the 13% Bonds is exercised, the Group undertakes to accept transfer of the relevant Preference Shares and/or 13% Bonds, as the case may be, and to issue the relevant Group Notes in respect thereof.

2.2 ***Consideration for mandatory transfer or exchange of Preference Shares and Perpetual Subordinated Bonds***

(a) Any Preference Shares which are transferred to the Group pursuant to the exercise of the Mandatory Exchange Option in respect of the Preference Shares will be exchanged for Final Repayment Notes or sold to the Group for the cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes (as the case may be) on the same economic terms as those upon which Preference Shares are exchanged or sold in the Exchange Offer.

(b) Any 13% Bonds which are transferred to the Group pursuant to the exercise of the Mandatory Exchange Option in respect of the 13% Bonds will be exchanged for Final Repayment Notes or sold to the Group for the cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes (as the case may be) on the same economic terms as those upon which 13% Bonds are exchanged or sold in the Exchange Offer.

(c) Any 5.5555% Bonds which are exchanged pursuant to the exercise of the Mandatory Exchange Option in respect of the 5.5555% Bonds will be exchanged on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer.

The references above to an exchange or sale on the same "economic terms" means that the principal amount of Group Notes or the Bank T2 Notes (as applicable) to be delivered, and the payments of accrued and unpaid dividends, accrued and unpaid interest and other amounts to be paid, will be the same as if such Holder's Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) had been exchanged or sold pursuant to the Exchange Offer. If, for any reason, any Mandatory Exchange Option does not settle on the same day as the Exchange Offers, the amount of accrued and unpaid dividends or interest (as applicable) will be adjusted accordingly.

2.3 ***Holder of Preference Shares who has not elected whether to receive Final Repayment Notes or Instalment Repayment Notes***

If a Holder of Preference Shares has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such Holder's Preference Shares are mandatorily transferred to the Group pursuant to the Preference Shares Mandatory Exchange Option, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

2.4 ***Holder of 13% Bonds who has not elected whether to receive Final Repayment Notes or Instalment Repayment Notes***

If a Holder of 13% Bonds has not made a valid election (in accordance with the procedures set out in this document) whether to receive Final Repayment Notes or Instalment Repayment Notes, and such Holder's 13% Bonds are mandatorily pursuant to the 13% Bonds Mandatory Exchange Option, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes, such Holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of 13% Bonds which are the subject of elections to receive Final Repayment Notes, such Holder will receive Instalment Repayment Notes.

In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the Holder will receive Final Repayment Notes.

3. DELIVERY OF BANK T2 NOTES AND GROUP NOTES AND PAYMENT OF THE ACCRUED DIVIDENDS, ACCRUED INTEREST AND OTHER AMOUNTS

3.1 *Delivery of Bank T2 Notes and Group Notes and Cash Payments*

References in this section to "Group Notes" include both the Final Repayment Notes and the Instalment Repayment Notes, whichever is applicable to a Holder.

The manner of delivery of Bank T2 Notes or Group Notes to a Holder will depend upon whether the Holder holds its Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) (1) in CREST, (2) in Euroclear or Clearstream, Luxembourg or (3) in certificated form outside the clearing systems.

(a) *Preference Shares and 13% Bonds held in CREST*

Holders who hold their Preference Shares or 13% Bonds (as the case may be) in CREST will, if the relevant Mandatory Exchange Option is exercised, receive their Group Notes in the same CREST account in which they hold their Preference Shares or 13% Bonds (as the case may be).

(b) *5.5555% Bonds held in CREST*

Holders who hold their 5.5555% Bonds in CREST will, if the relevant Mandatory Exchange Option is exercised, receive their Bank T2 Notes in the same CREST account from which they hold their 5.5555% Bonds.

(c) *Preference Shares and 13% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who hold their Preference Shares or 13% Bonds in Euroclear or Clearstream, Luxembourg will, if the relevant Mandatory Exchange Option is exercised, receive interests in their Group Notes in the same Euroclear or Clearstream, Luxembourg account in which they hold their Preference Shares or 13% Bonds (as the case may be).

(d) *5.5555% Bonds held in Euroclear or Clearstream, Luxembourg*

Holders who hold their 5.5555% Bonds in Euroclear or Clearstream, Luxembourg will, if the relevant Mandatory Exchange Option is exercised, receive interests in their Bank T2 Notes in the same Euroclear or Clearstream, Luxembourg account in which they hold their 5.5555% Bonds.

(e) *Preference Shares and 13% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

If a Holder holds Preference Shares or 13% Bonds (as the case may be) in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, any Group Notes to be delivered upon exercise of the relevant Mandatory Exchange Option will be issued to such Holder in certificated form outside CREST, and such Holder will be eligible to receive a certificate evidencing such holding from Computershare (as registrar for the Group Notes). Such certificate will be sent to the address of such Holder appearing in the register for the Preference Shares or, as the case may be, 13% Bonds in exchange for which the Group Notes are delivered.

(f) *5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg*

If a Holder holds 5.5555% Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, any Bank T2 Notes to be delivered upon exercise of the relevant Mandatory Exchange Option will be issued to such Holder in certificated form outside CREST, and such Holder will be eligible to receive a certificate evidencing such holding of Bank T2

Notes from Computershare (as registrar for the Bank T2 Notes). Such certificate will be sent to the address of such Holder appearing in the register for the 5.5555% Bonds in exchange for which the Bank T2 Notes are delivered.

3.2 ***Payment of the accrued dividends, accrued interest and other amounts***

Payment of the accrued dividends in respect of the Preference Shares (and the cash amount to be paid in exchange for Additional Preference Shares) will be made in accordance with the usual procedures of Computershare (as registrar in respect of the Preference Shares) for the payment of dividends on the Preference Shares.

Payment of the accrued interest on the 13% Bonds and the 5.5555% Bonds (as well as the deferred interest payment on the 13% Bonds originally scheduled for 31 July 2013 and the deferred interest payment on the 5.5555% Bonds originally scheduled for 14 December 2013) will be made in accordance with the usual procedures of Equiniti (as registrar in respect of the Perpetual Subordinated Bonds) for the payment of interest on the relevant Perpetual Subordinated Bonds.

4. THE PREFERENCE SHAREHOLDERS MEETING

4.1 ***Notice of Meeting***

Notice convening the Preference Shareholders Meeting will be given in accordance with the provisions of the Articles of Association of the Bank. The notice, which will contain the full form of the Extraordinary Resolution proposed to be passed, is expected to be in substantially the form set out at Part 9 of this Section C of this Offer Memorandum.

4.2 ***Time and place of Preference Shareholders Meeting***

The Preference Shareholders Meeting is expected to be convened for 1.00 p.m. on Wednesday, 11 December 2013 at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT.

4.3 ***Quorum and voting requirements***

In order to pass the Extraordinary Resolution, both:

(a) a quorum must be present at the Meeting (or, if applicable, any adjournment thereof); and

(b) not less than three-quarters of the votes cast at the Meeting (or, if applicable, the adjourned meeting) must be voted in favour of the Extraordinary Resolution. A Holder or other representative present at the Meeting will have one vote for each £1 in nominal amount of Preference Shares held or represented.

The quorum at the first scheduled Meeting shall be two or more persons holding or representing by proxy at least one-third in nominal amount of the aggregate amount of Preference Shares outstanding.

4.4 ***Adjourned meeting***

If, at the first scheduled Meeting, a quorum is not present, then an adjourned meeting will be convened in accordance with the Articles of Association. At any such adjourned meeting, the quorum shall be those holders present in person or by proxy, whatever the nominal amount of Preference Shares they hold.

If an adjourned meeting is required to be convened, the Bank will, provided such meeting will be held on or before 27 December 2013, postpone settlement of the Exchange Offer in respect of the Preference Shares to a date falling after that adjourned meeting. If such adjourned meeting will be held after 27 December 2013, the Bank shall have discretion whether or not to postpone settlement.

If the Bank and the Group amend the timetable for the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

4.5 ***Voting***

Holders who wish to vote in respect of the Extraordinary Resolution have the following options:

(a) *Eligible Holders may submit Exchange Instructions in the Exchange Offer*

Eligible Holders may elect to submit a valid Exchange Instruction pursuant to the Exchange Offer, which will also constitute the relevant Holder's instructions to appoint (i) the chairman of the Preference Shareholders Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed; and (ii) the chairman of the General Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the corresponding resolution proposed.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) an Exchange Instruction will not be able to attend the Preference Shareholders Meeting or the General Meeting itself, nor to vote against the Extraordinary Resolution or corresponding resolution proposed at the respective meetings.

(b) *Holders may otherwise attend, in person or by proxy, and vote at the Preference Shareholder Meeting*

Eligible Holders who do not wish to submit Exchange Instructions, and Holders that are not Eligible Holders, will be entitled to attend, in person or by proxy, the Preference Shareholder Meeting (and the General Meeting) and vote in favour of or against the Extraordinary Resolution (and the corresponding resolution). Holders may make such arrangements in the manner described in the notice convening the Preference Shareholder Meeting and the General Meeting, respectively.

Such Holders should be aware that attending the Preference Shareholder Meeting in person or making separate arrangements to appoint a proxy to do so on its behalf will not (even if such Holder votes in favour of the Extraordinary Resolution) make such Holder eligible to participate in the Exchange Offer.

Holders who wish to appoint a proxy to vote in favour of the Extraordinary Resolution at the Preference Shareholders Meeting and the corresponding resolution at the General Meeting will be required to block or immobilise their Preference Shares (in a manner consistent with that described in paragraph 1.8 of Part 4 of this Section C) in respect of which they cast their votes, and such votes will be irrevocable with effect from the Early Participation Deadline (except that such votes may be revoked in the same limited circumstances in which revocation of Exchange Instructions is permitted under Section E of this Offer Memorandum).

Holders of Preference Shares are encouraged (even if not voting in favour of the Extraordinary Resolution) to elect, through their voting form, whether they would prefer to receive Final Repayment Notes or Instalment Repayment Notes in the event their Preference Shares are subject to mandatory transfer to the Group pursuant to the implementation of the Proposals under the Liability Management Exercise.

4.6 ***Resolution to be passed without the benefit of the votes of U.S. persons***

Notwithstanding any other provision of this Offer Memorandum, the Bank will not implement the Proposal in respect of the Preference Shares, even if the Extraordinary Resolution is passed, unless it is content that the Extraordinary Resolution was passed without the benefit of votes cast by U.S. persons (or would still have been passed even if such votes had been disregarded).

For these purposes, the Bank will not implement the Proposal (notwithstanding the Extraordinary Resolution being passed) in either of the following circumstances:

(a) had such votes by U.S. persons not been cast, less than 75 per cent. of the votes cast would have been in favour of the Extraordinary Resolution; or

(b) had such votes by U.S. persons not been cast, a quorum would not have been present at the Preference Shareholder Meeting (or the adjourned meeting).

5. THE PERPETUAL SUBORDINATED BONDHOLDERS MEETINGS

5.1 *Notices of Meeting*

Notice convening each Perpetual Subordinated Bondholders Meeting will be given in accordance with the terms of the relevant trust deed constituting the Perpetual Subordinated Bonds. The notices, which will contain the full form of the Extraordinary Resolution proposed at each such Meeting, are expected to be in substantially the form set out at Part 10 (in the case of the 13% Bonds) and Part 11 (in the case of the 5.5555% Bonds) of this Section C of this Offer Memorandum.

5.2 *Time and place of Perpetual Subordinated Bondholders Meetings*

The Meeting in respect of the 13% Bonds is expected to be convened for 2.00 p.m. on Wednesday, 11 December 2013 at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT.

The Meeting in respect of the 5.5555% Bonds is expected to be convened for 3.00 p.m. on Wednesday, 11 December 2013 at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT.

5.3 *Quorum and voting requirements*

In order to pass an Extraordinary Resolution at the relevant Perpetual Subordinated Bondholders Meeting, both:

(a) a quorum must be present at the relevant Meeting (or, if applicable, any adjournment thereof); and

(b) not less than three-quarters of the votes cast at the Meeting (or, if applicable, the adjourned meeting) must be voted in favour of the Extraordinary Resolution. A Holder or other representative present at the Meeting will have one vote for each £1,000 in principal amount of Perpetual Subordinated Bonds of the relevant Series held or represented.

The quorum at each first scheduled Perpetual Subordinated Bondholders Meeting shall be one or more persons holding or representing by proxy not less than two-thirds of the principal amount of the relevant Series of Perpetual Subordinated Bonds for the time being outstanding.

5.4 *Adjourned meeting*

If, in respect of either Series of Perpetual Subordinated Bonds, a quorum is not present at the first scheduled Meeting, then an adjourned meeting will be convened in accordance with the provisions set out in the relevant trust deed. At any such adjourned meeting, the quorum shall be one or more persons holding or representing by proxy not less than one-third of the principal amount of the relevant Series of Perpetual Subordinated Bonds for the time being outstanding.

If one or more adjourned meetings is required to be convened, the Bank will, provided such meeting(s) will be held on or before 27 December 2013, postpone settlement of the Exchange Offers in respect of the Perpetual Subordinated Bonds to a date falling after such adjourned meeting(s). If any such adjourned meeting will be held after 27 December 2013, the Bank shall have discretion whether or not to defer or postpone settlement.

If the Bank and the Group amend the timetable for the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

5.5 *Voting*

Holders who wish to vote in respect of the relevant Extraordinary Resolution have the following options:

(a) *Eligible Holders may submit Exchange Instructions in the relevant Exchange Offer*

Eligible Holders may elect to submit a valid Exchange Instruction pursuant to the relevant Exchange Offer, which will also constitute the relevant Holder's instructions to appoint the chairman of the relevant Perpetual Subordinated Bondholders Meeting (including, if such meeting is adjourned, the chairman of that adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) an Exchange Instruction will not be able to attend the relevant Perpetual Subordinated Bondholders Meeting itself, nor to vote against the Extraordinary Resolution proposed at such meeting.

(b) *Holders may otherwise attend, in person or by proxy, and vote at the relevant Perpetual Subordinated Bondholder Meeting*

Eligible Holders who do not wish to submit Exchange Instructions, and Holders that are not Eligible Holders, will be entitled to attend, in person or by proxy, the relevant Perpetual Subordinated Bondholder Meeting and vote in favour of or against the Extraordinary Resolution proposed at such meeting. Holders may make such arrangements in the manner described in the notice convening the relevant Meeting.

Such Holders should be aware that attending the relevant Meeting in person or making separate arrangements to appoint a proxy to do so on its behalf will not (even if such Holder votes in favour of the Extraordinary Resolution) make such Holder eligible to participate in the relevant Exchange Offer.

Holders who wish to appoint a proxy to vote in favour of the Extraordinary Resolution will be required to block or immobilise their Perpetual Subordinated Bonds (in a manner consistent with that described in paragraph 1.8 of Part 4 of this Section C) in respect of which they cast their votes, and such votes will be irrevocable with effect from the Early Participation Deadline (except that such votes may be revoked in the same limited circumstances in which revocation of Exchange Instructions is permitted under Section E of this Offer Memorandum).

Holders of 13% Bonds are encouraged (even if not voting in favour of the relevant Extraordinary Resolution) to elect, through their voting form, whether they would prefer to receive Final Repayment Notes or Instalment Repayment Notes in the event their 13% Bonds are subject to mandatory transfer to the Group pursuant to the implementation of the relevant Proposal under the Liability Management Exercise.

5.6 *Resolutions to be passed without the benefit of votes of U.S. persons*

Notwithstanding any other provision of this Offer Memorandum, the Bank will not implement the Proposal in respect of a Series of Perpetual Subordinated Bonds, even if the Extraordinary Resolution for that Series is passed, unless it is content that such Extraordinary Resolution was passed without the benefit of votes cast by U.S. persons (or would still have been passed even if such votes had been disregarded).

For these purposes, the Bank will not implement the relevant Proposal (notwithstanding the Extraordinary Resolution being passed) in either of the following circumstances:

(a) had such votes by U.S. persons not been cast, less than 75 per cent. of the votes cast would have been in favour of the Extraordinary Resolution; or

(b) had such votes by U.S. persons not been cast, a quorum would not have been present at the relevant Meeting (or the adjourned meeting).

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 3

INDICATIVE TIMETABLE FOR THE OFFERS

The times and dates referred to below are indicative only and are subject to the right of the Bank and/or the Group to extend, re-open, amend and/or terminate the Exchange Offers or any of them at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank as soon as reasonably practicable.

Events	*Dates and Times (all times are London time)*
Announcement of the Exchange Offers Exchange Offers announced. Prospectuses published. Eligible Holders of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell their Existing Securities and/or vote in respect of the Proposals.	4 November 2013
Early Participation Deadline The deadline by which the Early Participation Threshold must be achieved in order for Preference Shares and Perpetual Subordinated Bonds to be exchanged or sold (as applicable) on the basis of the relevant "Early Consideration Amount" specified in the tables under paragraph 1 of Part 1 of this Section C.	4.30 p.m. on 29 November 2013
Expiration Deadline Deadline for receipt of all Exchange Instructions from Eligible Holders in respect of Preference Shares and Perpetual Subordinated Bonds.	4.30 p.m. on 6 December 2013
Meetings Meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds held to consider the Extraordinary Resolutions pursuant to the Proposals.	11 December 2013 1.00 p.m. in respect of the Preference Shares 2.00 p.m. in respect of the 13% Bonds 3.00 p.m. in respect of the 5.5555% Bonds
Offer Record Date The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (if it is successfully completed).	11 December 2013
Results Announcement Announcement of the results of the Liability Management Exercise.	12 December 2013
Settlement Date Expected settlement of the Offers (subject to satisfaction of the Settlement Condition), including issue and delivery of Bank T2 Notes and Group Notes and payment of Accrued Dividends, Accrued Interest and other relevant amounts.	18 December 2013

The above timetable does not account for any adjournment of the Meetings or any of them. In the event that any such Meeting is adjourned, the Bank may elect to amend the terms of the Exchange Offers or any of them including (without limitation) extending or re-opening the Exchange Offers or any of them and/or postponing the Settlement Date. If the timetable changes for any reason, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

If any of the Meetings are required to be adjourned, the Bank currently expects that the adjourned Meeting(s) will be held on or around 27 December 2013 and that the settlement date will be postponed to on or around 31 December 2013. In any event, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and the Group will prepare and publish a supplement to the Group Notes Prospectus.

Unless stated otherwise, announcements in relation to the Offers will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent, the contact details for which are at the end of this Offer Memorandum.

Holders are advised to check with any custodian, broker or other intermediary through which they hold Preference Shares or Perpetual Subordinated Bonds when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in (or, in the circumstances in which revocation is permitted, revoke their instructions to participate in) the relevant Exchange Offer and/or the relevant Proposal.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 4

PROCEDURES FOR PARTICIPATING IN THE OFFERS

Holders of Preference Shares or Perpetual Subordinated Bonds wishing to offer to exchange or sell their Preference Shares and Perpetual Subordinated Bonds in the Exchange Offers or otherwise vote on the Proposals should do so in accordance with the procedures described in this Section C Part 4.

1. GENERAL CONDITIONS TO PARTICIPATION IN THE EXCHANGE OFFERS AND THE PROPOSALS

1.1 ***Offer Restrictions***

Only Eligible Holders (being Holders who are eligible to participate in the Exchange Offers in accordance with the Offer Restrictions set out in Section F of this Offer Memorandum) may offer to exchange or sell Preference Shares and Perpetual Subordinated Bonds pursuant to the Exchange Offers.

1.2 ***Participating in the Proposals – options available to Holders***

Holders who wish to vote in respect of the relevant Extraordinary Resolution at the relevant Meeting have the following options:

(a) *Eligible Holders may submit Exchange Instructions in the Exchange Offers*

Eligible Holders may elect to submit a valid Exchange Instruction pursuant to the relevant Exchange Offer, which will also constitute the relevant Holder's instructions to appoint (i) the chairman of the Preference Shareholders Meeting, 13% Bondholders Meeting or (as the case may be) 5.5555% Bondholders Meeting (including, if any such meeting is adjourned, the chairman of that adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the Extraordinary Resolution proposed at such Meeting; and (ii) (in the case of Holders of Preference Shares only) the chairman of the General Meeting (including, if such meeting is adjourned, the chairman of that adjourned meeting) as proxy to vote on behalf of the relevant Holder in favour of the corresponding resolution proposed at such meeting.

Accordingly, a Holder who validly submits (or arranges to have submitted on its behalf) an Exchange Instruction will not be able to attend the relevant Meeting itself, nor to vote against the Extraordinary Resolution proposed at such Meeting.

(b) *Holders may otherwise attend, in person or by proxy, and vote at the relevant Meeting*

Eligible Holders who do not wish to submit Exchange Instructions, and Holders that are not Eligible Holders, will be entitled to attend, in person or by proxy, the Preference Shareholder Meeting, 13% Bondholders Meeting or 5.5555% Bondholders Meeting (as appropriate) and vote in favour of or against the Extraordinary Resolution proposed at such Meeting. Holders may make such arrangements in the manner described in the notice convening the relevant Meeting.

Such Holders should be aware that attending a Meeting in person or making separate arrangements to appoint a proxy to do so on its behalf will not (even if such Holder votes in favour of the Extraordinary Resolution) make such Holder eligible to participate in the Exchange Offer (and will prevent such Holder from participating in the Exchange Offer).

Holders who wish to appoint a proxy to vote in favour of the Extraordinary Resolution will be required to block or immobilise their Preference Shares, 13% Bonds or (as the case may be)

5.5555% Bonds (in a manner consistent with that described in paragraph 1.8 of this Part 4 of Section C) in respect of which they cast their votes.

1.3 ***Election of Final Repayment Notes or Instalment Repayment Notes by Holders of Preference Shares and 13% Bonds***

(a) *Holders election*

Holders of Preference Shares and 13% Bonds are able to elect whether they would like to receive Final Repayment Notes or Instalment Repayment Notes if the Liability Management Exercise is successfully completed. Such Holders are permitted to choose only one option.

Such Holders may make such election in Exchange Instructions or in voting-only instructions relating to the Proposals (and, for the avoidance of doubt, such Holders are able to make such election even if they vote against the relevant Extraordinary Resolution).

(b) *Manner of election*

If a Holder holds Preference Shares or 13% Bonds in CREST, Euroclear or Clearstream, Luxembourg, it should elect the option in the Exchange Instruction corresponding to either Final Repayment Notes or Instalment Repayment Notes.

If a Holder holds its Preference Shares or 13% Bonds in certificated form outside the clearing systems, such Holder should specify, on its Certificated Holding Exchange Instruction to be sent to it in paper form, whether it wishes to elect the Final Repayment Notes option or the Instalment Repayment Notes option.

(c) *Failure to make valid election*

If a Holder fails to make a valid election (including if it attempts to elect both options rather than choosing just one) and its Preference Shares or 13% Bonds (as applicable) are transferred to the Group in the Liability Management Exercise, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares or 13% Bonds (respectively) which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

1.4 ***Deadlines for submission of Exchange Instructions***

Holders are reminded of the following key dates and times:

- the earliest date on which a Holder of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell its Existing Securities is 4 November 2013.
- the Early Participation Deadline is scheduled for 4.30 p.m. (London time) on 29 November 2013.
- the Expiration Deadline (the last time at which it is possible to participate in the Exchange Offers) is scheduled for 4.30 p.m. (London time) on 6 December 2013.

The times and dates given above are indicative only, and may be changed at the option of the Bank. If the Bank changes any scheduled dates in the Exchange Offers or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

A holder who holds Preference Shares or Perpetual Subordinated Bonds through a custodian, broker or other financial intermediary and/or who holds its Preference Shares or Perpetual Subordinated Bonds in CREST, Euroclear or Clearstream, Luxembourg should note that it will need to provide instructions to such intermediary and/or CREST, Euroclear or Clearstream, Luxembourg (as applicable) before the times and dates specified above in order to meet the relevant deadlines.

1.5 ***Timing of receipt of Exchange Instructions***

The offering of Preference Shares for exchange or sale by a Holder will be deemed to have occurred upon receipt by Computershare of a valid Exchange Instruction submitted in accordance with the procedures described in this Section C Part 4.

The offering of 13% Bonds or 5.5555% Bonds for exchange or sale by a Holder will be deemed to have occurred upon receipt by Equiniti of a valid Exchange Instruction submitted in accordance with the procedures described in this Section C Part 4.

1.6 ***Preference Shares and Perpetual Subordinated Bonds to be offered for exchange or sale in whole denominations; minimum offer amount for Preference Shares***

The Preference Shares have a nominal amount of £1 each. Accordingly, the Preference Shares may be offered for exchange or sale in any whole multiple of £1, subject to a minimum of £2 if the Holder elects the Final Repayment Notes option (which is the minimum amount required, based on the Late Consideration Amount, in order to receive the minimum denomination of Final Repayment Notes, being £1). There is no minimum offer amount if the Holder elects the Instalment Repayment Notes option.

The specified denomination of each Perpetual Subordinated Bond is £1,000. Accordingly, 13% Bonds and 5.5555% Bonds must be offered for exchange or sale in principal amounts equal to £1,000 or a whole multiple of £1,000.

1.7 ***Instructions irrevocable except in limited circumstances***

It is a term of the Exchange Offers that Exchange Instructions are irrevocable except upon the publication of any supplements to the Prospectuses. Upon the publication of any such supplement, investors will have at least two Business Days to withdraw their Exchange Instructions – see further Section E of this Offer Memorandum.

1.8 ***Immobilisation of Preference Shares, 13% Bonds and 5.5555% Bonds***

The submission of a valid Exchange Instruction by or on behalf of a Holder will result in the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of that Exchange Instruction being immobilised from the time of such submission such that no transfers may be effected in relation to such Preference Shares, 13% Bonds or 5.5555% Bonds until settlement or termination of the relevant Exchange Offer (or if such instruction is revoked, in the limited circumstances in which such revocation is permitted). The manner in which such immobilisation is effected will depend upon how the relevant securities are held and offered for exchange or sale:

(a) *Preference Shares and Perpetual Subordinated Bonds held in CREST*

In the case of Preference Shares and Perpetual Subordinated Bonds held in CREST, immobilisation will be effected by the mandatory transfer of the relevant Preference Shares or Perpetual Subordinated Bonds to one or more escrow accounts in CREST set up by Computershare (in respect of the Preference Shares) or Equiniti (in respect of the Perpetual Subordinated Bonds) in connection with the Exchange Offers and the Proposals.

(b) *Preference Shares and Perpetual Subordinated Bonds held in certificated form*

In the case of Preference Shares and Perpetual Subordinated Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, immobilisation will be effected by the surrender of such Holder's certificate(s) evidencing the holding of those securities to Computershare (in the case of the Preference Shares) or Equiniti (in the case of Perpetual Subordinated Bonds), and Computershare or Equiniti (as applicable) will not register the transfer of such Preference Shares or Perpetual Subordinated Bonds in the register it maintains in respect of the securities represented by such Exchange Instruction.

(c) *Preference Shares and Perpetual Subordinated Bonds held in Euroclear and Clearstream, Luxembourg*

In the case of Preference Shares and Perpetual Subordinated Bonds held in Euroclear or Clearstream, Luxembourg, immobilisation will be effected by the blocking of the relevant Perpetual Subordinated Bonds in the Holder's account in accordance with the usual procedures of the relevant Clearing System (which will result in the underlying Preference Shares or Perpetual Subordinated Bonds, as the case may be, being transferred to escrow in CREST).

(d) *Holders to take reasonable steps to ensure no transfer of immobilised securities*

Holders and (if applicable) Direct Participants and CREST Participants who submit Exchange Instructions on their behalf must take the appropriate steps to ensure that no transfers may be effected in relation to such immobilised Preference Shares and Perpetual Subordinated Bonds.

1.9 ***Representations, warranties, acknowledgements, agreements and undertakings***

Holders submitting (or having submitted on their behalf) Exchange Instructions will be required to make and give, and will be deemed to have made and given, the representations, warranties, acknowledgements, agreements and undertakings set out in Part 5 of this Section C of this Offer Memorandum. Holders who have concerns about making or giving any such representations, warranties, acknowledgements, agreements and/or undertakings should contact Computershare (in the case of Holders of Preference Shares) or Equiniti (in the case of Holders of Perpetual Subordinated Bonds) immediately.

1.10 ***Authorisation to disclose information***

By submitting (or arranging to have submitted on its behalf) an Exchange Instruction, each Holder will be deemed to consent to CREST, Euroclear, Clearstream, Luxembourg, Computershare and/or Equiniti (as appropriate) providing details of the Holder and (if applicable) the Direct Participant or CREST Participant who submits an Exchange Instruction on its behalf to Computershare, Equiniti and the Exchange Agent (as appropriate) and for such information to be shared with the Bank, the Group, the Dealer Managers and their respective legal advisers.

1.11 ***Acceptance of offer results in binding contract***

By submitting (or arranging to have submitted on its behalf) a valid Exchange Instruction, a Holder will, if such offer to exchange or sell is accepted by the Bank, have entered into a binding agreement between such Holder and the Bank upon the terms and subject to the conditions of the relevant Exchange Offer.

1.12 ***Specific procedures***

Eligible Holders who hold their Preference Shares or Perpetual Subordinated Bonds held in CREST should follow the procedures set out in paragraph 2 below.

Eligible Holders who hold their Preference Shares or Perpetual Subordinated Bonds in certificated form outside CREST, Euroclear and Clearstream, Luxembourg should follow the procedures set out in paragraph 3 below.

Eligible Holders who hold their Preference Shares or Perpetual Subordinated Bonds in Euroclear or Clearstream, Luxembourg should follow the procedures set out in paragraph 4 below.

2. SPECIFIC PROCEDURES FOR HOLDERS OF PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS HELD IN CREST

The procedures contained under this paragraph 2 apply only to Preference Shares and Perpetual Subordinated Bonds held in CREST.

Procedures for offering Preference Shares or Perpetual Subordinated Bonds for exchange or sale (or otherwise for voting in favour of the relevant Proposals)

2.1 Only CREST Participants may submit Exchange Instructions in CREST. Each Holder that is not itself a CREST Participant must arrange for the CREST Participant through which such Holder holds its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) to submit a valid Exchange Instruction on its behalf before the relevant deadlines specified by CREST.

2.2 To offer to exchange or sell Preference Shares or Perpetual Subordinated Bonds held in CREST, a Holder must send (or, for a CREST sponsored member, procure that its CREST sponsor sends) a TTE Instruction (which must comply with paragraph 2.3 below in the case of an offer to exchange or sell Preference Shares or paragraph 2.4 below in the case of an offer to exchange or sell 13% Bonds or 5.5555% Bonds) in respect of the Preference Shares or Perpetual Subordinated Bonds to be offered for exchange or sale, which transfer to escrow must settle:

(a) if such Holder wishes to offer to exchange or sell its Preference Shares or Perpetual Subordinated Bonds by the Early Participation Deadline, by the Early Participation Deadline; or

(b) otherwise, by the Expiration Deadline.

2.3 Each TTE Instruction relating to Preference Shares should specify Computershare (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the relevant Preference Shares should be transferred. A TTE Instruction will not be valid unless and until it has settled and Computershare will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the number of Preference Shares to be transferred to an escrow balance;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the Holder wishes to select;

(g) the intended settlement date (which should be as soon as possible and in any event not later than the relevant deadline specified in paragraph 2.2 above);

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Computershare relevant to a Holder of Preference Shares are set out in the table below. **A Holder should elect the ID which corresponds to such Holder's preferred option**:

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your Preference Shares for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings).	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your Preference Shares to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings)	**OPT0001B**
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002A**
Option 4: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002B**
Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002C**

Option	CREST Member ID
Option 6: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002D**
NB: to vote AGAINST the resolutions proposed at the Preference Shareholders Meeting and the General Meeting, please use the paper voting instruction available from Computershare.	–

2.4 Each TTE Instruction relating to 13% Bonds or 5.5555% Bonds should specify Equiniti (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the relevant Perpetual Subordinated Bonds should be transferred. A TTE Instruction will not be valid unless and until it has settled and Equiniti will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

13% Bonds

(a) the principal amount of 13% Bonds to be transferred to an escrow balance;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the Holder wishes to select;

(g) the intended settlement date (which should be as soon as possible and in any event not later than the relevant deadline specified in paragraph 2.2 above);

(h) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 13% Bonds are set out in the table below. **A Holder should elect the ID which corresponds to such Holder's preferred option:**

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 13% Bonds for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting).	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your 13% Bonds to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting)	**OPT0001B**
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002A**
Option 4: <u>(U.S. Holders ONLY)</u> Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002B**
Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002C**
Option 6: <u>(U.S. Holders ONLY)</u> Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution AND if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002D**
NB: to vote AGAINST the resolution proposed at the 13% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	**–**

5.5555% Bonds

(a) the principal amount of 5.5555% Bonds to be transferred to an escrow balance;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the Holder wishes to select;

(g) the intended settlement date (which should be as soon as possible and in any event not later than the relevant deadline specified in paragraph 2.2 above);

(h) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 5.5555% Bonds are set out in the table below. **A Holder should elect the ID which corresponds to such Holder's preferred option:**

Option	**CREST Member ID**
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 5.5555% Bonds for **Bank T2 Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 5.5555% Bondholders Meeting as your proxy to vote those 5.5555% Bonds IN FAVOUR of the resolution to be proposed at that meeting).	**OPT55001**
Option 2: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502A**
Option 3: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502B**
NB: to vote AGAINST the resolution proposed at the 5.5555% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	–

2.5 After settlement of the TTE Instruction, Holders will not be able to access the Preference Shares or Perpetual Subordinated Bonds concerned in CREST for any transaction or charging purposes (subject to the revocation rights of Holders described in Section E of this Offer Memorandum). If such

Preference Shares and/or Perpetual Subordinated Bonds are accepted pursuant to the relevant Exchange Offer, Computershare (in its capacity as escrow agent for the Preference Shares) will transfer such Preference Shares to the Group and Equiniti (in its capacity as escrow agent for the Perpetual Subordinated Bonds) will transfer the 13% Bonds to the Group and will cancel the 5.5555% Bonds.

2.6 Holders are recommended to refer to the CREST Manual for further information on the CREST procedures outlined above.

2.7 Holders of Preference Shares and Perpetual Subordinated Bonds in CREST should note that normal system timings and limitations will apply in connection with a TTE Instruction. Holders are referred to the sections of the CREST Manual concerning practical limitations of the CREST system and timings.

Procedures for revoking Exchange Instructions

2.8 In the limited circumstances where Holders are permitted to revoke their Exchange Instructions (as described in Section E of this Offer Memorandum), TTE Instructions may be withdrawn by a Holder by sending (or, for a CREST sponsored member, procuring that its CREST sponsor sends) an ESA Instruction to settle in CREST (prior to the relevant deadline) in relation to each Exchange Instruction submitted. Such ESA Instruction must comply with paragraph 2.9 below in the case of Preference Shares or paragraph 2.10 below in the case of Perpetual Subordinated Bonds.

2.9 Each ESA Instruction relating to Preference Shares must, in order for it to be valid and settle, include the following details:

(a) the number of Preference Shares to be withdrawn;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out in paragraph 2.3 above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

2.10 Each ESA Instruction relating to Perpetual Subordinated Bonds must, in order for it to be valid and settle, include the following details:

13% Bonds

(a) the principal amount of 13% Bonds to be withdrawn;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out in paragraph 2.4 above and relating to the 13% Bonds;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

5.5555% Bonds

(a) the principal amount of 5.5555% Bonds to be withdrawn;

(b) the Holder's member account ID;

(c) the Holder's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out in paragraph 2.4 above and relating to the 5.5555% Bonds;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

2.11 Any such withdrawal of Exchange Instructions will be conditional upon Computershare (in the case of a withdrawal of Preference Shares) or Equiniti (in the case of a withdrawal of Perpetual Subordinated Bonds) verifying that the withdrawal request is validly made. Accordingly, Computershare or, as the case may be, Equiniti will, on behalf of the Bank, reject or accept the withdrawal by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

2.12 Upon a valid revocation of an Exchange Instruction, or in the event that the relevant Exchange Offer is terminated (including if the relevant offer to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds is not accepted), the relevant Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) will be returned to the relevant CREST account of the Holder (or its sponsor).

2.13 Any Holder who does not, within the applicable timeframe, exercise its right of revocation in the manner specified above, shall be deemed to have waived such right of revocation and its original Exchange Instruction will remain effective.

3. SPECIFIC PROCEDURES FOR HOLDERS OF PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS HELD IN CERTIFICATED FORM OUTSIDE CREST, EUROCLEAR AND CLEARSTREAM, LUXEMBOURG

The procedures contained under this paragraph 3 apply only to Preference Shares and Perpetual Subordinated Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg.

Procedures for offering Preference Shares or Perpetual Subordinated Bonds for exchange or sale

3.1 In this paragraph 3, references to the "**relevant Registrar**" mean:

(a) for holders of Preference Shares, Computershare; or

(b) for holders of 13% Bonds or 5.5555% Bonds, Equiniti.

3.2 To offer to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, a Holder must deliver to the relevant Registrar, not later than:

(a) if such Holder wishes to offer to exchange or sell its Preference Shares or Perpetual Subordinated Bonds by the Early Participation Deadline, the Early Participation Deadline; or

(b) otherwise, the Expiration Deadline,

a duly completed Certificated Holding Exchange Instruction, together with the certificate or certificates evidencing ownership of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of such Certificated Holding Exchange Instruction.

3.3 The form of Certificated Holding Exchange Instruction for the Preference Shares and the 13% Bonds will contain appropriate boxes for a Holder to specify whether it elects the Final Repayment Notes option or the Instalment Repayment Notes option.

3.4 The appropriate form of Certificated Holding Exchange Instruction will be mailed on or around 4 November 2013 to the relevant Holders of Preference Shares, 13% Bonds and 5.5555% Bonds at the address of each such Holder appearing in the register of such securities as at 31 October 2013 (in the case of the Preference Shares) and 30 October 2013 (in the case of the 13% Bonds and the 5.5555% Bonds). If a Holder has not received a Certificated Holding Exchange Instruction within five working days of 4 November 2013, or if it requires an additional copy of a Certificated Holding Exchange Instruction, it should contact the relevant Registrar without delay.

3.5 Holders who have lost their certificate(s) should notify the relevant Registrar by telephone as soon as possible, and in any event at least two Business Days in advance of any relevant deadline for submission of Exchange Instructions, to obtain a declaration and indemnity for return to the relevant Registrar by not later than the relevant deadline. Indemnities will only be accepted in lieu of certificates at the discretion of the Bank.

3.6 An Exchange Instruction relating to Preference Shares, 13% Bonds or 5.5555% Bonds held in certificated form outside CREST, Euroclear and Clearstream, Luxembourg will not be valid unless accompanied by either (i) the certificate(s) in respect of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) to which such Exchange Instruction relates, or (ii) a duly completed declaration and indemnity accepted by the Bank.

3.7 Computershare's address for the delivery of Certified Holding Exchange Instructions in relation to Preference Shares and related certificates is:

Computershare Investor Services PLC
Corporate Actions Projects
Bristol BS99 6AH
United Kingdom

3.8 Equiniti's address for the delivery of Certificated Holding Exchange Instructions in relation to 13% Bonds and 5.5555% Bonds and related certificates is:

Equiniti Limited
Corporate Actions
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
United Kingdom

3.9 Certificated Holding Exchange Instructions relating to Preference Shares will be required to specify, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number;

(b) confirmation that such Holder is an Eligible Holder;

(c) the number of Preference Shares which are being offered for exchange or sale;

(d) whether the Holder elects the Final Repayment Notes option or the Instalment Repayment Notes option; and

(e) the address to which (if the Exchange Offer is settled) the certificate evidencing such Holder's holding of Final Repayment Notes or Instalment Repayment Notes should be mailed (if different from the address currently on the register).

3.10 Certificated Holding Exchange Instructions relating to 13% Bonds will be required to specify, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number;

(b) confirmation that such Holder is an Eligible Holder;

(c) the principal amount of 13% Bonds which is being offered for exchange or sale;

(d) whether the Holder elects the Final Repayment Notes option or the Instalment Repayment Notes option; and

(e) the address to which (if the Exchange Offer is settled) the certificate evidencing such Holder's holding of Final Repayment Notes or Instalment Repayment Notes should be mailed (if different from the address currently on the register).

3.11 Certificated Holding Exchange Instructions relating to 5.5555% Bonds will be required to specify, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number;

(b) confirmation that such Holder is an Eligible Holder;

(c) the principal amount of 5.5555% Bonds which is being offered for exchange; and

(d) the address to which (if the Exchange Offer is settled) the certificates evidencing such Holder's holding of Bank T2 Notes should be mailed (if different from the address currently on the register).

Procedures for revoking Exchange Instructions

3.12 To revoke a Certificated Holding Exchange Instruction in the limited circumstances in which revocation is permitted, a Holder must deliver to the relevant Registrar, not later than the applicable revocation deadline, a written revocation instruction in such form as the relevant Registrar deems appropriate and shall make available to Holders in the event that a revocation right arises.

3.13 The Holder will be required to specify in the revocation instruction, amongst other information:

(a) the name and address of the relevant Holder and a contact telephone number; and

(b) the number of Preference Shares or, as the case may be, the principal amount of 13% Bonds or 5.5555% Bonds, which are being revoked.

3.14 Upon a valid revocation of a Certificated Holding Exchange Instruction, or in the event that the relevant Exchange Offer is terminated (including if the relevant offer to exchange or sell Preference Shares or Perpetual Subordinated Bonds is not accepted), the certificate(s) relating to the Preference Shares, 13% Bonds and/or 5.5555% Bonds (as applicable) which have been delivered to the relevant Registrar (and, if applicable, which are being revoked) will be returned to the relevant Holder at the address specified on its Certificated Holding Exchange Instruction.

3.15 Any Holder who does not, within the applicable timeframe, exercise its right of revocation in the manner specified above, shall be deemed to have waived such right of revocation and its original Exchange Instruction will remain effective.

4. SPECIFIC PROCEDURES FOR HOLDERS OF PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS HELD IN EUROCLEAR AND CLEARSTREAM, LUXEMBOURG

The procedures contained under this paragraph 4 apply only to Preference Shares and Perpetual Subordinated Bonds held in Euroclear or Clearstream, Luxembourg.

Procedures for offering Preference Shares and Perpetual Subordinated Bonds for exchange or sale

4.1 Only Direct Participants in Euroclear and Clearstream, Luxembourg may submit Exchange Instructions through such Clearing Systems. Each Holder that is not such a Direct Participant must arrange for the Direct Participant through which such Holder holds its Preference Shares, 13% Bonds or, as the case may be, 5.5555% Bonds to submit a valid Exchange Instruction through Euroclear or Clearstream, Luxembourg (as applicable) before the relevant deadlines specified by the relevant Clearing System.

4.2 The receipt of such Exchange Instruction will be acknowledged in accordance with the standard practices of such Clearing System and will result in the blocking of the relevant Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) in the Holder's account with the relevant Clearing System so that no transfers may be effected in relation to such Preference Shares, 13% Bonds or 5.5555% Bonds.

Procedures for revoking Exchange Instructions

4.3 In the limited circumstances in which revocation is permitted, an Exchange Instruction may be revoked in accordance with the usual procedures of the relevant Clearing System by the submission of an electronic withdrawal instruction.

4.4 To be valid, any withdrawal instruction must specify the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) to which the original Exchange Instruction related, the securities account to which such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) are credited and any other information required by the relevant Clearing System.

5. RESPONSIBILITY FOR DELIVERY OF EXCHANGE INSTRUCTIONS

5.1 It is the responsibility of Holders wishing to participate in the Exchange Offers to validly submit (or arrange to have validly submitted on their behalf) Exchange Instructions in respect of their Preference Shares, 13% Bonds and/or 5.5555% Bonds. The Bank and the Group have the right to waive any defects of such instructions submitted by Holders. However, they are not required to waive such defects and none of the Bank, the Group, the Exchange Agent or the relevant Registrar is required to notify a Holder of defects in their Exchange Instructions.

5.2 None of the Bank, the Group, the Dealer Managers, the Exchange Agent, Computershare or Equiniti will be responsible for the communication of Exchange Instructions by Holders or, where applicable, their custodian, broker, Direct Participant, CREST Participant or other intermediary.

5.3 If a beneficial owner holds its Preference Shares, 13% Bonds or 5.5555% Bonds through a custodian, broker or other intermediary, it should consult with that intermediary as to whether such intermediary will charge any service fees in connection with the services provided to such Holder in connection with the Exchange Offers and/or the Proposals.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 5

REPRESENTATIONS, WARRANTIES, ACKNOWLEDGEMENTS, AGREEMENTS AND UNDERTAKINGS

By submitting (or arranging to have submitted on its behalf) an Exchange Instruction, each Holder and (if applicable) the relevant Direct Participant or CREST Participant on its behalf (as the case may be) represents, warrants, acknowledges, agrees and undertakes to the Bank, the Group, the Dealer Managers, the Exchange Agent and the relevant Registrar, at the time of submission of such Exchange Instruction, the Early Participation Deadline (if submitted before that deadline), the relevant Expiration Deadline and at the time of settlement on the relevant Settlement Date, as follows:

1.1 it has received, reviewed and understood this Offer Memorandum and accepts the terms of the relevant Exchange Offer;

1.2 it is assuming all the risks inherent in participating in the relevant Exchange Offer, and has undertaken all the appropriate analysis of the implications of the relevant Exchange Offer, without reliance on (i) the Group (except that Holders of Preference Shares and 13% Bonds may place reliance on information contained in the Group Notes Prospectus, for which the Group accepts responsibility); (ii) the Bank (except that Holders of the 5.5555% Bonds may place reliance on information contained in the Bank T2 Prospectus, for which the Bank accepts responsibility); or (iii) the Dealer Managers, the Exchange Agent or the relevant Registrar;

1.3 by arranging for the blocking or immobilisation of its Preference Shares, 13% Bonds or 5.5555% Bonds (as the case may be) in the manner described in paragraph 1.8 of Part 4 of this Section C of this Offer Memorandum, it will be deemed to consent to details concerning the identity of any Direct Participant or CREST Participant (if relevant) to be disclosed to the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar and their respective advisers;

1.4 upon the terms and subject to the conditions of the relevant Exchange Offer, it offers to exchange or sell (as the case may be) the nominal amount of Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are so blocked or immobilised pursuant to the relevant Exchange Offer and, subject to and effective on the acceptance for exchange or sale by the Bank or the Group in respect of such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) pursuant to the relevant Exchange Offer, it irrevocably sells, assigns and transfers to the Group (in the case of any Preference Shares or 13% Bonds) or to the Bank (in the case of any 5.5555% Bonds) all right, title and interest in and to, and any and all claims in respect of or arising or having arisen as a result of its status as a Holder of, all such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) and renounces all right, title and interest in and to all such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) accepted for exchange or sale and waives and releases any rights or claims it may have against the Bank, the Group or any subsidiary of the Group with respect to any such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) or the relevant Exchange Offer;

1.5 that by delivering (or arranging for the delivery on its behalf of) a valid Exchange Instruction, it also (i) instructs the appointment of the chairman of the relevant Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as its proxy to vote in favour of the relevant Extraordinary Resolution in respect of all its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of such Exchange Instruction (and, if such Exchange Instruction is delivered in respect of Preference Shares on or before 28 November 2013, the corresponding Additional Preference Shares) and that, accordingly, such Holder will be unable to attend the relevant Meeting itself or appoint a different proxy to attend the Meeting on its behalf; and (ii) (in the case of a Holder of Preference Shares only) instructs the appointment of the chairman of the General Meeting (including, if such meeting is adjourned, the chairman of the adjourned meeting) as its proxy to vote in favour of the relevant corresponding resolution in respect of all its Preference Shares which are the subject of such Exchange Instruction (and, if such Exchange Instruction is delivered on or before 28 November 2013, the corresponding Additional Preference Shares) and that, accordingly, such Holder will be unable to attend the General Meeting itself or appoint a different proxy to attend the General Meeting on its behalf;

1.6 (in the case of a Holder of Preference Shares) that by delivering (or arranging for the delivery on its behalf of) a valid Exchange Instruction in respect of Preference Shares on or prior to 28 November 2013, it irrevocably directs the Bank to allot any Additional Preference Shares which would otherwise be allotted to such Holder in lieu of a cash dividend on 29 November 2013 to Computershare Investor Services PLC as nominee for such Holder, and irrevocably directs such nominee (i) if the Exchange Offers are settled, to deliver such Additional Preference Shares on behalf of such Holder to the Group on the Settlement Date in consideration for the payment to it in cash of an amount equal to the cash dividend which would have been payable on 29 November had the terms of the Preference Shares permitted that dividend instalment to be paid in cash, or (ii) if the Exchange Offers are not settled, to promptly deliver such Additional Preference Shares to such Holder;

1.7 it will not sell, pledge, hypothecate or otherwise encumber or transfer any Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of the Exchange Instruction from the date of its Exchange Instruction and it agrees that any purported sale, pledge, hypothecation or other encumbrance or transfer will be void and of no effect, and that the delivery of such Exchange Instruction shall constitute an undertaking to execute any further documents and give any further assurances that may be required in connection with any of the foregoing, in each case on and subject to the terms and conditions of the Exchange Offer;

1.8 with respect to any Bank T2 Notes or Group Notes (or interests therein) which are to be delivered to it in CREST, Euroclear or Clearstream, Luxembourg, it acknowledges and agrees that (a) the Bank and the Group (as applicable) will procure the issue of such Bank T2 Notes and Group Notes in CREST on the Settlement Date; (b) CREST (and, where applicable, Euroclear and Clearstream, Luxembourg) will thereafter arrange for such Bank T2 Notes and Group Notes (or, where applicable, interests therein) to be delivered to such Holder's account in CREST, Euroclear or Clearstream, Luxembourg (as applicable). It is possible that this process may not be completed on the Settlement Date, and accordingly the Holder may not receive its Bank T2 Notes and Group Notes (or, where applicable, interests therein) until after the Settlement Date; (c) the issue of the Bank T2 Notes and Group Notes in CREST on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such Bank T2 Notes and Group Notes. Thereafter, the Holder must look to CREST, Euroclear and/or Clearstream, Luxembourg (as applicable) for receipt of such Bank T2 Notes and Group Notes (or interests therein); and (d) provided that the Bank and the Group (as applicable) procure the issue the Bank T2 Notes and the Group Notes in CREST on or before the Settlement Date, neither the Bank nor the Group will be liable to pay any compensation or other additional amounts in the event that such Holder receives its entitlement to such Bank T2 Notes or Group Notes after the Settlement Date;

1.9 with respect to Bank T2 Notes and Group Notes which are to be held by it in certificated form outside CREST, Euroclear and Clearstream, Luxembourg, it acknowledges and agrees that (a) the Bank and the Group will, on the Settlement Date, instruct Computershare (as registrar for the Bank T2 Notes and Group Notes) to prepare and mail the certificate evidencing the holdings of such Bank T2 Notes or, as the case may be, Group Notes as soon as reasonably practicable; (b) Computershare will thereafter arrange for such certificate to be prepared and mailed to the relevant address of such Holder. Accordingly, such Holder will not receive its certificate until after the Settlement Date; (c) the instructions of the Bank and the Group to Computershare on or before the Settlement Date will discharge the Bank's and the Group's respective obligations in respect of the delivery of such certificate, and the Holder should look to Computershare for such certificate; and (d) provided that the Bank and the Group (as applicable), on or before the Settlement Date, instruct Computershare to prepare and mail the certificates, neither the Bank nor the Group will be liable to pay any compensation or other additional amounts in the event that such Holder receives its certificate after the Settlement Date;

1.10 with respect to the payment to it of any Accrued Dividends, Accrued Interest and/or any other amounts (as applicable) under the terms of the Offers, it acknowledges and agrees that (a) the Bank will pay, or procure the payment of, (i) an amount equal to all Accrued Dividends (and cash amounts to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (including deferred interest payments, where relevant) to Equiniti, in each case on or before the Settlement Date; (b) Computershare and/or Equiniti (as applicable) will thereafter arrange for the payment of such amounts to such Holder in accordance with their usual procedures for making payments of dividends and interest (as applicable) on such Preference Shares, 13% Bonds and 5.5555% Bonds (as applicable). Accordingly, the Holder may not receive its Accrued Dividends and/or Accrued Interest and/or other amounts (as applicable) until after the Settlement Date; (c) the payment by or on behalf of the Bank of (i) an amount equal to all Accrued Dividends (and cash amounts to be paid in exchange for Additional Preference Shares) to Computershare and (ii) an amount equal to all Accrued Interest (including deferred interest payments, where relevant) to Equiniti, in each case on or before the Settlement Date, will discharge the Bank's obligations in respect of the payment of such amounts, and such Holder should look to Computershare and/or Equiniti (as applicable) for its share of such amount(s); and (d) provided that the Bank pays, or procures the payment of such amounts to Computershare and Equiniti as mentioned above, in each case on or before the Settlement Date, neither the Bank nor the Group will be liable to pay any interest, compensation or other additional amounts in the event that such Holder receives its Accrued Dividends and/or Accrued Interest and/or other amounts after the Settlement Date;

1.11 in respect of its Existing Securities which it offers for exchange or sale and which are accepted on the terms of the relevant Exchange Offer, it (a) releases, to the fullest extent permitted by law, the Bank, the Group, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives) from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise or any part thereof; (b) waives, to the fullest extent permitted by law, all rights and entitlement it may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Bank, the Group, the Dealer Managers, the Exchange Agent, the Registrars, the Trustee and/or their respective financial and legal advisers (together in each case with their respective directors, members and representatives) in connection with the Liability Management Exercise and/or its Existing Securities; and (c) (if its Existing Securities are exchanged or sold in the Liability Management Exercise) waives, to the fullest extent permitted by law, all its rights, title and interest to and claims in respect of such Existing Securities (provided that such Holder does not release the Bank or the Group from their respective obligations or liabilities in their capacity as the persons responsible for the Bank T2 Prospectus and the Group Notes Prospectus, respectively);

1.12 it (by the delivery of its Exchange Instruction) irrevocably appoints each of the Exchange Agent and the relevant Registrar as its true and lawful agents and attorneys-in-fact (with full knowledge that each of the Exchange Agent and relevant Registrar also acts as agent of the Bank) with respect to the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of its Exchange Instruction, with full powers of substitution (such power of attorney being deemed to be an irrevocable power of attorney coupled with an interest) to: (i) transfer ownership of such Preference Shares or 13% Bonds to the Group or 5.5555% Bonds to the Bank (as applicable) upon the terms of the relevant Exchange Offer; (ii) present such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for transfer of ownership on the relevant security register; and (iii) receive all benefits and otherwise exercise all rights of beneficial ownership of such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable), except that the Exchange Agent and relevant Registrar will have no rights to or control over (except as agent of the Bank) the Bank T2 Notes, Group Notes, Accrued Dividends, Accrued Interest and/or other cash amounts which are deliverable to the Holder in exchange for its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) under the terms of the Exchange Offers, all in accordance with the terms and conditions of the relevant Exchange Offer as described in this Offer Memorandum;

1.13 it agrees to ratify and confirm each and every act or thing that may be done or effected by the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any of their respective directors or any person nominated by any of them in the proper exercise of his or her powers and/or authority hereunder;

1.14 it agrees to do all such acts and things as shall be necessary and execute any additional documents deemed by the Bank to be desirable to (i) complete the transfer of the Preference Shares or 13% Bonds to the Group and the transfer to the Bank and/or cancellation of the 5.5555% Bonds (as applicable) against delivery and payment (as applicable) of the relevant Bank T2 Notes, Group Notes, Accrued Dividends, Accrued Interest and/or other cash amounts (as applicable), and/or (ii) perfect any of the authorities expressed to be given hereunder;

1.15 it has observed the laws of all relevant jurisdictions; obtained all requisite governmental, exchange control or other required consents; complied with all requisite formalities; and paid any issue, transfer or other taxes or requisite payments due from it in each respect in connection with any offer or acceptance in any jurisdiction and that it has not taken or omitted to take any action in breach of the terms of the relevant Exchange Offer, or which will or may result in the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any other person acting in breach of the legal or regulatory requirements of any such jurisdiction in connection with the Offers or any invitation for Holders to offer to exchange or sell their Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) in connection therewith;

1.16 all authority conferred or agreed to be conferred pursuant to its representations, warranties, undertakings and directions and all of its obligations shall be binding upon its successors, assigns, heirs, executors, trustees in bankruptcy, insolvency practitioners and legal representatives and shall not be affected by, and shall survive, its death, incapacity, bankruptcy, insolvency or any other similar proceedings;

1.17 except for the generic description of certain taxation considerations expressly set out in the relevant Prospectus(es), including the Offer Memorandum, (which the Holder acknowledges does not constitute advice and is not tailored to any particular investor), no information has been provided to it by the Bank, the Group, the Dealer Managers, the Exchange Agent or the relevant Registrar with regard to the tax consequences to Holders, beneficial owners or Direct Participants or CREST Participants arising from the exchange or sale of Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) in the Exchange Offers or the receipt, or transfer or payment of Bank T2 Notes, Group Notes, Accrued Dividends, Accrued Interest and/or other cash amounts (as applicable). It hereby acknowledges that it is solely liable for any taxes and similar or related payments imposed on it under the laws of any applicable jurisdiction as a result of its participation in the relevant Exchange Offer and agrees that it will not and does not have any right of recourse (whether by way of reimbursement, indemnity or otherwise) against the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any other person in respect of such taxes and payments;

1.18 it is not a person to whom it is unlawful to make an invitation pursuant to the relevant Exchange Offer under applicable laws, it has not distributed or forwarded this Offer Memorandum or any other document or material relating to the Exchange Offers to any such person and it has (before submitting, or arranging for the submission on its behalf, as the case may be, of the Exchange Instruction in respect of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which it is offering for exchange or sale) complied with all laws and regulations applicable to it for the purposes of its participation in the relevant Exchange Offer;

1.19 it acknowledges that none of the Bank T2 Notes or Group Notes, nor any guarantee in respect thereof, have been or will be registered under the Securities Act or any other applicable U.S. State securities laws and agrees that it will not sell or otherwise transfer the New Securities during the 40 day period commencing on the Settlement Date for the Exchange Offers (i) except outside of the United States in a transaction complying with Rule 903 or 904 of Regulation S, and (ii) it will send to each distributor, dealer or person receiving a selling concession, fee or other remuneration that purchases New Securities from it or through it a confirmation or notice setting forth the restrictions on offers and sales of the New Securities within the United States or to, or for the account or benefit of, U.S. persons;

1.20 it has full power and authority to submit for exchange or sale (as applicable) the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) hereby submitted for exchange or sale and if such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) are accepted for exchange or sale, such Preference Shares or 13% Bonds will be transferred to the Group (with full title free from all liens, charges and encumbrances, not subject to any adverse claim and together with all rights attached thereto) or, as the case may be, such 5.5555% Bonds will be cancelled;

1.21 it holds and will hold, until the time of settlement on the relevant Settlement Date, the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) which are the subject of its Exchange Instruction, immobilised in the relevant manner and will ensure that, at any time pending the transfer of such Preference Shares or 13% Bonds to the Group or, as the case may be, the transfer to the Bank and/or cancellation of such 5.5555% Bonds (as applicable) on the relevant Settlement Date, no transfers of such Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) may be effected;

1.22 the terms and conditions of the Exchange Offers shall be deemed to be incorporated in, and form a part of, the Exchange Instruction which shall be read and construed accordingly and that the information given by or on behalf of such Holder in the Exchange Instruction is true and will be true in all respects at the time of the exchange;

1.23 it accepts that, subject to applicable law or otherwise expressly provided in this Offer Memorandum, (i) its Exchange Instruction is irrevocable once submitted, and (ii) the Bank and the Group are under no obligation to Holders to accept Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) offered for exchange or sale and accordingly offers to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) may be accepted or rejected by the Bank for any reason in the Bank's and/or the Group's sole discretion; and it accepts that the Bank and the Group may not be able to accept an offer to exchange or sell Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for a variety of reasons;

1.24 the receipt from a Holder or from a Direct Participant or CREST Participant on behalf of a beneficial owner of an Exchange Instruction will (where applicable) constitute instructions to debit the securities in such Holder's or Direct Participant's account (or the account of the relevant Registrar in which such securities have been immobilised) on the relevant Settlement Date in respect of all of the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) that such Holder, Direct Participant or CREST Participant has so immobilised and which have been accepted, upon receipt by the relevant Clearing System of an instruction from the Exchange Agent, to receive those Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for the account of the Bank or the Group, subject to the automatic withdrawal of those instructions in the event that the relevant Exchange Offer is terminated by the Bank or the Group or the withdrawal of such Exchange Instruction (in the limited circumstances in which such withdrawal is permitted) in accordance with the procedures set out in this Offer Memorandum;

1.25 it understands that acceptance for exchange or sale of its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) offered for exchange or sale by it pursuant to the relevant Exchange Offer will constitute a binding agreement between it and the Bank or Group (as the case may be), in accordance with and subject to the terms and conditions of the relevant Exchange Offer;

1.26 it understands that the Bank and the Group may, at their sole discretion, extend, re-open, amend, waive any condition of (other than the Settlement Condition and the Acceptance Conditions) or terminate the Exchange Offers or any of them at any time, and that in the event of a termination of the relevant Exchange Offer, the Exchange Instructions with respect to the Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) will be released (and the Preference Shares, 13% Bonds or

5.5555% Bonds (as applicable) returned to the Holder or, as the case may be, unblocked in the relevant Clearing System account or, if immobilised in an account of the relevant Registrar, released to such Holder);

1.27 none of the Bank, the Group, the Dealer Managers, the Exchange Agent, the relevant Registrar or any of their respective directors or employees, has given it any information with respect to the Exchange Offers save as expressly set out in the Bank T2 Prospectus and the Group Notes Prospectus (including, in each case, this Offer Memorandum) nor has any of them made any recommendation to it as to whether it should offer any of its Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for exchange or sale in the Exchange Offers, and the Holder has made its own decision with regard to offering Preference Shares, 13% Bonds or 5.5555% Bonds (as applicable) for exchange or sale in the Exchange Offers based on any legal, tax or financial advice it has deemed necessary to seek;

1.28 it (or any account for which it is acting) is a person other than a "U.S. person" (as defined in Regulation S under the Securities Act) and is acquiring the Bank T2 Notes or (as applicable) Group Notes in an offshore transaction in accordance with Regulation S under the Securities Act;

1.29 it is not located or resident in the United Kingdom or, if it is located or resident in the United Kingdom, it is either (i) a holder of Preference Shares, 13% Bonds or 5.5555% Bonds, or (ii) any other person also falling within Article 43(2) or within Article 49(2)(a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**Order**") or falling within the definition of investment professionals (as defined in Article 19(5)) of the Order;

1.30 it is outside the Republic of France or, if it is located in the Republic of France, it is a (i) provider of investment services relating to portfolio management for the account of third parties ("*personnes fournissant le service d'investissement de gestion de portefeuille pour compte de tiers*"), and/or (ii) qualified investor acting for its own account (*Investisseur Qualifié*) other than an individual, (as defined in and in accordance with article L. 411-1, L.411-2, D.411-1 to D.411-3 of the French *Code Monétaire et Financier*);

1.31 it is not resident or located in the Kingdom of Belgium or, if it is located or resident in the Kingdom of Belgium, it is a "qualified investor" within the meaning of Article 6, paragraph 3 of the Public Takeover Law and Article 10 of the Prospectus Law, acting on its own account;

1.32 it is outside the European Economic Area or, if it is located in the European Economic Area (but outside the United Kingdom, France and Belgium), either (i) it is a 'qualified investor' as defined in the Prospectus Directive or (ii) it is able to participate in the Liability Management Exercise on the grounds that any other circumstances falling within Article 3(2) of the Prospectus Directive apply; and

1.33 it acknowledges that the Bank, the Group, the Dealer Managers, the Exchange Agent and the relevant Registrar will rely upon the truth and accuracy of the foregoing acknowledgments, agreements, representations, warranties, undertakings and directions.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 6

COMPARISON OF CERTAIN KEY FEATURES OF THE PREFERENCE SHARES, THE FINAL REPAYMENT NOTES AND THE INSTALMENT REPAYMENT NOTES

AND

WORKED EXAMPLES

1. Comparison of Certain Features

The following table compares certain key features of the Preference Shares, the Final Repayment Notes and the Instalment Repayment Notes. This is a summary of certain features only, and Holders are recommended to read the Group Notes Prospectus carefully and take any financial or legal advice which they consider appropriate prior to making a decision with respect to the Offer.

	Preference Shares	**Final Repayment Notes**	**Instalment Repayment Notes**
Issuer	Bank	Group	Group
Guarantors	N/A	The Final Repayment Notes and the Instalment Repayment Notes are guaranteed (on a subordinated basis) by Funeral Services Limited, Somerfield Stores Limited, Co-operative Group Holdings (2011) Limited, Co-operative Group Food Limited, Co-operative Group Healthcare Limited, The Co-operative Pharmacy National Distribution Centre Limited and Rochpion Properties (4) LLP.	
Credit ratings	Not rated	The Final Repayment Notes and the Instalment Repayment Notes are expected to be rated CCC+ by Standard & Poor's Credit Market Services Europe Ltd., a division of The McGraw-Hill Companies Inc. which is established in the European Union and is registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	
Nominal amount	The Preference Shares have a nominal amount of £1 each.	The Final Repayment Notes will have a principal amount of £1 each.	The Instalment Repayment Notes will have a principal amount of £0.12 (12 pence) each.
Dividends / Interest rate	The Preference Shares accrue dividends at a rate of 9.25% per year.	The Final Repayment Notes will accrue interest at a rate of 11% per year.	The Instalment Repayment Notes will not bear interest.
Frequency of payment	Dividends are payable in half-year instalments every six months.	Interest will be payable in yearly instalments every twelve months. Principal will be repaid in one payment on the twelfth anniversary of the issue date.	Payments of principal will be made in yearly instalments every twelve months.

	Preference Shares	Final Repayment Notes	Instalment Repayment Notes
Deferral of Dividend / Interest / Payments	The Bank must not pay dividends in cash if either (i) it has insufficient profits and reserves or (ii) in the judgement of the Directors, payment would breach capital adequacy requirements imposed by the Prudential Regulation Authority. If the Bank does not pay dividends in cash due to the reasons above, then (provided it has sufficient reserves available for capitalisation) it is required to allot additional Preference Shares to each holder in lieu of the cash payment. The number of Preference Shares to be delivered is calculated by multiplying the cash dividend which would otherwise be payable by four-thirds, and rounding the resulting figure down to the nearest £1.	The Group will not have any right or discretion to defer or cancel an interest payment. Accordingly, payments of interest on the Final Repayment Notes will be mandatory, and failure to pay will constitute an event of default under the terms of the Final Repayment Notes.	The Group will not have any right or discretion to defer or cancel any scheduled instalment payment. Accordingly, the amounts of principal of the Instalment Repayment Notes payable each year will be mandatory, and failure to pay will constitute an event of default under the terms of the Instalment Repayment Notes.
Scheduled repayment of principal	The Preference Shares do not have a maturity date. Accordingly, there is no date on which the Bank is required to repay the Preference Shares.	The Final Repayment Notes will mature on the twelfth anniversary of their issue date. At that time, the Group will be required to repay the Final Repayment Notes at par and the Final Repayment Notes will then be cancelled.	The principal amount of the Instalment Repayment Notes will be repaid in twelve equal annual instalments. The final instalment will be payable on the twelfth anniversary of the date of issue of the Instalment Repayment Notes, and the Instalment Repayment Notes will then be cancelled.

	Preference Shares	Final Repayment Notes	Instalment Repayment Notes
Repayment of principal in other circumstances	The terms of the Preference Shares do not give the Bank any right or obligation to repay the Preference Shares.	Holders of the Final Repayment Notes and the Instalment Repayment Notes will, following a change of control of the Group which results in one or more ratings of the Group falling below investment grade, have the option (for a limited period) to require the Group to redeem the Final Repayment Notes and the Instalment Repayment Notes. If 80% or more of the Final Repayment Notes or the Instalment Repayment Notes are redeemed in such circumstances, the Group will have the option to redeem the remaining Final Repayment Notes and/or Instalment Repayment Notes (as applicable). The Group will be entitled to redeem the Final Repayment Notes and the Instalment Repayment Notes in the event of certain changes in tax law which result in more onerous obligations on the Group with respect to the Final Repayment Notes and the Instalment Repayment Notes, respectively.	
Ranking	On a winding up of the Bank, the Preference Shares would rank above the ordinary shares and below any Dated Notes and Perpetual Subordinated Bonds which remain outstanding. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a Preference Share holder may lose some or the entire amount of its investment.	The Final Repayment Notes and Instalment Repayment Notes will rank alongside each other in a winding-up of the Group. The Final Repayment Notes and the Instalment Repayment Notes are subordinated obligations of the Group. On a winding up of the Bank but not of the Group, the Final Repayment Notes and the Instalment Repayment Notes will remain outstanding and will continue to be subordinated obligations of the Group. On a winding up of the Group, the Final Repayment Notes and the Instalment Repayment Notes will rank alongside each other and with other subordinated obligations of the Group. Each guarantor's obligations under the guarantee will rank alongside other subordinated obligations of such guarantor. In the event of insolvency of the Group, a holder of Final Repayment Notes and/or Instalment Repayment Notes may lose some or the entire amount of its investment.	
Manner in which securities can be held	The Preference Shares may currently be held electronically in CREST, Euroclear or Clearstream, Luxembourg or in certificated (physical) form outside those clearing systems.	The Final Repayment Notes and the Instalment Repayment Notes will be available to hold in CREST, Euroclear and Clearstream, Luxembourg and in certificated (physical) form outside those clearing systems.	

2. Worked Examples

The following examples are intended to assist Holders to understand the difference in income they will be eligible to receive if their Preference Shares are exchanged or sold in the Liability Management Exercise. The examples are calculated on the theoretical assumption that the Bank continues to pay dividends on its Preference Shares in cash, (although this may not necessarily be the case under the terms of the Preference Shares).

The examples, in each case, assume the following fact pattern:

- the Holder holds £1,000 in nominal amount of Preference Shares, which he has held since 28 November 2013 (the record date for determining eligibility for Additional Preference Shares) or earlier;
- the Liability Management Exercise settles on 18 December 2013 (if the Liability Management Exercise settles after this date, the Holder will be entitled to receive a slightly higher amount in respect of Accrued Dividends than is shown in the examples below);
- the Holder will be eligible to receive £61 in nominal amount of Additional Preference Shares (in lieu of a cash dividend of £46.25) on 29 November 2013; and
- the Holder holds its Final Repayment Notes or Instalment Repayment Notes for the full term of such securities (i.e. twelve years).

Example 1 – Exchange for <u>Final Repayment Notes</u> on the basis of the <u>Early Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H1**" holds £1,000 in nominal amount of Preference Shares.
  - H1 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
  - The Bank has no obligation to repay the Preference Shares.
- H1's Preference Shares are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H1 will receive:
  - £601 in principal amount of Final Repayment Notes;
  - a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
  - a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H1 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H1 holds £601 in principal amount of Final Repayment Notes:
  - H1 receives annual income on its Final Repayment Notes of £66.11 (£601 x 11%). This income is paid in one annual instalment.
  - On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H1 will receive £601 (excluding interest).

Example 2 – Exchange for <u>Final Repayment Notes</u> on the basis of the <u>Late Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H2**" holds £1,000 in nominal amount of Preference Shares.
  - H2 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
  - The Bank has no obligation to repay the Preference Shares.
- H2's Preference Shares are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H2 will receive:
  - £551 in principal amount of Final Repayment Notes;
  - a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
  - a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H2 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H2 holds £551 in principal amount of Final Repayment Notes:
  - H2 receives annual income on its Final Repayment Notes of £60.61 (£551 x 11%). This income is paid in one annual instalment.
  - On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H2 will receive £551 (excluding interest).

Example 3 – Sale for consideration payable in instalments represented by <u>Instalment Repayment Notes</u> on the basis of the <u>Early Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H3**" holds £1,000 in nominal amount of Preference Shares.
  - H3 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
  - The Bank has no obligation to repay the Preference Shares.
- H3's Preference Shares are sold to the Group and H3 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H3 will receive:
  - £1,110 in principal amount of Instalment Repayment Notes;
  - a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
  - a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H3 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H3 holds £1,110 in principal amount of Instalment Repayment Notes:
  - H3 receives an amount each year of £92.50 (being the repayment of an instalment of principal of its Instalment Repayment Notes).

- ◦ On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £92.50 (being an amount equal to the final instalment of principal).

Example 4 – Sale for consideration payable in instalments represented by <u>Instalment Repayment Notes</u> on the basis of the <u>Late Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H4**" holds £1,000 in nominal amount of Preference Shares.
  - ◦ H4 receives annual income on its Preference Shares of £92.50 (£1,000 x 9.25%). This income is paid in two half-yearly instalments of £46.25.
  - ◦ The Bank has no obligation to repay the Preference Shares.
- H4's Preference Shares are sold to the Group and H4 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H4 will receive:
  - ◦ £1,060 in principal amount of Instalment Repayment Notes;
  - ◦ a cash payment of £4.56 equal to the Accrued Dividends on his Preference Shares since 30 November 2013; and
  - ◦ a cash payment of £46.25 equal to the cash dividend which the Bank would have paid H4 on 29 November 2013 if permitted by the terms of the Preference Shares.
- Following the Liability Management Exercise, H4 holds £1,060 in principal amount of Instalment Repayment Notes:
  - ◦ H4 receives an amount each year of £88.33 (being the repayment of an instalment of principal of its Instalment Repayment Notes).
  - ◦ On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £88.33 (being an amount equal to the final instalment of principal).

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 7

COMPARISON OF CERTAIN KEY FEATURES OF THE 13% BONDS, THE FINAL REPAYMENT NOTES AND THE INSTALMENT REPAYMENT NOTES

AND

WORKED EXAMPLES

1. Comparison of Certain Features

The following table compares certain key features of the 13% Bonds, the Final Repayment Notes and the Instalment Repayment Notes. This is a summary of certain features only, and Holders are recommended to read the Group Notes Prospectus carefully and take any financial or legal advice which they consider appropriate prior to making a decision with respect to the Offer.

	13% Bonds	**Final Repayment Notes**	**Instalment Repayment Notes**
Issuer	Bank	Group	Group
Guarantors	N/A	The Final Repayment Notes and the Instalment Repayment Notes are guaranteed (on a subordinated basis) by Funeral Services Limited, Somerfield Stores Limited, Co-operative Group Holdings (2011) Limited, Co-operative Group Food Limited, Co-operative Group Healthcare Limited, The Co-operative Pharmacy National Distribution Centre Limited and Rochpion Properties (4) LLP.	
Credit ratings	The 13% Bonds are currently rated Ca by Moody's Investors Service Limited and CC by Fitch Ratings Limited, which are in each case established in the European Union and registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	The Final Repayment Notes and the Instalment Repayment Notes are expected to be rated CCC+ by Standard & Poor's Credit Market Services Europe Ltd., a division of The McGraw-Hill Companies Inc. which is established in the European Union and is registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	
Nominal amount	The 13% Bonds have a principal amount of £1,000 each.	The Final Repayment Notes will have a principal amount of £1 each.	The Instalment Repayment Notes will have a principal amount of £0.12 (12 pence) each.

	13% Bonds	Final Repayment Notes	Instalment Repayment Notes
Interest rate	The 13% Bonds accrue interest at a rate of 13% per year.	The Final Repayment Notes will accrue interest at a rate of 11% per year.	The Instalment Repayment Notes will not bear interest.
Frequency of payment	Interest is payable in half-yearly instalments every six months.	Interest will be payable in yearly instalments every twelve months. Principal will be repaid in one payment on the twelfth anniversary of the issue date.	Payments of principal will be made in yearly instalments every twelve months.
Deferral of Interest / Payments	The Bank currently may elect to defer any interest payment. The Bank may (subject to regulatory consent) pay deferred interest at any time, and in any event all deferred interest will become payable upon any redemption or purchase of 13% Bonds or in the event of a winding up of the Bank. Whilst any deferred interest remains unpaid, the Bank is not permitted to make discretionary payments on instruments which rank alongside, or junior to, the 13% Bonds (but is able to make mandatory payments on such instruments).	The Group will not have any right or discretion to defer or cancel an interest payment. Accordingly, payments of interest on the Final Repayment Notes will be mandatory, and failure to pay will constitute an event of default under the terms of the Final Repayment Notes.	The Group will not have any right or discretion to defer or cancel any scheduled instalment payment. Accordingly, the amounts of instalments of principal of the Instalment Repayment Notes payable each year will be mandatory, and failure to pay will constitute an event of default under the terms of the Instalment Repayment Notes.
Scheduled repayment of principal	The 13% Bonds do not have a maturity date. Accordingly, there is no date on which the Bank is required to repay the 13% Bonds.	The Final Repayment Notes will mature on the twelfth anniversary of their issue date. At that time, the Group will be required to repay the Final Repayment Notes at par and the Final Repayment Notes will then be cancelled.	The principal amount of the Instalment Repayment Notes will be repaid in twelve annual instalments. The final instalment will be payable on the twelfth anniversary of the date of issue of the Instalment Repayment Notes, and the Instalment Repayment Notes will then be cancelled.

	13% Bonds	Final Repayment Notes	Instalment Repayment Notes
Repayment of principal in other circumstances	The Bank may (subject to obtaining PRA consent) repay and cancel the 13% Bonds if, due to a change in law or regulation, it becomes subject to certain more onerous tax obligations.	Holders of the Final Repayment Notes and the Instalment Repayment Notes will, following a change of control of the Group which results in one or more ratings of the Group falling below investment grade, have the option (for a limited period) to require the Group to redeem the Final Repayment Notes and the Instalment Repayment Notes. If 80% or more of the Final Repayment Notes or the Instalment Repayment Notes are redeemed in such circumstances, the Group will have the option to redeem the remaining Final Repayment Notes and/or Instalment Repayment Notes (as applicable). The Group will be entitled to redeem the Final Repayment Notes and the Instalment Repayment Notes in the event of certain changes in tax law which result in more onerous obligations on the Group with respect to the Final Repayment Notes and the Instalment Repayment Notes, respectively.	
Ranking	On a winding up of the Bank, the 13% Bonds would rank above the Preference Shares and ordinary shares of the Bank and below the Dated Notes. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a 13% Bonds holder may lose some or the entire amount of its investment.	The Final Repayment Notes and Instalment Repayment Notes will rank alongside each other in a winding-up of the Group. The Final Repayment Notes and the Instalment Repayment Notes are subordinated obligations of the Group. On a winding up of the Bank but not of the Group, the Final Repayment Notes and the Instalment Repayment Notes will remain outstanding and will continue to be subordinated obligations of the Group. On a winding up of the Group, the Final Repayment Notes and the Instalment Repayment Notes will rank alongside each other and with other subordinated obligations of the Group. Each guarantor's obligations under the guarantee will rank alongside other subordinated obligations of such guarantor. In the event of insolvency of the Group, a holder of Final Repayment Notes and/or Instalment Repayment Notes may lose some or the entire amount of its investment.	
Manner in which securities can be held	The 13% Bonds may currently be held electronically in CREST, Euroclear or Clearstream, Luxembourg or in certificated (physical) form outside those clearing systems.	The Final Repayment Notes and the Instalment Repayment Notes will be available to hold in CREST, Euroclear and Clearstream, Luxembourg and in certificated (physical) form outside those clearing systems.	

2. Worked Examples

The following examples are intended to assist Holders to understand the difference in income they will be eligible to receive if their 13% Bonds are exchanged or sold in the Liability Management Exercise. The examples are calculated on the theoretical assumption that the Bank continues to pay (and not defer) interest on its 13% Bonds, (although this may not necessarily be the case under the terms of the 13% Bonds).

The examples, in each case, assume the following fact pattern:

- the Holder holds, and offers for exchange or sale, £1,000 in nominal amount of 13% Bonds;
- the Liability Management Exercise settles on 18 December 2013 (if the Liability Management Exercise settles after this date, the Holder will be entitled to receive a slightly higher amount in respect of Accrued Interest than is shown in the examples below); and
- the Holder holds its Final Repayment Notes or Instalment Repayment Notes for the full term of such securities (i.e. twelve years).

Example 1 – Exchange for <u>Final Repayment Notes</u> on the basis of the <u>Early Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H1**" holds £1,000 in nominal amount of 13% Bonds.
    - ◦ H1 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
    - ◦ The Bank has no obligation to repay the 13% Bonds.
- H1's 13% Bonds are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H1 will receive:
    - ◦ £844 in principal amount of Final Repayment Notes;
    - ◦ a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
    - ◦ a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.
- Following the Liability Management Exercise, H1 holds £844 in principal amount of Final Repayment Notes:
    - ◦ H1 receives annual income on its Final Repayment Notes of £92.84 (£844 x 11%). This income is paid in one annual instalment.
    - ◦ On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H1 will receive £844 (excluding interest).

Example 2 – Exchange for <u>Final Repayment Notes</u> on the basis of the <u>Late Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H2**" holds £1,000 in nominal amount of 13% Bonds.
    - ◦ H2 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
    - ◦ The Bank has no obligation to repay the 13% Bonds.
- H2's 13% Bonds are exchanged for Final Repayment Notes. Upon settlement of the Liability Management Exercise, H2 will receive:

- ◦ £794 in principal amount of Final Repayment Notes;
  - ◦ a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
  - ◦ a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.

- Following the Liability Management Exercise, H2 holds £794 in principal amount of Final Repayment Notes:
  - ◦ H2 receives annual income on its Final Repayment Notes of £87.34 (£794 x 11%). This income is paid in one annual instalment.
  - ◦ On the twelfth anniversary of the issue date of the Final Repayment Notes, the Group will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Final Repayment Notes at par, and H2 will receive £794 (excluding interest).

Example 3 – Sale for consideration payable in instalments represented by <u>Instalment Repayment Notes</u> on the basis of the <u>Early Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H3**" holds £1,000 in nominal amount of 13% Bonds.
  - ◦ H3 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
  - ◦ The Bank has no obligation to repay the 13% Bonds.
- H3's 13% Bonds are sold to the Group and H3 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H3 will receive:
  - ◦ £1,560 in principal amount of Instalment Repayment Notes;
  - ◦ a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
  - ◦ a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.
- Following the Liability Management Exercise, H3 holds £1,560 in principal amount of Instalment Repayment Notes:
  - ◦ H3 receives an amount each year of £130 (being the repayment of an instalment of principal of its Instalment Repayment Notes).
  - ◦ On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £130 (being an amount equal to the final instalment of principal).

Example 4 – Sale for consideration payable in instalments represented by <u>Instalment Repayment Notes on the basis of the Late Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H4**" holds £1,000 in nominal amount of 13% Bonds.
  - ◦ H4 receives annual income on its 13% Bonds of £130 (£1,000 x 13%). This income is paid in two half-yearly instalments of £65.
  - ◦ The Bank has no obligation to repay the 13% Bonds.

- H4's 13% Bonds are sold to the Group and H4 receives Instalment Repayment Notes. Upon settlement of the Liability Management Exercise, H4 will receive:
  - £1,510 in principal amount of Instalment Repayment Notes;
  - a cash payment of £49.46 equal to the Accrued Interest on his 13% Bonds since 31 July 2013; and
  - a cash payment of £65 equal to the deferred interest payment on his 13% Bonds originally scheduled for 31 July 2013.
- Following the Liability Management Exercise, H4 holds £1,510 in principal amount of Instalment Repayment Notes:
  - H4 receives an amount each year of £125.83 (being the repayment of an instalment of principal of its Instalment Repayment Notes).
  - On the twelfth anniversary of the issue date of the Instalment Repayment Notes, the Group will (provided it remains solvent), make a final payment of £125.83 (being an amount equal to the final instalment of principal).

SECTION C: PREFERENCE SHARES
AND PERPETUAL SUBORDINATED BONDS

PART 8

COMPARISON OF CERTAIN KEY FEATURES OF THE 5.5555% BONDS AND THE BANK T2 NOTES

AND

WORKED EXAMPLES

1. Comparison of Certain Features

The following table compares certain key features of the 5.5555% Bonds and the Bank T2 Notes. This is a summary of certain features only, and Holders are recommended to read the Bank T2 Prospectus carefully and take any financial or legal advice which they consider appropriate prior to making a decision with respect to the Offer.

	5.5555% Bonds	**Bank T2 Notes**
Issuer	Bank	Bank.
Guarantors	None.	None.
Credit ratings	The 5.5555% Bonds are currently rated Ca by Moody's Investors Service Limited and CC by Fitch Ratings Limited, which are in each case established in the European Union and registered under Regulation (EC) No 1060/2009 (as amended) (the CRA Regulation). *A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.*	The Bank T2 Notes will not be rated upon issue.
Principal amount	The 5.5555% Bonds have a principal amount of £1,000 each.	The Bank T2 Notes will have a principal amount of £10 each.
Dividends / Interest rate	The 5.5555% Bonds accrue interest at a fixed rate of 5.5555% per year up to 14 December 2015, and thereafter at a floating rate of interest equal to 3-month LIBOR plus 2.05 per cent.	The Bank T2 Notes will accrue interest at a rate of 11% per year.
Frequency of payment	Interest is payable in half-yearly instalments every six months up to (and including) 14 December 2015, and thereafter in quarterly instalments every three months.	Interest will be payable in quarterly instalments every three months.

	5.5555% Bonds	Bank T2 Notes
Deferral of interest	The Bank currently may elect to defer any interest payment. The Bank currently expects that, if it does not redeem the 5.5555% Bonds on the interest payment date scheduled for 14 December 2015, the 5.5555% Bonds may cease to qualify as regulatory capital from that date. If the 5.5555% Bonds cease to qualify as regulatory capital, the Bank will lose its option to defer interest payments. The Bank may (subject to regulatory consent) pay deferred interest at any time, and in any event all deferred interest will become payable upon any redemption or purchase of 5.5555% Bonds or in the event of a winding up of the Bank. Whilst any deferred interest remains unpaid, the Bank is not permitted to make discretionary payments on instruments which rank alongside, or junior to, the 5.5555% Bonds (but is able to make mandatory payments on such instruments).	The Bank will not have any right or discretion to defer or cancel an interest payment. Accordingly, payments of interest on the Bank T2 Notes will be mandatory, and failure to pay will constitute an event of default under the terms of the Bank T2 Notes.
Repayment of principal at maturity	The 5.5555% Bonds do not have a maturity date. Accordingly, there is no date on which the Bank is required to repay the 5.5555% Bonds.	The Bank T2 Notes will mature on the tenth anniversary of their issue date. At that time, the Bank will be required to repay the Bank T2 Notes at par (i.e. their face amount) and the Bank T2 Notes will then be cancelled.
Repayment of principal in other circumstances	The Bank may (subject to obtaining PRA consent) repay and cancel the 5.5555% Bonds at its option on 14 December 2015 or any quarterly interest payment date thereafter. In addition, the Bank may (subject to obtaining PRA consent) repay and cancel the 5.5555% Bonds if, due to a change in law or regulation, it becomes subject to certain more onerous tax obligations.	The Bank may (subject to obtaining PRA consent) repay and cancel the Bank T2 Notes early at 101% of their face amount if, due to a change in law or regulation after the issue date, it becomes subject to certain more onerous tax obligations or all of the Bank T2 Notes cease to be eligible for recognition as regulatory capital of the Bank (and such changes must not have been foreseeable at the time of issue).

	5.5555% Bonds	Bank T2 Notes
Ranking	On a winding up of the Bank, the 5.5555% Bonds would rank above the Preference Shares and ordinary shares of the Bank and below the Dated Notes. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a 5.5555% Bonds holder may lose some or the entire amount of its investment.	On a winding up of the Bank, the Bank T2 Notes would rank above the 5.5555% Bonds (had they remained outstanding) and below depositors and other senior creditors of the Bank. In the event of insolvency of the Bank, or if the UK authorities were to consider the Bank to be in severe financial difficulty and take action under UK law to resolve the Bank, a Bank T2 Notes holder may lose some or the entire amount of its investment.
Manner in which securities can be held	The 5.5555% Bonds may currently be held electronically in CREST, Euroclear or Clearstream, Luxembourg or in certificated (physical) form outside those clearing systems.	The Bank T2 Notes will be available to hold in CREST, Euroclear and Clearstream, Luxembourg and in certificated (physical) form outside those clearing systems.

2. Worked Examples

The following examples are intended to assist Holders to understand the difference in income they will be eligible to receive if their 5.5555% Bonds are exchanged in the Liability Management Exercise. The examples are calculated on the theoretical assumption that the Bank continues to pay (rather than defer) interest on its 5.5555% Bonds, (although that may not necessarily be the case under the terms of the 5.5555% Bonds).

The examples, in each case, assume the following fact pattern:

- the Holder holds, and offers to exchange, £1,000 in nominal amount of 5.5555% Bonds;
- the Liability Management Exercise settles on 18 December 2013 (if the Liability Management Exercise settles after this date, the Holder will be entitled to receive a slightly higher amount in respect of Accrued Interest than is shown in the examples below); and
- the Holder holds its Bank T2 Notes for the full term of such securities (i.e. ten years).

Example 1 – 5.5555% Bonds exchanged on the basis of the <u>Early Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H1**" holds £1,000 in nominal amount of 5.5555% Bonds.
    - H1 receives annual income on its 5.5555% Bonds of £55.54 (£1,000 x 5.5555%, adjusted for semi-annual rounding). This income is paid in two half-yearly instalments of £27.77.
    - The Bank has no obligation to repay the 5.5555% Bonds.
- H1's 5.5555% Bonds are exchanged for Bank T2 Notes. Upon settlement of the Liability Management Exercise, H1 will receive:
    - £530 in principal amount of Bank T2 Notes;
    - a cash payment of £0.61 equal to the Accrued Interest on his 5.5555% Bonds since 14 December 2013; and
    - a cash payment of £27.77 equal to the deferred interest payment on his 5.5555% Bonds originally scheduled for 14 December 2013.
- Following the Liability Management Exercise, H1 holds £530 in principal amount of Bank T2 Notes.
    - H1 receives annual income on its Bank T2 Notes of £58.28 (£530 x 11%, adjusted for quarterly rounding). This income is paid in four instalments of £14.57 every three months.
    - On the tenth anniversary of the issue date of the Bank T2 Notes, the Bank will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Bank T2 Notes at par, and H1 will receive £530 (excluding interest).

Example 2 – 5.5555% Bonds exchanged on the basis of the <u>Late Consideration Amount</u>

- Before the Liability Management Exercise, Holder "**H2**" holds £1,000 in nominal amount of 5.5555% Bonds.
    - H2 receives annual income on its 5.5555% Bonds of £55.54 (£1,000 x 5.5555%, adjusted for semi-annual rounding). This income is paid in two half-yearly instalments of £27.77.
    - The Bank has no obligation to repay the 5.5555% Bonds.
- H2's 5.5555% Bonds are exchanged for Bank T2 Notes. Upon settlement of the Liability Management Exercise, H2 will receive:
    - £480 in principal amount of Bank T2 Notes;

- a cash payment of £0.61 equal to the Accrued Interest on his 5.5555% Bonds since 14 December 2013; and
- a cash payment of £27.77 equal to the deferred interest payment on his 5.5555% Bonds originally scheduled for 14 December 2013.

- Following the Liability Management Exercise, H2 holds £480 in principal amount of Bank T2 Notes.
  - H2 receives annual income on its Bank T2 Notes of £52.80 (£480 x 11%, adjusted for quarterly rounding). This income is paid in four instalments of £13.20 every three months.
  - On the tenth anniversary of the issue date of the Bank T2 Notes, the Bank will (provided it remains solvent), in addition to the final interest payment then due, repay the principal amount of the Bank T2 Notes at par, and H2 will receive £480 (excluding interest).

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 9

FORM OF NOTICE CONVENING THE MEETING IN RESPECT OF THE PREFERENCE SHARES

THIS NOTICE IS IMPORTANT AND REQUIRES THE IMMEDIATE ATTENTION OF HOLDERS. IF HOLDERS ARE IN ANY DOUBT AS TO THE ACTION THEY SHOULD TAKE, THEY SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISERS AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 IMMEDIATELY.

THE CO-OPERATIVE BANK p.l.c.

(incorporated in England and Wales with registered number 990937)

(the "**Bank**")

NOTICE OF A MEETING

of the holders of those of the

£75,000,000
9.25 PER CENT. NON-CUMULATIVE IRREDEEMABLE PREFERENCE SHARES OF £1 EACH
(ISIN: GB0002224516)

of the Bank presently outstanding
(the "**Holders**" and the "**Preference Shares**" respectively).

As at the date of this notice, £60,000,000 of the Preference Shares are presently outstanding.

NOTICE IS HEREBY GIVEN that a Meeting of the Holders convened by the Bank will be held at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT on Wednesday, 11 December, 2013 at 1.00 p.m. (London time) for the purpose of considering and, if thought fit, passing the following resolution (the "**Resolution**") which will be proposed as an Extraordinary Resolution in accordance with the provisions of the Bank's Articles of Association (the "**Articles of Association**") (the "**Proposal**").

EXTRAORDINARY RESOLUTION

"THAT this Meeting of the holders (the "**Holders**" or "**holders**") of those of the £75,000,000 9.25 per cent. Non-Cumulative Irredeemable Preference Shares of £1 each of The Co-operative Bank p.l.c. presently outstanding (the "**Preference Shares**" and the "**Bank**" respectively) issued under the Articles of Association of the Bank (the "**Articles of Association**") hereby:

1. assents to and sanctions the modification of the terms of the Preference Shares (as currently set out in Article 4.(B) of the Articles of Association) to the following extent:

   Notwithstanding Article 4.(B)(d) or any other provision of the Articles of Association of the Bank, the Bank may, at its option and without the need for the consent or approval of the holders of the Preference Shares, purchase (or repurchase) and cancel any share capital of the Bank from time to time, in any manner and at any price, and any such purchase (or repurchase) and cancellation shall not be treated as a modification or variation of the rights of the holders of the Preference Share within the meaning of Article 4.(B)(d).

2. assents to and sanctions the modification of the terms of the Preference Shares (as currently set out in Article 4.(B) of the Articles of Association) conferring on the Bank a mandatory exchange option on the following terms:

(1) The Bank may, upon giving not less than one day's prior notice to the holders of the Preference Shares in accordance with paragraph (8) below, at its option and without the consent or approval of the holders of the Preference Shares, require and effect the mandatory transfer of the legal and beneficial title to, and all interests in, all outstanding Preference Shares (other than Excluded Preference Shares) to Co-operative Group, on the terms set out in the following paragraphs (2) to (10) (the "**Mandatory Exchange Option**").

(2) The mandatory transfer of a holder's Preference Shares (other than Excluded Preference Shares and Additional Preference Shares) to Co-operative Group will be effected (having regard to paragraphs (3) and (4) below) on the date specified in the notice referred to in paragraph (1) above (the "**Settlement Date**") either:

(a) by way of exchange of such holder's Preference Shares for a principal amount of Final Repayment Notes equal to the principal amount of Final Repayment Notes which such holder would have received had those Preference Shares been exchanged for Final Repayment Notes in the Exchange Offer (on the same terms as those on which Preference Shares are exchanged for Final Repayment Notes in the Exchange Offer); or

(b) by way of sale of such holder's Preference Shares to Co-operative Group in consideration for a cash consideration which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by a principal amount of Instalment Repayment Notes equal to the principal amount of Instalment Repayment Notes which such holder would have received had those Preference Shares been sold to Co-operative Group in the Exchange Offer (on the same terms as those on which Preference Shares are sold to Co-operative Group in the Exchange Offer).

(3) Where any such holder of Preference Shares (other than Excluded Preference Shares and Additional Preference Shares) has, in accordance with the procedures of the Liability Management Exercise, validly elected which Group Notes it would prefer to receive upon the transfer of its Preference Shares to Co-operative Group, such holder shall be entitled to receive such Group Notes.

(4) Where a holder of Preference Shares (other than Excluded Preference Shares and Additional Preference Shares) has not validly elected (in accordance with the procedures provided under the Liability Management Exercise) which Group Notes it would prefer to receive upon the transfer of Preference Shares to Co-operative Group, then (i) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the aggregate nominal amount of Preference Shares which are the subject of elections to receive Instalment Repayment Notes is greater than the aggregate nominal amount of Preference Shares which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

(5) The mandatory exchange of the Additional Preference Shares will be effected on the Settlement Date by:

(a) the mandatory transfer to Co-operative Group of such Additional Preference Shares; and

(b) the payment by or on behalf of the Bank to the holders of a cash amount (in pounds sterling) equal to the cash dividend which the Bank would have paid on or around 30 November 2013 had it been able to do so under the terms of the Preference Shares.

(6) In addition, holders of the Preference Shares which are transferred to Co-operative Group pursuant to the Mandatory Exchange Option will be entitled to receive a cash amount equal to the accrued dividends on their Preference Shares (other than Additional Preference Shares) for the period from (and including) 30 November 2013 to (but excluding) the Settlement Date (calculated on the assumption that dividends accrue from day-to-day on a non-compounding basis).

(7) The Bank shall procure the issue of the Group Notes by Co-operative Group on the Settlement Date.

(8) Notwithstanding any other provision of the Bank's Articles of Association as regards the giving of notices, the notice referred to in paragraph (1) above shall be validly given upon the publication of such notice on the Regulatory News Service (RNS) operated by the London Stock Exchange plc, and shall be deemed to have been given on the date of such publication. The Bank will, in addition, procure that the notice be mailed to the holders of Preference Shares at their respective addresses in the register maintained by the Bank (or by a registrar on its behalf) in respect of the Preference Shares.

(9) The Mandatory Exchange Option, including the provisions of these paragraphs (1) to (10), shall apply notwithstanding any other provision of the Articles of Association. In the event of any inconsistency between the provisions of these paragraphs (1) to (10) and any other provision of the Articles of Association, the provisions of these paragraphs (1) to (10) shall prevail.

(10) For the purposes of the Mandatory Exchange Option:

"**Additional Preference Shares**" means any additional Preference Shares (other than Additional Preference Shares which are also Excluded Preference Shares) which were (or are deemed to have been) allotted on or around 29 November 2013 in lieu of a cash dividend scheduled for 30 November 2013 (and for these purposes, 6⅛ per cent. of the aggregate nominal amount of the Preference Shares (excluding Excluded Preference Shares) outstanding will be deemed to have been so allotted and to so constitute such amount of Additional Preference Shares);

"**Co-operative Group**" means Co-operative Group Limited;

"**Exchange Offer**" means the invitation to holders of Preference Shares to offer to exchange or sell their Preference Shares in the Liability Management Exercise;

"**Excluded Preference Shares**" means those Preference Shares and Additional Preference Shares which are being exchanged or sold pursuant to the Exchange Offer on or around the Settlement Date;

"**Final Repayment Notes**" means sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries;

"**Group Notes**" means the Final Repayment Notes and the Instalment Repayment Notes;

"**Instalment Repayment Notes**" means sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) having their last payment date in 2025, to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; and

"**Liability Management Exercise**" means the liability management exercise (in respect of, amongst other securities, the Preference Shares) described in the announcement made by the Bank and/or Co-operative Group on or around 4 November 2013;

3. assents to and sanctions, to the fullest extent permitted by law and under the Articles of Association, in respect of all holders of Preference Shares:

   (a) the release, to the fullest extent permitted by law, of all Relevant Persons (as defined below) and each of them from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise or any part thereof;

   (b) the waiver, to the fullest extent permitted by law, of all rights and entitlement that the holders or any of them may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Relevant Persons or any of them in connection with the Liability Management Exercise and/or their Preference Shares;

   (c) (following the transfer of the holders' Preference Shares to Co-operative Group and upon delivery of the relevant Group Notes to such holders in accordance with the terms of the Liability Management Exercise) the waiver, to the fullest extent permitted by law, of all the rights, title and interest of the holders to and claims in respect of such Preference Shares; and

   (d) the modification, abrogation, compromise or arrangement in respect of the rights of all holders necessary to give effect to the foregoing provisions of this paragraph 3.

   provided, however, that nothing in this paragraph 3 shall constitute a release of the Bank or Co-operative Group from, or a waiver of the rights and entitlements of Holders in respect of, their respective obligations or liabilities in their capacity as persons responsible for the respective prospectuses published by them in connection with the Liability Management Exercise.

   For these purposes, "**Relevant Persons**" means each of the Bank, Co-operative Group, Co-operative Banking Group Limited, HSBC Bank plc and UBS Limited (in their capacity as dealer managers in connection with the Liability Management Exercise), Lucid Issuer Services Limited (in its capacity as exchange agent in connection with the Liability Management Exercise), the Registrar (as defined below) and, in each case, their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives);

4. sanctions every abrogation, modification, compromise or arrangement in respect of the rights of the holders appertaining to the Preference Shares against the Bank, whether or not such rights arise under the Articles of Association, involved in or resulting from or to be effected by, the modifications and other arrangements referred to in paragraphs 1, 2 and 3 of this Resolution and their implementation;

5. authorises, empowers and directs the Bank and the registrar in respect of the Preference Shares (the "**Registrar**") (i) to execute, including on behalf of the holders of the Preference Shares, all such deeds, instruments, forms of transfer and other documents of any nature, (ii) to make any such entries in the register maintained in respect of the Preference Shares and (iii) to do any and all acts and things, which in each case may be necessary or appropriate to carry out and give effect to (A) this Resolution, (B) the implementation of the modifications and other arrangements referred to in paragraphs 1, 2 and 3 of this Resolution and/or (C) the Mandatory Exchange Option referred to above;

6. discharges and exonerates the Bank and the Registrar from all liability for which it may have become or may become responsible with respect to the Preference Shares in respect of any act or omission in connection with the modifications and other arrangements referred to in paragraphs 1, 2 and 3 of this Resolution, their implementation, or this Resolution or the giving effect to the Mandatory Exchange Option referred to above; and

7. agrees that if any paragraph of this Resolution is or becomes illegal, invalid or unenforceable that will not affect the legality, validity or enforceability of any other paragraph of this Resolution and accordingly the remainder of this Resolution shall be effective."

The Directors of the Bank have no interests in the Preference Shares described in this Notice.

Set out below are the market values (as a percentage of their nominal amount) of the Preference Shares on or around the first dealing day in each of the six months prior to the date of this Notice (and 21 October 2013, which is the latest date for which information was available prior to publication of this Notice):

Date	**Market Value* (%)**
3 June 2013	62.000
1 July 2013	52.000
1 August 2013	50.250
2 September 2013	44.500
1 October 2013	43.250
21 October 2013	49.750

* Source: Bloomberg (composite prices where available; otherwise, prices sourced to the extent available)

Background to the Proposal

The Proposal forms part of a wider liability management exercise (the "**Liability Management Exercise**") being conducted by the Bank as part of its capital actions plan, originally announced by the Bank on 17 June 2013, to raise £1.5 billion of common equity tier 1 capital.

As part of the Liability Management Exercise, holders of the Preference Shares are being invited to offer to exchange or sell their Preference Shares to Co-operative Group and receive new Group Notes (as defined in the Resolution) to be issued by Co-operative Group (the "**Exchange Offer**"). Detailed information regarding the Liability Management Exercise (including the Exchange Offer), Co-operative Group and the Group Notes is contained in a prospectus dated 4 November 2013 published by Co-operative Group in connection with the Liability Management Exercise and the offer and issue of the Group Notes (the "**Prospectus**"). The Prospectus can be accessed via the Regulatory News Service (RNS) operated by the London Stock Exchange plc, which can be accessed at the following web link: *www.lseg.com/areas-expertise/market-information/regulatory-news-service*; and at: *http://www.co-operative.coop/bondholders*. Holders who are unable to access the Prospectus at that web link should contact the Registrar at the details below.

Holders are urged to read the Prospectus carefully. Holders should note that a Holder who offers to exchange or sell its Preference Shares in the Exchange Offer will also appoint a proxy to vote in favour of the Resolution. If the Resolution is passed and implemented, the Bank will have the right to effect the mandatory transfer of any Preference Shares (which are not exchanged or sold in the Exchange Offer) to Co-operative Group on the same economic terms as those upon which Preference Shares are exchanged or sold (as the case may be) in the Exchange Offer.

Other important information

The attention of Holders is drawn to the quorum required for the Meeting and for an adjourned Meeting which is set out in paragraph 2 of "*Voting and Quorum*" below.

Copies of the current Articles of Association of the Bank and of certain other relevant documents will be available for inspection by Holders at the specified offices of the Registrar set out below.

Any Holders who are in any doubt as to the impact of the implementation of the Proposal are urged to seek their own financial, legal and other advice as they consider appropriate.

Holders who wish to make arrangements to attend (in person or by proxy) and vote at the Meeting may do so in any manner provided for in the Articles of Association and described below under "*Voting and Quorum*". However, Holders who are eligible and wish to participate in the Exchange Offer should make arrangements to participate in the Exchange Offer in the manner specified in the Prospectus, rather than making arrangements as described below.

VOTING AND QUORUM

1. The provisions governing the convening and holding of a Meeting are set out in the Articles of Association, a copy of which is available for inspection by the Holders during normal business hours at the specified office of the Registrar set out below.

Terms used herein but not defined have the meaning given to them in the Consent and Exchange Offer Memorandum (the "**CEOM**") scheduled to the Prospectus.

IMPORTANT: The Preference Shares are either in certificated form or uncertificated form in CREST. A registered holding of Preference Shares in certificated form will be represented by a certificate (each a "**Holder Certificate**"). The only Holders for the purposes of Preference Shares held through CREST, Euroclear or Clearstream, Luxembourg (each a "**Clearing System**") are CREST Participants appearing on the register of shares (each such participant, together with each other registered holder of the Preference Shares appearing on such register, a "**Registered Holder**"). Each person (a "**Beneficial Owner**") who is the owner of a particular nominal amount of the Preference Shares through a Clearing System or its respective Direct Participant (in the case of Euroclear or Clearstream, Luxembourg) should note that such person is not considered to be a Holder for the purposes of Preference Shares and will only be entitled to attend and vote at the Meeting or to appoint a proxy to do so in accordance with the procedures set out below.

Any reference herein to a Beneficial Owner sending voting instructions to the relevant CREST participant or arranging for a Corporate Letter of Representation to be issued to it by the relevant CREST Participant (together the "**Corporate Actions**") shall mean:

(i) where the Beneficial Owner holds through a broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in CREST, procuring that such party carries out such Corporate Actions on its behalf; and

(ii) where the Beneficial Owner holds through a Direct Participant or other broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in Euroclear or Clearstream, Luxembourg, procuring that such Direct Participant or other party carries out such Corporation Actions (by issuing instructions in a form acceptable to such clearing Systems) through such Clearing Systems and before any deadlines specified by such Clearing Systems.

Where Corporate Actions are provided by a Direct Participant on behalf of a Beneficial Owner, the Preference Shares held by that Beneficial Owner shall be blocked in accordance with the usual procedures of Euroclear and Clearstream, Luxembourg which, in the case of instructions to vote in favour of the Resolution as provided in 1.2.1 below, will result in the underlying Preference Shares being transferred to escrow in CREST pursuant to a corresponding TTE Instruction.

1.1 Preference Shares in certificated form

A Registered Holder wishing to attend and vote at the relevant Meeting in person must produce at such Meeting either, in the case of an individual holder, a Holder Certificate or, in the case of a corporate holder, a certificate evidencing such corporate holder's entitlement to the Preference Shares and a duly approved resolution of the directors or other governing body of such corporation authorising such person to act as the corporation's representative (a "**representative**") at the relevant Meeting together, in each case, with satisfactory evidence of identity.

A Registered Holder not wishing to attend and vote at the relevant Meeting in person may by instrument in writing in the English language (a "**form of proxy**") in the form available from the Registrar, signed by the Registered Holder or, in the case of a corporation, executed under its common seal or signed on its behalf by an attorney or a duly authorised officer of the corporation and delivered to the specified office of the Registrar not less than 48 hours before the time fixed for the meeting, appoint any person (a "**proxy**") to act on his or its behalf in connection with the Meeting (or any adjourned such Meeting). A proxy need not be a member of the Bank.

A proxy or representative so appointed shall so long as such appointment remains in force be deemed, for all purposes in connection with the Meeting (or any adjourned such Meeting) to be the holder of the Preference Shares to which such appointment relates and the holder of the Preference Shares shall be deemed for such purposes not to be the holder.

The CREST electronic proxy appointment service is not available for this event. CREST members should carefully read the relevant sections of the consent and exchange offer memorandum which is appended to, and forms part of, the Prospectus for relevant voting procedures.

1.2 **Preference Shares in uncertificated form in CREST**

Each CREST Participant that is a Registered Holder should, if it is not the Beneficial Owner of the Preference Shares, seek instructions from the Beneficial Owner(s) in accordance with its usual procedures. A CREST sponsored member wishing to vote in favour of the Resolution or revoke any such vote should instruct its CREST sponsor to issue a TTE Instruction to the Registrar (or if a revocation, an ESA Instruction) with the details set out below.

Each CREST Participant that is a Registered Holder, if it is the beneficial owner of the Preference Shares, can vote in favour of the Resolution by issuing a TTE Instruction with the details set out in paragraph 1.2.1, revoke by issuing an ESA Instruction with the details set out in paragraph 1.2.2, vote against the Resolution by filling out the paper voting instruction referred to in paragraph 1.2.3, and attend the Meeting by bringing a Corporate Letter of Representation containing the details referred to in paragraph 1.2.4.

1.2.1 A Beneficial Owner wishing to vote IN FAVOUR of the Resolution must send the voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a TTE Instruction and making an election as to which Group Notes it would like to receive by specifying which of the six options set out below is applicable. Any voting instruction must be received by the CREST Participant (i) in the case of an instruction under OPT0001A or OPT0001B below, prior to 4.30 p.m. (London time) on 6 December 2013, or (ii) in the case of an instruction under OPT0002A, OPT0002B, OPT0002C or OPT0002D below, not less than 48 hours before the time of the meeting (the "**Voting Deadline**"). **However Beneficial Owners are strongly encouraged to ensure that their CREST Participant submits all instructions by 4.30 p.m. (London time) on 29 November 2013**, since the terms of the Liability Management Exercise are more favourable for holders of Preference Shares if certain levels of participation in the Liability Management Exercise are achieved by this earlier deadline. A TTE Instruction must comply with the paragraph below.

Each TTE Instruction should specify Computershare (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the Preference Shares should be transferred. A TTE Instruction will not be valid unless and until it has settled and Computershare will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the principal amount of Preference Shares to be transferred to an escrow balance;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the CREST Participant wishes to select and in accordance with any voting instructions provided by any Beneficial Owner;

(g) the intended settlement date;

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Computershare relevant to a Holder of Preference Shares are set out in the table below. **A Beneficial Owner should elect the ID which corresponds to such Beneficial Owner's preferred option**:

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your Preference Shares for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings). **NB: electing this Option automatically results in offering to exchange some or all of the Beneficial Owner's Preference Shares for Final Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your Preference Shares to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the Preference Shareholders Meeting and the chairman of the General Meeting as your proxies to vote those Preference Shares IN FAVOUR of the resolutions to be proposed at those meetings). **NB: electing this Option automatically results in offering to sell some or all of the Beneficial Owner's Preference Shares to the Group for cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001B**

Option	CREST Member ID
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002A**
Option 4: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002B**
Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002C**
Option 6: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolutions at the Preference Shareholders Meeting and the General Meeting (without offering to exchange or sell your Preference Shares) by appointing the chairman of each such meeting as your proxy to vote some or all of your Preference Shares in favour of such resolutions **AND** if the Preference Shares Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT0002D**
NB: to vote AGAINST the resolutions proposed at the Preference Shareholders Meeting and the General Meeting, please use the paper voting instruction available from Computershare.	–

Any vote in favour of the resolution pursuant to a TTE Instruction as provided herein will automatically appoint the chairman of the Meeting as the relevant CREST Participant's proxy to vote the Preference Shares referred in such TTE Instruction in such way.

1.2.2 A Beneficial Owner wishing to <u>REVOKE</u> a voting instruction given under 1.2.1 above and the corresponding TTE Instruction may do so at any time prior to the Voting Deadline by sending voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues an ESA Instruction to settle in CREST. Any such ESA Instruction must contain the following details:

(a) the number of Preference Shares to be withdrawn;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number (being GB0002224516);

(e) Computershare's participant ID, being: 3RA13;

(f) the relevant CREST member account ID of Computershare (in its capacity as a CREST receiving agent) from the table set out above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the voting instruction to be withdrawn;

(i) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

Any such revocation of a TTE Instruction will be conditional upon Computershare verifying that the revocation is validly made. Accordingly, Computershare will, on behalf of the Bank, reject or accept the revocation by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

1.2.3 A Beneficial Owner wishing to vote <u>AGAINST</u> the Resolution must send voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a no vote in respect of the nominal amount of Preference Shares the subject of such voting instructions by filling out the paper voting instruction which was provided with this Notice to each Registered Holder. A Beneficial Owner should also specify in its voting instruction whether it elects to receive either Final Repayment Notes or Instalment Repayment Notes if the Preference Shares Mandatory Exchange Option is exercised. Copies of the paper voting instruction are also available from Computershare.

1.2.4 A Beneficial Owner wishing to <u>ATTEND</u> the Meeting must arrange for its CREST Participant to issue a Corporate Letter of Representation to it. Any such Letter of Representation should be on the headed paper of such participant, should detail the person attending and the nominal amount of Preference Shares held by such person, and be signed by the CREST Participant.

2. The quorum required at the Meeting is two or more persons present being proxies or representatives or holding Preference Shares and representing or holding in the aggregate not less than one third in nominal amount of the Preference Shares for the time being outstanding. If a quorum is not present at the Meeting, the Meeting will be adjourned and the Resolution will be considered at an adjourned

Meeting (notice of which will be given to the Holders). The quorum at such an adjourned Meeting will be those persons present being proxies or representatives or holding Preference Shares, whatever the nominal amount of Preference Shares held or represented by them.

Holders should note this quorum requirement and should be aware that if the Holders either present or appropriately represented at the Meeting are insufficient to form a quorum the Resolution, and consequently the Proposal, cannot be formally considered thereat. Holders are therefore encouraged either to attend the Meeting in person or to arrange to be represented at the Meeting as soon as possible.

3. Every question submitted to the Meeting shall be decided in the first instance by a show of hands and in case of equality of votes the chairman of the Meeting shall both on a show of hands and on a poll have a casting vote in addition to the vote or votes (if any) to which he may be entitled as a proxy or as representative or as a Holder.

Unless a poll is (before or on the declaration of the result of the show of hands) demanded by the chairman of the Meeting or by not less than five Holders having the right to vote on the Resolution or by a Holder or Holders representing not less than 10 per cent. of the total voting rights of all the Holders having the right to vote on the Resolution, a declaration by the chairman of the relevant Meeting that a resolution has been carried or carried by a particular majority or lost or not carried by a particular majority, and an entry to that effect in the book containing the minutes of the proceedings of the Meeting shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.

On a show of hands every person who is present and is a proxy or representative or a Holder who produces a Holder Certificate shall have one vote and on a poll every person who is so present shall have one vote in respect of each £1 nominal amount of the Preference Shares in respect of which he is a proxy or representative or in respect of each £1 nominal amount of the Preference Shares represented by the Holder Certificate so produced.

4. To be passed, the Resolution requires a majority in favour consisting of not less than three-quarters of the votes cast. If passed, the Resolution will be binding upon all the Holders, whether or not present at such Meeting and whether or not voting.

REGISTRAR

Computershare Investor Services PLC
The Pavilions
Bridgwater Road
Bristol BS99 6ZZ
United Kingdom

This Notice is given by:

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dated 4 November 2013.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 10

FORM OF NOTICE CONVENING THE MEETING IN RESPECT OF THE 13% BONDS

THIS NOTICE IS IMPORTANT AND REQUIRES THE IMMEDIATE ATTENTION OF HOLDERS. IF HOLDERS ARE IN ANY DOUBT AS TO THE ACTION THEY SHOULD TAKE, THEY SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISERS AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 IMMEDIATELY.

THE CO-OPERATIVE BANK p.l.c.

(incorporated in England and Wales with registered number 990937)

(the "**Bank**")

NOTICE OF A MEETING

of the holders of those of the

£110,000,000
13 PER CENT. PERPETUAL SUBORDINATED BONDS

(ISIN: GB00B3VH4201)

of the Bank presently outstanding
(the "**Holders**" and the "**13% Bonds**" respectively).

NOTICE IS HEREBY GIVEN that a Meeting of the Holders convened by the Bank will be held at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT on Wednesday, 11 December, 2013 at 2.00 p.m. (London time) for the purpose of considering and, if thought fit, passing the following resolution (the "**Resolution**") which will be proposed as an Extraordinary Resolution in accordance with the provisions of the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the Holders and constituting the 13% Bonds (the "**Proposal**").

EXTRAORDINARY RESOLUTION

"THAT this Meeting of the holders of the £110,000,000 13 per cent. Perpetual Subordinated Bonds of The Co-operative Bank p.l.c. presently outstanding (the "**13% Bonds**" and the "**Bank**" respectively) constituted by the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the holders of the 13% Bonds (the "**Holders**" or "**holders**") hereby:

1. assents to and sanctions the modification of the Terms and Conditions of the 13% Bonds as set out in Schedule 1 to the Trust Deed by the insertion of the following new Condition 19:

"19. MANDATORY EXCHANGE OPTION

19.1 The Issuer may, upon giving not less than one day's prior notice to the Bondholders and the Trustee in accordance with Condition 19.7 below, at its option and without the consent or approval of the Bondholders or the Trustee, require and effect (having regard to Conditions 19.3 and 19.4 below) the mandatory transfer of the legal and beneficial title to, and all interests in, all outstanding Bonds (other than Excluded Bonds) to Co-operative Group, on the terms set out in this Condition 19 (the "**Mandatory Exchange Option**").

19.2 The mandatory transfer of a holder's Bonds (other than Excluded Bonds) to Co-operative Group will be effected on the date specified in the notice referred to in Condition 19.1 (the "**Settlement Date**") either:

(a) by way of exchange of such holder's Bonds for a principal amount of Final Repayment Notes equal to the principal amount of Final Repayment Notes which such holder would have received had those Bonds been exchanged for Final Repayment Notes in the Exchange Offer (on the same terms as those on which Bonds are exchanged for Final Repayment Notes in the Exchange Offer); or

(b) by way of sale to Co-operative Group in consideration for a cash consideration which will be paid in twelve equal instalments over twelve years up to (and including) 2025, and which will be represented by a principal amount of Instalment Repayment Notes equal to the principal amount of Instalment Repayment Notes which such holder would have received had those Bonds been sold to Co-operative Group in the Exchange Offer (on the same terms as those on which Bonds are sold to Co-operative Group in the Exchange Offer).

19.3 Where any such holder of Bonds (other than Excluded Bonds) has, in accordance with the procedures of the Liability Management Exercise, validly elected which Group Notes it would prefer to receive upon the transfer of its Bonds to Co-operative Group, such holder shall be entitled to receive such Group Notes.

19.4 Where a holder of Bonds (other than Excluded Bonds) has not validly elected (in accordance with the procedures provided under the Liability Management Exercise) which Group Notes it would prefer to receive upon the transfer of its Bonds to Co-operative Group, then (i) if (in the Liability Management Exercise) the nominal amount of Bonds which are the subject of elections to receive Final Repayment Notes is greater than the nominal amount of Bonds which are the subject of elections to receive Instalment Repayment Notes, such holder will receive Final Repayment Notes, or (ii) if (in the Liability Management Exercise) the nominal amount of Bonds which are the subject of elections to receive Instalment Repayment Notes is greater than the nominal amount of Bonds which are the subject of elections to receive Final Repayment Notes, such holder will receive Instalment Repayment Notes. In the event that elections for Final Repayment Notes and Instalment Repayment Notes are identical (in terms of nominal amount), the holder will receive Final Repayment Notes.

19.5 In addition, holders of the Bonds which are transferred to Co-operative Group pursuant to this Condition 19 will be entitled to receive accrued interest on their Bonds for the period from (and including) 31 July 2013 to (but excluding) the Settlement Date.

Holders of Bonds will also separately be entitled to receive the deferred interest payment originally scheduled for 31 July 2013 upon settlement of the Liability Management Exercise. This italicised text is for information only and does not form part of these Conditions.

19.6 The Issuer shall procure the issue of the Group Notes by Co-operative Group on the Settlement Date.

19.7 Notwithstanding Condition 12 and any other provision in these Conditions as regards the giving of notices, the notice referred to in Condition 19.1 shall be validly given upon the publication of such notice on the Regulatory News Service (RNS) operated by the London Stock Exchange plc, and shall be deemed to have been given on the date of such publication. The Issuer will, in addition, procure that the notice be mailed to the Bondholders at their respective addresses in the register of Bondholders maintained by the Registrar.

19.8 This Condition 19 shall apply notwithstanding any other provision of these Conditions. In the event of any inconsistency between this Condition 19 and any other provision of these Conditions, this Condition 19 shall prevail.

19.9 In this Condition 19:

"**Co-operative Group**" means Co-operative Group Limited;

"**Exchange Offer**" means the invitation to holders of Bonds to offer to exchange or sell their Bonds in the Liability Management Exercise;

"**Excluded Bonds**" means those Bonds which are being exchanged or sold pursuant to the Exchange Offer on or around the Settlement Date.

"**Final Repayment Notes**" means sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630) to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries;

"**Group Notes**" means the Final Repayment Notes and the Instalment Repayment Notes;

"**Instalment Repayment Notes**" means sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29) having their last payment date in 2025, to be issued by Co-operative Group and guaranteed (on a subordinated basis) by certain of its subsidiaries; and

"**Liability Management Exercise**" means the liability management exercise (in respect of, amongst other securities, the Bonds) described in the announcement made by the Issuer and/or Co-operative Group on or around 4 November 2013."

2. assents to and sanctions, to the fullest extent permitted by law and under the Trust Deed, in respect of all holders of 13% Bonds:

(a) the release, to the fullest extent permitted by law, of all Relevant Persons (as defined below) and each of them from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise (as defined above) or any part thereof;

(b) the waiver, to the fullest extent permitted by law, of all rights and entitlement that the holders or any of them may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Relevant Persons or any of them in connection with the Liability Management Exercise and/or their 13% Bonds;

(c) (following the transfer of the holders' 13% Bonds to Co-operative Group (as defined above) and upon delivery of the relevant Group Notes (as defined above) to such holders in accordance with the terms of the Liability Management Exercise) the waiver, to the fullest extent permitted by law, of all the rights, title and interest of the holders to and claims in respect of such 13% Bonds; and

(d) the modification, abrogation, compromise or arrangement in respect of the rights of all holders necessary to give effect to the foregoing provisions of this paragraph 2.

provided, however, that nothing in this paragraph 2 shall constitute a release of the Bank or Co-operative Group from, or a waiver of the rights and entitlements of Holders in respect of, their respective obligations or liabilities in their capacity as persons responsible for the respective prospectuses published by them in connection with the Liability Management Exercise.

For these purposes, "**Relevant Persons**" means each of the Bank, Co-operative Group, Co-operative Banking Group Limited, HSBC Bank plc and UBS Limited (in their capacity as dealer managers in connection with the Liability Management Exercise), Lucid Issuer Services Limited (in its capacity as exchange agent in connection with the Liability Management Exercise), the Registrar (as defined below), the Trustee and, in each case, their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives);

3. sanctions every abrogation, modification, compromise or arrangement in respect of the rights of the Holders appertaining to the 13% Bonds against the Bank, whether or not such rights arise under the Trust Deed, involved in or resulting from or to be effected by, the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and their implementation;

4. authorises, empowers and directs the Trustee to concur in the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and, in order to give effect to and to implement the modifications referred to in paragraph 1, forthwith to execute a Supplemental Trust Deed in the form of the draft produced to this Meeting and for the purpose of identification signed by the Chairman thereof with such amendments (if any) thereto as the Trustee shall require and to concur in, and to execute and do, all such other deeds, instruments, acts and things as may be necessary or appropriate to carry out and give effect to this Resolution and the implementation of the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution;

5. authorises, empowers and directs the Bank and the registrar in respect of the 13% Bonds (the "**Registrar**") (i) to execute, including on behalf of the holders of the 13% Bonds, all such deeds, instruments, forms of transfer and other documents of any nature, (ii) to make any such entries in the register maintained in respect of the 13% Bonds and (iii) to do any and all acts and things, which in each case may be necessary or appropriate to give effect to (A) this Resolution and/or (B) the Mandatory Exchange Option referred to above; and

6. discharges and exonerates the Trustee and the Registrar from all liability for which either of them may have become or may become responsible under the 13% Bonds, the Trust Deed or the registrar's agreement relating to the 13% Bonds in respect of any act or omission in connection with the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution, their implementation, or this Resolution or the giving effect to the Mandatory Exchange Option referred to above; and

7. agrees that if any paragraph of this Resolution is or becomes illegal, invalid or unenforceable that will not affect the legality, validity or enforceability of any other paragraph of this Resolution and accordingly the remainder of this Resolution shall be effective."

The Directors of the Bank have no interests in the 13% Bonds described in this Notice.

Set out below are the market values (as a percentage of their nominal amount) of the 13% Bonds on or around the first dealing day in each of the six months prior to the date of this Notice (including 1 November 2013, which is the latest practicable date for which information was available prior to publication of this Notice):

Date	**Market Value* (%)**
3 June 2013	80.937
1 July 2013	Information not available
1 August 2013	56.501
2 September 2013	54.356
1 October 2013	52.537
1 November 2013	72.349

*Source: Bloomberg (composite prices where available; otherwise, prices sourced to the extent available)

Background to the Proposal

The Proposal forms part of a wider liability management exercise (the "**Liability Management Exercise**") being conducted by the Bank as part of its capital actions plan, originally announced by the Bank on 17 June 2013, to raise £1.5 billion of common equity tier 1 capital.

As part of the Liability Management Exercise, holders of the 13% Bonds are being invited to offer to exchange or sell their 13% Bonds to Co-operative Group and to receive Group Notes (as defined in the Resolution above) to be issued by Co-operative Group (the "**Exchange Offer**"). Detailed information regarding the Liability Management Exercise (including the Exchange Offer), Co-operative Group and the Group Notes is contained in a prospectus dated 4 November 2013 published by Co-operative Group in connection with the Liability Management Exercise and the offer and issue of the Group Notes (the "**Prospectus**"). The Prospectus can be accessed via the Regulatory News Service (RNS) operated by the London Stock Exchange plc, which can be accessed at the following web link: *www.lseg.com/areas-expertise/market-information/regulatory-news-service*; and at: *http://www.co-operative.coop/bondholders*. Holders who are unable to access the Prospectus at that web link should contact the Registrar at the details below.

Holders are urged to read the Prospectus carefully. Holders should note that a Holder who offers to exchange or sell its 13% Bonds in the Exchange Offer will also appoint a proxy to vote in favour of the Resolution. If the Resolution is passed and implemented, the Bank will have the right to effect the mandatory transfer of any 13% Bonds (which are not exchanged or sold in the Exchange Offer) to Co-operative Group on the same economic terms as those upon which 13% Bonds are exchanged or sold (as the case may be) in the Exchange Offer.

Other important information

The attention of Holders is drawn to the quorum required for the Meeting and for an adjourned Meeting which is set out in paragraph 2 of "*Voting and Quorum*" below.

Copies of the Trust Deed (including the Terms and Conditions of the 13% Bonds) and the draft Supplemental Trust Deed referred to in the Resolution set out above and of certain other relevant documents will be available for inspection by Holders at the specified offices of the Registrar set out below.

In accordance with normal practice, the Trustee expresses no opinion as to the merits of the Proposal (which it was not involved in negotiating). It has, however, authorised it to be stated that, on the basis of the information set out in this Notice, (which it recommends Holders to read carefully), it has no objection to the Resolution being submitted to the Holders for their consideration. The Trustee has, however, not been involved in formulating the Proposal and makes no representation that all relevant information has been disclosed to Holders in this Notice. Accordingly, the Trustee urges Holders who are in any doubt as to the impact of the implementation of the Proposal to seek their own financial, legal and other advice as they consider appropriate.

Holders who wish to make arrangements to attend (in person or by proxy) and vote at the Meeting may do so in any manner set out in the Trust Deed and described below under "*Voting and Quorum*". However, Holders who are eligible and wish to participate in the Exchange Offer should make arrangements to participate in the Exchange Offer in the manner specified in the Prospectus, rather than making arrangements as described below.

VOTING AND QUORUM

1. The provisions governing the convening and holding of a Meeting are set out in Schedule 3 to the Trust Deed, a copy of which is available for inspection by the Holders during normal business hours at the specified office of the Registrar set out below.

   Terms used herein but not defined have the meaning given to them in the Consent and Exchange Offer Memorandum (the "**CEOM**") scheduled to the Prospectus.

   IMPORTANT: The 13% Bonds are either in certificated form or uncertificated form in CREST. A registered holding of 13% Bonds in certificated form will be represented by a certificate (each a "**Bond Certificate**"). The only Holders for the purposes of 13% Bonds held through CREST, Euroclear or Clearstream, Luxembourg (each a "**Clearing System**") are CREST Participants appearing on the register of 13% Bonds (each such participant, together with each other registered holder of the 13% Bonds appearing on such register, a "**Registered Holder**"). Each person (a "**Beneficial Owner**") who is the owner of a particular principal amount of the 13% Bonds through a Clearing System or its respective Direct Participant (in the case of Euroclear or Clearstream, Luxembourg) should note that such person is not considered to be a Holder for the purposes of 13% Bonds and will only be entitled to attend and vote at the Meeting or to appoint a proxy to do so in accordance with the procedures set out below.

Any reference herein to a Beneficial Owner sending voting instructions to the relevant CREST participant or arranging for a Corporate Letter of Representation to be issued to it by the relevant CREST Participant (together the "**Corporate Actions**") shall mean:

(i) where the Beneficial Owner holds through a broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in CREST, procuring that such party carries out such Corporate Actions on its behalf; and

(ii) where the Beneficial Owner holds through a Direct Participant or other broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in Euroclear or Clearstream, Luxembourg, procuring that such Direct Participant or other party carries out such Corporation Actions (by issuing instructions in a form acceptable to such clearing Systems) through such Clearing Systems and before any deadlines specified by such Clearing Systems.

Where Corporate Actions are provided by a Direct Participant on behalf of a Beneficial Owner, the 13% Bonds held by that Beneficial Owner shall be blocked in accordance with the usual procedures of Euroclear and Clearstream, Luxembourg which, in the case of instructions to vote in favour of the Resolution as provided in 1.2.1 below, will result in the underlying 13% Bonds being transferred to escrow in CREST pursuant to a corresponding TTE Instruction.

1.1 ***Bonds in certificated form***

A Registered Holder wishing to attend and vote at the relevant Meeting in person must produce at such Meeting either, in the case of an individual holder, a Bond Certificate or, in the case of a corporate holder, a duly approved resolution of the directors or other governing body of such corporation authorising such person to act as the corporation's representative (a "**representative**") at the relevant Meeting together, in each case, with satisfactory evidence of identity.

A Registered Holder not wishing to attend and vote at the relevant Meeting in person may by instrument in writing in the English language (a "**form of proxy**") in the form available from the Registrar, signed by the Registered Holder or, in the case of a corporation, executed under its common seal or signed on its behalf by an attorney or a duly authorised officer of the corporation and delivered to the specified office of the Registrar not less than 48 hours before the time fixed for the meeting, appoint any person (a "**proxy**") to act on his or its behalf in connection with the Meeting (or any adjourned such Meeting).

A proxy or representative so appointed shall so long as such appointment remains in force be deemed, for all purposes in connection with the Meeting (or any adjourned such Meeting) to be the holder of the 13% Bonds to which such appointment relates and the holder of the 13% Bonds shall be deemed for such purposes not to be the holder.

1.2 ***Bonds in uncertificated form in CREST***

Each CREST Participant that is a Registered Holder should, if it is not the Beneficial Owner of the 13% Bonds, seek instructions from the Beneficial Owner(s) in accordance with its usual procedures. A CREST sponsored member wishing to vote in favour of the Resolution or revoke any such vote should instruct its CREST sponsor to issue a TTE Instruction to the Registrar (or if a revocation, an ESA Instruction) with the details set out below.

Each CREST Participant that is a Registered Holder, if it is the beneficial owner of the 13% Bonds, can vote in favour of the Resolution by issuing a TTE Instruction with the details set out in paragraph 1.2.1, revoke by issuing an ESA Instruction with the details set out in paragraph 1.2.2, vote against the Resolution by filling out the paper voting instruction referred to in paragraph 1.2.3, and attend the Meeting by bringing a Corporate Letter of Representation containing the details referred to in paragraph 1.2.4.

1.2.1 A Beneficial Owner wishing to vote IN FAVOUR of the Resolution must send the voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a TTE Instruction and making an election as to which Group Notes it would like to receive by specifying which of the six options set out below is applicable. Any voting instruction must be received by the CREST Participant (i) in the case of an instruction under OPT0001A or OPT0001B below, prior to 4.30 p.m. (London time) on 6 December 2013, or (ii) in the case of an instruction under OPT0002A, OPT0002B, OPT0002C or OPT0002D below, not less than 48 hours before the time of the meeting (the "**Voting Deadline**"). **However Beneficial Owners are strongly encouraged to ensure that their CREST Participant submits all instructions by 4.30 p.m. (London time) on 29 November 2013**, since the terms of the Liability Management Exercise are more favourable for holders of 13% Bonds if certain levels of participation in the Liability Management Exercise are achieved by this earlier deadline. A TTE Instruction must comply with the paragraph below.

Each TTE Instruction should specify Equiniti (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the 13% Bonds should be transferred. A TTE Instruction will not be valid unless and until it has settled and Equiniti will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the principal amount of 13% Bonds to be transferred to an escrow balance;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the CREST Participant wishes to select and in accordance with any voting instructions provided by any Beneficial Owner;

(g) the intended settlement date;

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 13% Bonds are set out in the table below. **A Beneficial Owner should elect the ID which corresponds to such Beneficial Owner's preferred option:**

Option	CREST Member ID
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 13% Bonds for **Final Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting). **NB: electing this Option automatically results in offering to exchange some or all of the Beneficial Owner's 13% Bonds for Final Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001A**
Option 2: (Not available to U.S. Holders) Offer to sell some or all of your 13% Bonds to the Group for cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 13% Bondholders Meeting as your proxy to vote those 13% Bonds IN FAVOUR of the resolution to be proposed at that meeting). **NB: electing this Option automatically results in offering to sell some or all of the Beneficial Owner's 13% Bonds to the Group for cash consideration payable in instalments over twelve years and represented by Instalment Repayment Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT0001B**
Option 3: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002A**
Option 4: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive **Final Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002B**

Option 5: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002C**
Option 6: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 13% Bondholders Meeting (without offering to exchange or sell your 13% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 13% Bonds in favour of such resolution **AND** if the 13% Bonds Mandatory Exchange Option is exercised elect to receive cash consideration payable in instalments over twelve years and represented by **Instalment Repayment Notes**. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE.	**OPT0002D**
NB: to vote AGAINST the resolution proposed at the 13% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	–

Any vote in favour of the resolution pursuant to a TTE Instruction as provided herein will automatically appoint the chairman of the Meeting as the relevant CREST Participant's proxy to vote the 13% Bonds referred in such TTE Instruction in such way.

1.2.2 A Beneficial Owner wishing to REVOKE a voting instruction given under 1.2.1 above and the corresponding TTE Instruction may do so at any time prior to the Voting Deadline by sending voting instructions to its CREST Participant in accordance with such participants usual procedures requesting that such participant issues an ESA Instruction to settle in CREST. Any such ESA Instruction must contain the following details:

(a) the principal amount of 13% Bonds to be withdrawn;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VH4201;

(e) Equiniti's participant ID, being: 2RA35;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the Exchange Instruction to be withdrawn;

(i) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

Any such revocation of a TTE Instruction will be conditional upon Equiniti verifying that the revocation is validly made. Accordingly, Equiniti will, on behalf of the Bank, reject or accept the revocation by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

1.2.3 A Beneficial Owner wishing to vote AGAINST the Resolution must send voting instructions to its CREST Participant in accordance with such participants usual procedures requesting that such participant issues a no vote in respect of the principal amount of 13% Bonds the subject of such voting instructions by filling out the paper voting instruction which was provided with this Notice to each Registered Holder. A Beneficial Owner should also specify in its voting instruction whether it elects to receive either Final Repayment Notes or Instalment Repayment Notes if the 13% Bonds Mandatory Exchange Option is exercised. Copies of the paper voting instruction are also available from Equiniti.

1.2.4 A Beneficial Owner wishing to ATTEND the Meeting must arrange for its CREST Participant to issue a Corporate Letter of Representation to it. Any such Letter of Representation should be on the headed paper of such participant, should detail the person attending and the principal amount of 13% Bonds held by such person, and be signed by the CREST Participant.

2. The quorum required at the Meeting is one or more persons present being proxies or representatives or holding 13% Bonds and representing or holding in the aggregate not less than two thirds in principal amount of the 13% Bonds for the time being outstanding. If a quorum is not present at the Meeting, the Meeting will be adjourned and the Resolution will be considered at an adjourned Meeting (notice of which will be given to the Holders). The quorum at such an adjourned Meeting will be one or more persons present being proxies or representatives or holding 13% Bonds and representing or holding in the aggregate not less than one-third of the principal amount of the 13% Bonds for the time being outstanding.

Holders should note this quorum requirement and should be aware that if the Holders either present or appropriately represented at the Meeting are insufficient to form a quorum the Resolution, and consequently the Proposal, cannot be formally considered thereat. Holders are therefore encouraged either to attend the Meeting in person or to arrange to be represented at the Meeting as soon as possible.

3. Every question submitted to the Meeting shall be decided in the first instance by a show of hands and in case of equality of votes the chairman of the Meeting shall both on a show of hands and on a poll have a casting vote in addition to the vote or votes (if any) to which he may be entitled as a proxy or as representative or as a Holder.

Unless a poll is (before or on the declaration of the result of the show of hands) demanded by the chairman of the Meeting, the Bank, the Trustee or one or more persons holding one or more of the 13% Bonds or being proxies or representatives or holding 13% Bonds and representing or holding in the aggregate not less than one-fiftieth in principal amount of such 13% Bonds for the time being outstanding, a declaration by the chairman of the relevant Meeting that a resolution has been carried or carried by a particular majority or lost or not carried by a particular majority shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.

On a show of hands every person who is present and is a proxy or representative or a Holder who produces a Bond Certificate shall have one vote and on a poll every person who is so present shall have one vote in respect of each £1,000 principal amount of the 13% Bonds in respect of which he is a proxy or representative or in respect of each £1,000 principal amount of the 13% Bonds represented by the Bond Certificate so produced.

4. To be passed, the Resolution requires a majority in favour consisting of not less than three-quarters of the votes cast. If passed, the Resolution will be binding upon all the Holders, whether or not present at such Meeting and whether or not voting.

REGISTRAR

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA
United Kingdom

TRUSTEE

The Law Debenture Trust Corporation p.l.c.
Fifth Floor
100 Wood Street
London EC2V 7EX
United Kingdom

This Notice is given by:

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dated 4 November 2013.

SECTION C: PREFERENCE SHARES AND PERPETUAL SUBORDINATED BONDS

PART 11

FORM OF NOTICE CONVENING THE MEETING IN RESPECT OF THE 5.5555% BONDS

THIS NOTICE IS IMPORTANT AND REQUIRES THE IMMEDIATE ATTENTION OF HOLDERS. IF HOLDERS ARE IN ANY DOUBT AS TO THE ACTION THEY SHOULD TAKE, THEY SHOULD CONSULT THEIR OWN PROFESSIONAL ADVISERS AUTHORISED UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 IMMEDIATELY.

THE CO-OPERATIVE BANK p.l.c.

(incorporated in England and Wales with registered number 990937)

(the "**Bank**")

NOTICE OF A MEETING

of the holders of those of the

£200,000,000
5.5555 PER CENT. PERPETUAL SUBORDINATED BONDS

(ISIN: GB00B3VMBW45)

of the Bank presently outstanding
(the "**Holders**" and the "**5.5555% Bonds**" respectively).

NOTICE IS HEREBY GIVEN that a Meeting of the Holders convened by the Bank will be held at Holiday Inn London (Bloomsbury), Coram Street, London WC1N 1HT on Wednesday, 11 December, 2013 at 3.00 p.m. (London time) for the purpose of considering and, if thought fit, passing the following resolution (the "**Resolution**") which will be proposed as an Extraordinary Resolution in accordance with the provisions of the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the Holders and constituting the 5.5555% Bonds (the "**Proposal**").

EXTRAORDINARY RESOLUTION

"THAT this Meeting of the holders of the £200,000,000 5.5555 per cent. Perpetual Subordinated Bonds of The Co-operative Bank p.l.c. presently outstanding (the "**5.5555% Bonds**" and the "**Bank**" respectively) constituted by the Trust Deed dated 1 August 2009 (the "**Trust Deed**") made between the Bank and The Law Debenture Trust Corporation p.l.c. (the "**Trustee**") as trustee for the holders of the 5.5555% Bonds (the "**Holders**") hereby:

1. assents to and sanctions the modification of the Terms and Conditions of the 5.5555% Bonds as set out in Schedule 1 to the Trust Deed by the insertion of the following new Condition 19:

"19. MANDATORY EXCHANGE OPTION

19.1 The Issuer may, upon giving not less than one day's prior notice to the Bondholders and the Trustee in accordance with Condition 19.4 below, at its option and without the consent or approval of the Bondholders or the Trustee, require and effect the mandatory exchange of all outstanding Bonds (other than Excluded Bonds) for Bank T2 Notes, on the terms set out in this Condition 19 (the "**Mandatory Exchange Option**").

19.2 The mandatory exchange of the Bonds (other than Excluded Bonds) will be effected on the date specified in the notice referred to in Condition 19.1 (the "**Settlement Date**") by:

(a) the redemption and cancellation of such Bonds by the Issuer; and

(b) the issue by the Issuer, to each holder of such Bonds, of a principal amount of Bank T2 Notes equal to the principal amount of Bank T2 Notes which such holder would have received had those Bonds been exchanged for Bank T2 Notes in the Exchange Offer (on the same terms as those on which Bonds are exchanged for Bank T2 Notes in the Exchange Offer).

19.3 In addition, holders of the Bonds which are exchanged pursuant to this Condition 19 will be entitled to receive accrued interest on their Bonds for the period from (and including) 14 December 2013 to (but excluding) the Settlement Date.

Holders of Bonds will also separately be entitled to receive the deferred interest payment originally scheduled for 14 December 2013 upon settlement of the Liability Management Exercise. This italicised text is for information only and does not form part of these Conditions.

19.4 Notwithstanding Condition 12 and any other provision in these Conditions as regards the giving of notices, the notice referred to in Condition 19.1 shall be validly given upon the publication of such notice on the Regulatory News Service (RNS) operated by the London Stock Exchange plc, and shall be deemed to have been given on the date of such publication. The Issuer will, in addition, procure that the notice be mailed to the Bondholders at their respective addresses in the register of Bondholders maintained by the Registrar.

19.5 This Condition 19 shall apply notwithstanding any other provision of these Conditions. In the event of any inconsistency between this Condition 19 and any other provision of these Conditions, this Condition 19 shall prevail.

19.6 In this Condition 19:

"**Bank T2 Notes**" means sterling-denominated 11 per cent. subordinated notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Issuer;

"**Exchange Offer**" means the invitation to holders of the Bonds to offer to exchange their Bonds in the Liability Management Exercise;

"**Excluded Bonds**" means those Bonds which are being exchanged pursuant to the Exchange Offer on or around the Settlement Date; and

"**Liability Management Exercise**" means the liability management exercise (in respect of, amongst other securities, the Bonds) described in the announcement made by the Issuer and/or Co-operative Group Limited on or around 4 November 2013."

2. assents to and sanctions, to the fullest extent permitted by law and under the Trust Deed, in respect of all holders of 5.5555% Bonds:

(a) the release, to the fullest extent permitted by law, of all Relevant Persons (as defined below) and each of them from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Liability Management Exercise (as defined above) or any part thereof;

(b) the waiver, to the fullest extent permitted by law, of all rights and entitlement that the holders or any of them may otherwise have or acquire to bring, participate in or enforce legal proceedings of any nature against the Relevant Persons or any of them in connection with the Liability Management Exercise and/or their 5.5555% Bonds;

(c) (following the exchange of the holders' 5.5555% Bonds for Bank T2 Notes (as defined above) in accordance with the terms of the Liability Management Exercise) the waiver, to the fullest extent permitted by law, of all the rights, title and interest of the holders to and claims in respect of such 5.5555% Bonds; and

(d) the modification, abrogation, compromise or arrangement in respect of the rights of all holders necessary to give effect to the foregoing provisions of this paragraph 2.

provided, however, that nothing in this paragraph 2 shall constitute a release of the Bank or Co-operative Group from, or a waiver of the rights and entitlements of Holders in respect of, their respective obligations or liabilities in their capacity as persons responsible for the respective prospectuses published by them in connection with the Liability Management Exercise.

For these purposes, "**Relevant Persons**" means each of the Bank, Co-operative Group Limited, Co-operative Banking Group Limited, HSBC Bank plc and UBS Limited (in their capacity as dealer managers in connection with the Liability Management Exercise), Lucid Issuer Services Limited (in its capacity as exchange agent in connection with the Liability Management Exercise), the Registrar (as defined below), the Trustee and, in each case, their respective financial and legal advisers (together in each case with their respective directors, members, employees and representatives);

3. sanctions every abrogation, modification, compromise or arrangement in respect of the rights of the Holders appertaining to the 5.5555% Bonds against the Bank, whether or not such rights arise under the Trust Deed, involved in or resulting from or to be effected by, the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and their implementation;

4. authorises, empowers and directs the Trustee to concur in the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution and, in order to give effect to and to implement the modifications referred to in paragraph 1, forthwith to execute a Supplemental Trust Deed in the form of the draft produced to this Meeting and for the purpose of identification signed by the Chairman thereof with such amendments (if any) thereto as the Trustee shall require and to concur in, and to execute and do, all such other deeds, instruments, acts and things as may be necessary or appropriate to carry out and give effect to this Resolution and the implementation of the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution;

5. authorises, empowers and directs the Bank and the registrar in respect of the 5.5555% Bonds (the "**Registrar**") (i) to execute, including on behalf of the holders of the 5.5555% Bonds, all such deeds, instruments, forms of transfer and other documents of any nature, (ii) to make any such entries in the register maintained in respect of the 5.5555% Bonds and (iii) to do any and all acts and things, which in each case may be necessary or appropriate to give effect to (A) this Resolution and/or the (B) Mandatory Exchange Option referred to above; and

6. discharges and exonerates the Trustee and the Registrar from all liability for which either of them may have become or may become responsible under the 5.5555% Bonds, the Trust Deed or the registrar's agreement relating to the 5.5555% Bonds in respect of any act or omission in connection with the modifications and other arrangements referred to in paragraphs 1 and 2 of this Resolution, their implementation, or this Resolution or the giving effect to the Mandatory Exchange Option referred to above; and

7. agrees that if any paragraph of this Resolution is or becomes illegal, invalid or unenforceable that will not affect the legality, validity or enforceability of any other paragraph of this Resolution and accordingly the remainder of this Resolution shall be effective."

The Directors of the Bank have no interests in the 5.5555% Bonds described in this Notice.

Set out below are the market values (as a percentage of their nominal amount) of the 5.5555% Bonds on or around the first dealing day in each of the six months prior to the date of this Notice (including 1 November 2013, which is the latest practicable date for which information was available prior to publication of this Notice):

Date	Market Value* (%)
3 June 2013	51.609
1 July 2013	38.449
1 August 2013	38.872
2 September 2013	36.590
1 October 2013	34.280
1 November 2013	46.563

*Source: Bloomberg (composite prices where available; otherwise, prices sourced to the extent available)

Background to the Proposal

The Proposal forms part of a wider liability management exercise (the "**Liability Management Exercise**") being conducted by the Bank as part of its capital actions plan, originally announced by the Bank on 17 June 2013, to raise £1.5 billion of common equity tier 1 capital.

As part of the Liability Management Exercise, holders of the 5.5555% Bonds are being invited to offer to exchange their 5.5555% Bonds for new Bank T2 Notes (as defined in the Resolution above) to be issued by the Bank (the "**Exchange Offer**"). Detailed information regarding the Liability Management Exercise (including the Exchange Offer), the Bank and the Bank T2 Notes is contained in a prospectus dated 4 November 2013 published by the Bank in connection with the Liability Management Exercise and the offer and issue of the Bank T2 Notes (the "**Prospectus**"). The Prospectus can be accessed via the Regulatory News Service (RNS) operated by the London Stock Exchange plc, which can be accessed at the following web link: *www.lseg.com/areas-expertise/market-information/regulatory-news-service*; and at: *http://www.co-operative.coop/bondholders*. Holders who are unable to access the Prospectus at that web link should contact the Registrar at the details below.

Holders are urged to read the Prospectus carefully. Holders should note that a Holder who offers to exchange its 5.5555% Bonds in the Exchange Offer will also appoint a proxy to vote in favour of the Resolution. If the Resolution is passed and implemented, the Bank will have the right to effect the exchange of any 5.5555% Bonds (which are not exchanged in the Exchange Offer) for Bank T2 Notes on the same economic terms as those upon which 5.5555% Bonds are exchanged in the Exchange Offer.

Other important information

The attention of Holders is drawn to the quorum required for the Meeting and for an adjourned Meeting which is set out in paragraph 2 of "*Voting and Quorum*" below.

Copies of the Trust Deed (including the Terms and Conditions of the 5.5555% Bonds) and the draft Supplemental Trust Deed referred to in the Resolution set out above and of certain other relevant documents will be available for inspection by Holders at the specified offices of the Registrar set out below.

In accordance with normal practice, the Trustee expresses no opinion as to the merits of the Proposal (which it was not involved in negotiating). It has, however, authorised it to be stated that, on the basis of the information set out in this Notice, (which it recommends Holders to read carefully), it has no objection to the Resolution being submitted to the Holders for their consideration. The Trustee has, however, not been involved in formulating the Proposal and makes no representation that all relevant information has been disclosed to Holders in this Notice. Accordingly, the Trustee urges Holders who are in any doubt as to the impact of the implementation of the Proposal to seek their own financial, legal and other advice as they consider appropriate.

Holders who wish to make arrangements to attend (in person or by proxy) and vote at the Meeting may do so in any manner set out in the Trust Deed and described below under "*Voting and Quorum*". However, Holders who are eligible and wish to participate in the Exchange Offer should make arrangements to participate in the Exchange Offer in the manner specified in the Prospectus, rather than making arrangements as described below.

VOTING AND QUORUM

1. The provisions governing the convening and holding of a Meeting are set out in Schedule 3 to the Trust Deed, a copy of which is available for inspection by the Holders during normal business hours at the specified office of the Registrar set out below.

   Terms used herein but not defined have the meaning given to them in the Consent and Exchange Offer Memorandum (the "**CEOM**") scheduled to the Prospectus.

   IMPORTANT: The 5.5555% Bonds are either in certificated form or uncertificated form in CREST. A registered holding of 5.5555% Bonds in certificated form will be represented by a certificate (each a "**Bond Certificate**"). The only Holders for the purposes of Bonds held through CREST, Euroclear or Clearstream, Luxembourg (each a "**Clearing System**") are CREST Participants appearing on the register of 5.5555% Bonds (each such participant, together with each other registered holder of the 5.5555% Bonds appearing on such register, a "**Registered Holder**"). Each person (a "**Beneficial Owner**") who is the owner of a particular principal amount of the 5.5555% Bonds through a Clearing System or its respective Direct Participant (in the case of Euroclear or Clearstream, Luxembourg) should note that such person is not considered to be a Holder for the purposes of 5.5555% Bonds and will only be entitled to attend and vote at the Meeting or to appoint a proxy to do so in accordance with the procedures set out below.

   Any reference herein to a Beneficial Owner sending voting instructions to the relevant CREST participant or arranging for a Corporate Letter of Representation to be issued to it by the relevant CREST Participant (together the "**Corporate Actions**") shall mean:

   (i) where the Beneficial Owner holds through a broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in CREST, procuring that such party carries out such Corporate Actions on its behalf; and

   (ii) where the Beneficial Owner holds through a Direct Participant or other broker, dealer, commercial bank, trust company, custodian, nominee or intermediary in Euroclear or Clearstream, Luxembourg, procuring that such Direct Participant or other party carries out such Corporation Actions (by issuing instructions in a form acceptable to such clearing Systems) through such Clearing Systems and before any deadlines specified by such Clearing Systems.

   Where Corporate Actions are provided by a Direct Participant on behalf of a Beneficial Owner, the 5.5555% Bonds held by that Beneficial Owner shall be blocked in accordance with the usual procedures of Euroclear and Clearstream, Luxembourg which, in the case of instructions to vote in favour of the Resolution as provided in 1.2.1 below, will result in the underlying 5.5555% Bonds being transferred to escrow in CREST pursuant to a corresponding TTE Instruction.

1.1 ***Bonds in certificated form***

   A Registered Holder wishing to attend and vote at the relevant Meeting in person must produce at such Meeting either, in the case of an individual holder, a Bond Certificate or, in the case of a corporate holder, a duly approved resolution of the directors or other governing body of such corporation authorising such person to act as the corporation's representative (a "**representative**") at the relevant Meeting together, in each case, with satisfactory evidence of identity.

   A Registered Holder not wishing to attend and vote at the relevant Meeting in person may by instrument in writing in the English language (a "**form of proxy**") in the form available from the Registrar, signed by the Registered Holder or, in the case of a corporation, executed under its common seal or signed on its behalf by an attorney or a duly authorised officer of the corporation and delivered to the specified office of the Registrar not less than 48 hours before the time fixed for the meeting, appoint any person (a "**proxy**") to act on his or its behalf in connection with the Meeting (or any adjourned such Meeting).

A proxy or representative so appointed shall so long as such appointment remains in force be deemed, for all purposes in connection with the Meeting (or any adjourned such Meeting) to be the holder of the 5.5555% Bonds to which such appointment relates and the holder of the 5.5555% Bonds shall be deemed for such purposes not to be the holder.

1.2 ***Bonds in uncertificated form in CREST***

Each CREST Participant that is a Registered Holder should, if it is not the Beneficial Owner of the 5.5555% Bonds, seek instructions from the Beneficial Owner(s) in accordance with its usual procedures. A CREST sponsored member wishing to vote in favour of the Resolution or revoke any such vote should instruct its CREST sponsor to issue a TTE Instruction to the Registrar (or if a revocation, an ESA Instruction) with the details set out below.

Each CREST Participant that is a Registered Holder, if it is the beneficial owner of the 5.5555% Bonds, can vote in favour of the Resolution by issuing a TTE Instruction with the details set out in paragraph 1.2.1, revoke by issuing an ESA Instruction with the details set out in paragraph 1.2.2, vote against the Resolution by filling out the paper voting instruction referred to in paragraph 1.2.3, and attend the Meeting by bringing a Corporate Letter of Representation containing the details referred to in paragraph 1.2.4.

1.2.1 A Beneficial Owner wishing to vote <u>IN FAVOUR</u> of the Resolution must send the voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a TTE Instruction by specifying which of the three options set out below is applicable. Any voting instruction must be received by the CREST Participant (i) in the case of an instruction under OPT55001 below, prior to 4.30 p.m. (London time) on 6 December 2013, or (ii) in the case of an instruction under OPT5502A or OPT5502B below, not less than 48 hours before the time of the meeting (the "**Voting Deadline**"). **However Beneficial Owners are strongly encouraged to ensure that their CREST Participant submits all instructions by 4.30 p.m. (London time) on 29 November 2013**, since the terms of the Liability Management Exercise are more favourable for holders of 5.5555% Bonds if certain levels of participation in the Liability Management Exercise are achieved by this earlier deadline. A TTE Instruction must comply with the paragraph below.

Each TTE Instruction should specify Equiniti (in its capacity as a CREST Participant under its participant ID referred to below) as the escrow agent to whom the 5.5555% Bonds should be transferred. A TTE Instruction will not be valid unless and until it has settled and Equiniti will not take any action in respect of any TTE Instruction until such time. The TTE Instruction must be properly authenticated in accordance with EUI's specifications and must contain, in addition to the other information which is required for a TTE Instruction to settle in CREST, the following details:

(a) the principal amount of 5.5555% Bonds to be transferred to an escrow balance;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out after sub-paragraph (j) below, corresponding to the option which the CREST Participant wishes to select and in accordance with any voting instructions provided by any Beneficial Owner;

(g) the intended settlement date;

(h) the corporate action number for the Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(i) the standard TTE instruction of priority 80; and

(j) a contact number, to be inserted in the shared note field.

For the purposes of sub-paragraph (f) above, the relevant CREST member IDs of Equiniti relevant to a Holder of 5.5555% Bonds are set out in the table below. **A Beneficial Owner should elect the ID which corresponds to such Beneficial Owner's preferred option:**

Option	**CREST Member ID**
Option 1: (Not available to U.S. Holders) Offer to exchange some or all of your 5.5555% Bonds for **Bank T2 Notes** in the Exchange Offer (in which case you will also automatically appoint the chairman of the 5.5555% Bondholders Meeting as your proxy to vote those 5.5555% Bonds IN FAVOUR of the resolution to be proposed at that meeting). **NB: electing this Option automatically results in offering to exchange some or all of the Beneficial Owner's 5.5555% Bonds for Bank T2 Notes in the Exchange Offer. The Beneficial Owner should read the terms of the CEOM carefully before electing this Option.**	**OPT55001**
Option 2: (Not available to U.S. Holders) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502A**
Option 3: (U.S. Holders ONLY) Vote **IN FAVOUR** of the resolution at the 5.5555% Bondholders Meeting (without offering to exchange your 5.5555% Bonds) by appointing the chairman of such meeting as your proxy to vote some or all of your 5.5555% Bonds in favour of such resolution. YOU MUST SUBMIT THE RELEVANT STOCK TO CORRECTLY RECORD YOUR VOTE	**OPT5502B**
NB: to vote AGAINST the resolution proposed at the 5.5555% Bondholders Meeting, please use the paper voting instruction available from Equiniti.	–

Any vote in favour of the resolution pursuant to a TTE Instruction as provided herein will automatically appoint the chairman of the Meeting as the relevant CREST Participant's proxy to vote the 5.5555% Bonds referred in such TTE Instruction in such way.

1.2.2 A Beneficial Owner wishing to <u>REVOKE</u> a voting instruction given under 1.2.1 above and the corresponding TTE Instruction may do so at any time prior to the Voting Deadline by sending voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues an ESA Instruction to settle in CREST. Any such ESA Instruction must contain the following details:

(a) the principal amount of 5.5555% Bonds to be withdrawn;

(b) the CREST Participant's member account ID;

(c) the CREST Participant's participant ID;

(d) the relevant corporate action ISIN number, being: GB00B3VMBW45;

(e) Equiniti's participant ID, being: 6RA99;

(f) the relevant CREST member account ID of Equiniti (in its capacity as a CREST receiving agent) from the table set out above;

(g) the intended settlement date for the withdrawal;

(h) the transaction reference number of the voting instruction to be withdrawn;

(i) the corporate action number for the relevant Exchange Offer. This is allocated by EUI and can be found by viewing the relevant corporate action details in CREST;

(j) the standard TTE instruction of priority 80; and

(k) a contact number, to be inserted in the shared note field.

Any such revocation of a TTE Instruction will be conditional upon Equiniti verifying that the revocation is validly made. Accordingly, Equiniti will, on behalf of the Bank, reject or accept the revocation by transmitting in CREST a receiving agent reject (AEAD) or receiving agent accept (AEAN) message.

1.2.3 A Beneficial Owner wishing to vote AGAINST the Resolution must send voting instructions to its CREST Participant in accordance with such participant's usual procedures requesting that such participant issues a no vote in respect of the respect of the principal amount of 5.5555% Bonds the subject of such voting instructions by filling out the paper voting instruction which was provided with this Notice to each Registered Holder. Copies of the paper voting instruction are also available from Equiniti.

1.2.4 A Beneficial Owner wishing to ATTEND the Meeting must arrange for its CREST Participant to issue a Corporate Letter of Representation to it. Any such Letter of Representation should be on the headed paper of such participant, should detail the person attending and the principal amount of 5.5555% Bonds held by such person, and be signed by the CREST Participant.

2. The quorum required at the Meeting is one or more persons present being proxies or representatives or holding 5.5555% Bonds and representing or holding in the aggregate not less than two thirds in principal amount of the 5.5555% Bonds for the time being outstanding. If a quorum is not present at the Meeting, the Meeting will be adjourned and the Resolution will be considered at an adjourned Meeting (notice of which will be given to the Holders). The quorum at such an adjourned Meeting will be one or more persons present being proxies or representatives or holding 5.5555% Bonds and representing or holding in the aggregate not less than one-third of the principal amount of the 5.5555% Bonds for the time being outstanding

Holders should note this quorum requirement and should be aware that if the Holders either present or appropriately represented at the Meeting are insufficient to form a quorum the Resolution, and consequently the Proposal, cannot be formally considered thereat. Holders are therefore encouraged either to attend the Meeting in person or to arrange to be represented at the Meeting as soon as possible.

3. Every question submitted to the Meeting shall be decided in the first instance by a show of hands and in case of equality of votes the chairman of the Meeting shall both on a show of hands and on a poll

have a casting vote in addition to the vote or votes (if any) to which he may be entitled as a proxy or as representative or as a Holder.

Unless a poll is (before or on the declaration of the result of the show of hands) demanded by the chairman of the Meeting, the Bank, the Trustee or one or more persons holding one or more of the 5.5555% Bonds or being proxies or representatives or holding 5.5555% Bonds and representing or holding in the aggregate not less than one-fiftieth in principal amount of such 5.5555% Bonds for the time being outstanding, a declaration by the chairman of the relevant Meeting that a resolution has been carried or carried by a particular majority or lost or not carried by a particular majority shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded in favour or against such resolution.

On a show of hands every person who is present and is a proxy or representative or a Holder who produces a Bond Certificate shall have one vote and on a poll every person who is so present shall have one vote in respect of each £1,000 principal amount of the 5.5555% Bonds in respect of which he is a proxy or representative or in respect of each £1,000 principal amount of the 5.5555% Bonds represented by the Bond Certificate so produced.

4. To be passed, the Resolution requires a majority in favour consisting of not less than three-quarters of the votes cast. If passed, the Resolution will be binding upon all the Holders, whether or not present at such Meeting and whether or not voting.

REGISTRAR

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA
United Kingdom

TRUSTEE

The Law Debenture Trust Corporation p.l.c.
Fifth Floor
100 Wood Street
London EC2V 7EX
United Kingdom

This Notice is given by:

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dated 4 November 2013.

SECTION D

SCHEME OF ARRANGEMENT IN RESPECT OF THE DATED NOTES

Information in this Offer Memorandum relating to the Scheme is provided by way of a summary description only. Full details of the Scheme will be set out in the Explanatory Statement and Holders of Dated Notes should wait for the Explanatory Statement to be made available by the Bank before taking any action in connection with the Scheme. Any decision to be taken by a Holder of Dated Notes in respect of the Scheme should be made on the basis of the Explanatory Statement only.

Application of this Section D

This Section D applies to the following securities issued by the Bank:

Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998)
(the "**2016 Notes**")

5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942)
(the "**2019 Notes**")

9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902)
(the "**April 2021 Notes**")

Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984)
(the "**November 2021 Notes**")

7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868)
(the "**2022 Notes**")

5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183)
(the "**2024 Notes**")

5.875% Subordinated Notes due 2033 (ISIN: XS0145065602)
(the "**2033 Notes**")

(together, the "**Dated Notes**" and each a "**Series**" of Dated Notes)

Introduction to this Section D

The offers in respect of the Dated Notes are being conducted by way of the Scheme, which is a scheme of arrangement under Part 26 of the Companies Act 2006. The formal terms of the Scheme are set out in the Explanatory Statement. This Section D contains a brief description of certain features of the Scheme, and should be read in conjunction with the Explanatory Statement (which shall, in the event of any inconsistency, prevail over this Section D).

Capitalised terms used in this Section are defined in Section L of this Offer Memorandum.

This Section is split into the following parts:

Part 1: Details of the Scheme of Arrangement
Part 2: Indicative Timetable for the Scheme of Arrangement

Other relevant information

Holders of Dated Notes are recommended to read carefully the Scheme Documents (which incorporate the Bank T2 Prospectus).

Holders are also directed to the following Sections of this Offer Memorandum, which contain further information relevant to the Scheme in relation to the Dated Notes:

- Section A: Rationale for the Liability Management Exercise
- Section B: Offer Consideration – Overview Table
- Section E: Amendment and Termination and Revocation Rights
- Section G: Information on the Bank, the Group and the New Securities
- Section H: Risk Factors and Other Considerations
- Section I: Taxation Considerations
- Section J: Dealer Managers, Exchange Agent, Information Agent and Registrars
- Section K: General Notices and Important Information
- Section L: Definitions

SECTION D – DATED NOTES

PART 1

DETAILS OF THE SCHEME OF ARRANGEMENT

1. SUMMARY OFFERING TABLE

The following table summarises the consideration available to Holders of Dated Notes in the Scheme:

Existing Securities	**ISIN**	**Consideration Amount[1, 5]** (per £1,000 of Scheme Claim[4])		**New Ordinary Shares Conversion Price[5]**
		Bank T2 Notes[2]	**New Ordinary Shares[3]**	
2016 Notes	XS0254625998	£102.63	£897.37	£7.7718292 per share
2019 Notes	XS0189539942	£102.63	£897.37	
April 2021 Notes	XS0620315902	£102.63	£897.37	
November 2021 Notes	XS0274155984	£102.63	£897.37	
2022 Notes	XS0864253868	£102.63	£897.37	
2024 Notes	XS0188218183	£102.63	£897.37	
2033 Notes	XS0145065602	£102.63	£897.37	

Notes:

1 The number of New Ordinary Shares and principal amount of Bank T2 Notes which a holder of Dated Notes will be eligible to receive in respect of its Scheme Claim will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

2 New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853) to be issued by the Bank.

3 New Ordinary Shares to be issued by the Bank. If the Liability Management Exercise is successfully completed, the Group's existing equity stake in the Bank will be converted into deferred shares and effectively reduced to nil and a total of 250,000,000 New Ordinary Shares will be issued at that time, of which:

(i) 75,000,000 (representing 30 per cent. of the total) will be issued to the Group in consideration for its fresh injection of capital into the Bank through the Liability Management Exercise and the 2014 Commitment (representing an effective subscription price of £6.16 per share);

(ii) 112,500,000 (representing 45 per cent. of the total) will be issued to holders of the Dated Notes in the Scheme in exchange for their Dated Notes, to be distributed in the Scheme *pro rata* amongst such holders based on their respective Scheme Claims (representing, based on the total value of Scheme Claims and the number of New Ordinary Shares issued in the Scheme to holders of Dated Notes, an implied subscription price equal to the New Ordinary Shares Conversion Price). The New Ordinary Shares referred to in the table above are these 112,500,000 New Ordinary Shares; and

(iii) 62,500,000 (representing the balance of 25 per cent. of the total) will be available for subscription by holders of Dated Notes pursuant to, and on the terms of, the Scheme for an aggregate consideration equal to £125 million (representing an effective subscription price of £2.00 per share).

4 A Holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date (expected to be 10 December 2013), provided that a Holder's Scheme Claim in respect of Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated on the basis of an exchange rate of £0.85644 per €1.00.

5 Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the Consideration Amounts and the New Ordinary Shares Conversion Price in this table are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the Floating Rate Callable Step-up Dated Subordinated Notes due 2016. For the purpose of the indicative figures above, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on 14 November 2013 and, once determined, the Bank will announce the final Consideration Amounts and New Ordinary Shares Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final Consideration Amounts and New Ordinary Shares Conversion Price are not expected to differ materially from the indicative Consideration Amounts and New Ordinary Shares Conversion Price specified above.

....

The Scheme will also provide that 62,500,000 additional New Ordinary Shares will be made available to Holders of the Dated Notes for subscription for an aggregate consideration equal to £125 million, all pursuant to, and on the terms of, the Scheme.

2. DESCRIPTION OF THE SCHEME

This section contains a description of the Scheme and should be read in conjunction with the more detailed information which will be presented in the Explanatory Statement forming part of the Scheme Documents. The Explanatory Statement will be made available to Scheme Creditors immediately following the Scheme Convening Hearing. Scheme Creditors are also referred to the practice statement letter published by the Bank in connection with the Scheme.

The terms of the Scheme will be considered by the Court at the Scheme Convening Hearing and the Scheme Sanction Hearing. The Scheme Convening Hearing is expected to be held on 18 November 2013 and the Scheme Sanction Hearing is anticipated to be held on or about 16 December 2013.

The convening of the Scheme Meeting and the sanctioning of the Scheme by the Court are subject to the discretion of the Court. Leave to convene the Scheme Meeting will not necessarily be granted at the Scheme Convening Hearing and/or the Scheme Meeting may not be convened in the manner sought by the Bank and described herein. Holders of Dated Notes should read carefully the Explanatory Statement once it is made available (which is currently expected to be 19 November 2013) for definitive information with respect to the Scheme.

2.1 *Purpose of the Scheme*

The purpose of the Scheme, as part of the Liability Management Exercise, is to enable the Bank, with the approval of the requisite majorities of Scheme Creditors, to require and effect the exchange of the entire aggregate principal amount of Dated Notes outstanding, together with any accrued but unpaid interest on such Dated Notes up to (and including) the Scheme Record Date, for a combination of New Ordinary Shares and Bank T2 Notes.

If the requisite majorities of Scheme Creditors vote in favour of the Scheme at the Scheme Meeting and the Court sanctions the Scheme at the Scheme Sanction Hearing, the Bank will, subject to satisfaction of certain conditions to the implementation of the Scheme (which will be described in the Explanatory Statement), be able to require and effect the exchange of all Dated Notes in accordance with the terms of the Scheme, including Dated Notes held by Holders who do not vote in favour of the Scheme.

2.2 *Nature of the Scheme*

The Scheme is a scheme of arrangement under the laws of England and Wales. A scheme of arrangement is a formal procedure under Part 26 of the Companies Act 2006 which enables a company to agree a compromise or arrangement with its creditors or any class of its creditors in respect of its debts or obligations owed to those creditors. A scheme of arrangement requires the following to occur in order to become legally binding:

(a) the approval of a majority in number representing at least 75 per cent. in value of the creditors or class of creditors present in person or by proxy and voting at the meeting convened to approve the scheme of arrangement;

(b) the approval of the Court by the making of an order sanctioning the scheme of arrangement; and

(c) the delivery of the order sanctioning the scheme of arrangement to the Registrar of Companies.

If the scheme of arrangement is approved by the requisite majorities and sanctioned by the Court and the order sanctioning the scheme of arrangement is delivered as set out above, the scheme of arrangement will bind all the creditors subject to it, both those creditors who voted in favour of it and those creditors who voted against it or did not vote at all.

A scheme of arrangement cannot be sanctioned by the Court unless the Court is satisfied, among other things, that the relevant provisions of part 26 of the Companies Act 2006 have been complied with and an intelligent and honest person, a member of the class concerned and acting in respect of his own interest, might reasonably approve the scheme of arrangement.

2.3 ***Key Dates and Times***

An indicative timetable for the Scheme is set out in Part 2 of this Section D. Certain key dates relevant to the Scheme are set out below:

- the initial Court hearing, at which the Bank will seek leave to convene the Scheme Meeting (the "**Scheme Convening Hearing**") is expected to be held on 18 November 2013.
- the Voting Instruction Deadline is scheduled for 4.30 p.m. (London time) on 10 December 2013.
- the Scheme Record Date is expected to be 10 December 2013.
- the Scheme Meeting is expected to be convened on 11 December 2013.
- the second Court hearing, at which the Bank will request the sanction of the Scheme by the Court (the "**Scheme Sanction Hearing**"), is expected to be held on 16 December 2013.
- the Scheme Settlement Date is expected to be 18 December 2013.

The times and dates given above are indicative only, and may be changed by the Bank if so required or permitted by the Court.

2.4 ***Identity of Scheme Creditors***

The Scheme will be proposed by the Bank in respect of the Dated Notes. The creditors in respect of which the Scheme will be proposed (the "**Scheme Creditors**") will consist of:

(a) the direct creditors in respect of the Dated Notes - the common depositary for each Series of Dated Notes as holder of the global note or global notes representing the relevant Series of Dated Notes and the trustee for each Series of Dated Notes solely as the beneficiary of the covenant to pay principal and interest on the relevant Series of Dated Notes; and

(b) the contingent creditors in respect of the Dated Notes - the Holders as the beneficial owners of and/or the persons with the ultimate economic interest in the Dated Notes.

The Holders, as the beneficial owners of and/or the persons with the ultimate economic interest in the Dated Notes, are the persons with the "real" interest in the Dated Notes and accordingly they will be entitled to vote in respect of the Scheme. To avoid double counting in respect of the Dated Notes, the trustee and common depositary in respect of each Series of Dated Notes will not exercise any voting rights to which they may be entitled as Scheme Creditors. References in this Offer Memorandum to "Scheme Creditors" should be construed accordingly.

2.5 ***Composition of class for the Scheme Meeting***

By their terms, the Dated Notes would rank *pari passu* amongst themselves on a winding up of the Bank. Further, if the Liability Management Exercise were to be unsuccessful and the relevant UK authorities were to exercise their powers under the Banking Act 2009 in order to resolve the Bank, the Bank believes that all of the Holders of the Dated Notes would be treated equally.

Accordingly, the rights of all of the Holders of Dated Notes are substantially the same (or are not so dissimilar as to make it impossible for them to consult together with a view to their common interest). The Bank therefore considers that it is appropriate for the Holders of the Dated Notes to vote together as one class at the Scheme Meeting.

2.6 ***Scheme Meeting***

The Scheme Meeting, for the purpose of considering and, if thought fit, approving the Scheme, will be convened in accordance with the order of the Court made at the Scheme Convening Hearing. The Bank will request the Court to order that the Scheme Meeting be convened on 11 December 2013.

For the avoidance of doubt and as the Scheme Meeting will be convened pursuant to an order of the Court, the procedures for the Scheme Meeting will be as set out in the Explanatory Statement (and not the procedures for the convening of noteholder meetings as set out in the trust deeds applicable to the Dated Notes).

2.7 ***Voting at the Scheme***

Detailed instructions in relation to voting at the Scheme Meeting will be set out in the Explanatory Statement.

In order to vote at the Scheme Meeting (either in person or by proxy), each Holder will be required to ensure that its Account Holder (or, if the Holder is an Account Holder, it) has completed and submitted to the Information Agent a valid Account Holder Letter before the Voting Instruction Deadline (being 4.30 p.m. (London time) on 10 December 2013).

If a Holder has not delivered a valid Account Holder Letter for the purpose of voting to the Information Agent before the Voting Instruction Deadline, then (subject to the following paragraph) that Holder will not be entitled to vote at the Scheme Meeting. Furthermore, as described below, if the Scheme is sanctioned and implemented, a Holder which has not delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing will not receive its New Ordinary Shares and Bank T2 Notes, which it is entitled to receive as Scheme Consideration in exchange for its Dated Notes, on the Scheme Settlement Date, but will need to take certain additional steps in order to demonstrate to the reasonable satisfaction of the Bank that it was a Scheme Creditor as at the Scheme Record Date and/or is eligible (or has nominated a Designated Recipient) to receive such Scheme Consideration.

Notwithstanding the foregoing paragraph, the chairman appointed in respect of the Scheme Meeting (the "**Scheme Chairman**") will be entitled, at his/her sole discretion, to permit a Holder in respect of which a completed Account Holder Letter has not been delivered prior to the Voting Instruction Deadline to vote at the Scheme Meeting if the Scheme Chairman considers that the relevant Holder has produced sufficient proof that it is a Scheme Creditor.

2.8 ***Scheme becoming effective***

Scheme Sanction Hearing

If the Scheme is approved by the Scheme Creditors at the Scheme Meeting, a date is then set for the Scheme Sanction Hearing for the Court to sanction the Scheme. Once the date of the Scheme Sanction Hearing is confirmed by the Court, the Bank will give notice to the Scheme Creditors via the Regulatory News Service (RNS) operated by the London Stock Exchange. The Bank currently expects that the Scheme Sanction Hearing will be held on or about 16 December 2013.

At the Scheme Sanction Hearing, the Bank will be entitled to consent on behalf of all Scheme Creditors to any modification of the Scheme or any term or condition which the Court may think fit to approve or impose and which would not directly or indirectly have a materially adverse effect on the interests of any Scheme Creditor under the Scheme.

The Scheme (if approved by the requisite majority of Scheme Creditors at the Scheme Meeting and sanctioned by the Court at the Scheme Sanction Hearing) will become effective in accordance with its terms, and will be binding on the Bank and the Scheme Creditors, when an office copy of the order of the Court sanctioning the Scheme is delivered to the Registrar of Companies.

Scheme Settlement Date

If the Scheme becomes effective, the Bank currently expects the exchange of the Dated Notes for a combination of New Ordinary Shares and Bank T2 Notes to be effected on 18 December 2013 (the "**Scheme Settlement Date**").

On and from the Scheme Settlement Date, the Scheme Creditors will have no further rights, title or benefit to the Dated Notes but shall be entitled to receive Scheme Consideration in accordance with the terms of the Scheme.

3. SCHEME CONSIDERATION

3.1 *Overview of Scheme Consideration*

If the Scheme is sanctioned and implemented, all the Dated Notes (together with accrued and unpaid interest thereon up to (and including) the Scheme Record Date) will be exchanged on the Scheme Settlement Date for:

(a) a number of New Ordinary Shares in the Bank; and

(b) a principal amount of Bank T2 Notes issued by the Bank.

The number of New Ordinary Shares and principal amount of Bank T2 Notes to which a Holder will become entitled will be determined in accordance with the terms of the Scheme which are described in the following provisions of this paragraph 3.

The consideration to which Holders will become entitled upon exchange of their Dated Notes (together with accrued and unpaid interest thereon up to (and including) the Scheme Record Date) pursuant to the Scheme (comprising the New Ordinary Shares and Bank T2 Notes) is referred to in this Offer Memorandum as "**Scheme Consideration**".

3.2 *Early Participation Threshold not relevant*

The number of New Ordinary Shares and principal amount of Bank T2 Notes which a Holder will receive in exchange for its Dated Notes (on the basis of its Scheme Claim as defined below) if the Liability Management Exercise is successfully completed will be the same irrespective of whether or not the Early Participation Threshold is achieved by the Early Participation Deadline.

3.3 *Scheme Consideration: accrued interest and Scheme Claims*

The "**Scheme Record Date**" for the Scheme is currently expected to be 10 December 2013.

A Holder's claim in the Scheme (its "**Scheme Claim**") will be equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme Claim in respect of 2016 Notes (which are denominated in euro) shall be the Sterling-Equivalent of such sum, calculated as provided in paragraph 3.6 below.

The amount of a Holder's Scheme Claim will be used to determine the number of New Ordinary Shares and principal amount of Bank T2 Notes which such Holder will be entitled to receive in exchange for its Dated Notes if the Scheme is settled, as further described in paragraphs 3.4 and 3.5 below. For the avoidance of doubt, no accrued interest will be paid in cash pursuant to the Scheme.

The Scheme will provide that any interest that accrues or falls due for payment after the Scheme Record Date will be irrevocably cancelled on the Scheme Settlement Date.

Note:

Since Scheme Claims will include a component of accrued and unpaid interest on the Dated Notes and there is a finite amount of New Ordinary Shares and Bank T2 Notes available in the Scheme, the percentages and Conversion Price given in paragraphs 3.4 and 3.5 below are indicative only, pending determination of the floating rate of interest applicable to the interest period commencing 18 November 2013 in respect of the 2016 Notes. For the purpose of the indicative figures below, an assumed 3-month EURIBOR rate of 0.228 per cent. (the rate prevailing as at 30 October 2013) has been applied. The actual rate is expected to be determined on 14 November 2013 and, once determined, the Bank will announce the final percentages and Conversion Price via the Regulatory News Service (RNS) operated by the London Stock Exchange. The final percentages and Conversion Price are not expected to differ materially from the indicative percentages and Conversion Price specified in paragraphs 3.4 and 3.5 below.

3.4 ***Scheme Consideration: number of New Ordinary Shares***

The number of New Ordinary Shares to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by:

(a) multiplying such Holder's Scheme Claim by 89.737* per cent.; and

(b) dividing the resulting figure by £7.7718292* (being the Conversion Price for the New Ordinary Shares) and, if necessary, rounding such figure down to the nearest whole number of New Ordinary Shares (any fractional amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

**Indicative only – see the Note in paragraph 3.3 above.*

3.5 ***Scheme Consideration: principal amount of Bank T2 Notes***

The principal amount of Bank T2 Notes to which a Holder will (if the Scheme is settled) be entitled based on its Scheme Claim will be calculated by multiplying such Holder's Scheme Claim by 10.263* per cent. and, if necessary, rounding the resulting figure down to the nearest whole multiple of £10 (being the minimum denomination of the Bank T2 Notes) (any amount so rounded down will be discarded and the Holder shall have no entitlement in respect thereof).

**Indicative only – see the Note in paragraph 3.3 above.*

3.6 ***Sterling-Equivalent amounts for the 2016 Notes***

The "**Sterling-Equivalent**" of any euro amount in respect of a 2016 Note will, for the purposes of determining the Scheme Claim of a Holder of 2016 Notes and for all other purposes under the Liability Management Exercise (including for determining the weighting of the votes of Holders of 2016 Notes at the Scheme Meeting) be the amount in sterling determined by the Bank to be equivalent to such euro amount by reference to the Scheme FX Rate of £0.85644 per €1.00.

4. OFFER OF ADDITIONAL NEW ORDINARY SHARES

62,500,000 additional New Ordinary Shares (the "**Additional New Ordinary Shares**") will be made available to Holders of the Dated Notes for subscription at an effective subscription price of £2 per Additional New Ordinary Share under the terms of the Scheme for an aggregate consideration equal to £125 million (the "**Additional New Ordinary Shares Offer**").

The Bank has entered into an agreement with certain Holders of the Dated Notes (the "**Purchasers**") on 4 November 2013 (the "**Purchase Agreement**"). The terms of the Purchase Agreement provide that the Purchasers will subscribe for any Additional New Ordinary Shares unallocated or not taken up under the Additional New Ordinary Shares Offer. The Bank will pay the Purchasers a fee equal to 4 per cent. of £125 million (the "**Purchaser Premium**").

All Holders of Dated Notes will be entitled to participate in a sub-purchase of the Additional New Ordinary Shares which are the subject of the Purchase Agreement (the "**Sub-purchase Offer**", and the sub-purchase of the Additional New Ordinary Shares the subject of the Purchase Agreement, the "**Sub-purchase**"). The Sub-purchase Offer will be available to all Holders of Dated Notes, including the Purchasers. To participate in the Sub-purchase Offer, a Holder of Dated Notes (the "**Sub-purchaser**") will be entitled to nominate the commitment which that Holder is prepared to sub-purchase, subject to a maximum commitment of £125 million and a minimum commitment of £100,000. The allocation of sub-purchasing commitments to a Holder of Dated Notes that wishes to participate in the Sub-purchase Offer will, in the case of aggregate nominations being less than £125 million, be the amount of Sub-purchasers' nominations and, in the case of nominations in aggregate exceeding £125 million, be *pro rata* based on the proportion of its Scheme Claim (as at the Scheme Record Date) to the aggregate Scheme Claims of all Holders (as at the Record Date) who have elected to participate in the Sub-purchase Offer, subject to (i) a minimum commitment of £100,000 and (ii) a maximum commitment equal to the amount of the sub-purchasing commitment elected for by that Holder (the "**Sub-purchasing Commitment**"); provided always that the aggregate amount of all Sub-purchasing Commitments allocated to all Holders of Dated Notes that participate in the Sub-purchase Offer is no greater than £125 million.

The Sub-purchasers will be required to enter into an agreement with the Bank on or around the date of the Scheme Meeting (the "**Sub-purchase Agreement**"). The Bank will pay each Sub-purchaser a fee equal to 2 per cent. of their Sub-purchasing Commitment, provided that they comply with their obligations under the Sub-purchase Agreement (the "**Sub-purchaser Premium**"). The aggregate Purchaser Premium payable to the Purchasers will be reduced in an amount equal to the aggregate Sub-purchaser Premium paid to the Sub-purchasers, such reduction to be allocated among the Purchasers based on their subscription commitment as set out in the Purchase Agreement.

To the extent that the aggregate allocation of Additional New Ordinary Shares to all Holders of Dated Notes who elect to participate in the Additional New Ordinary Shares Offer is less than 62,500,000 Additional New Ordinary Shares, the Sub-purchasers pursuant to the Sub-purchase Agreement will be required to subscribe for such number of remaining Additional New Ordinary Shares up to their Sub-purchasing Commitments. If there are still Additional New Ordinary Shares to be issued, the Purchasers under the Purchase Agreement will be required to subscribe for the remaining Additional New Ordinary Shares in accordance with the terms of the Purchase Agreement. Furthermore, if a Holder of Dated Notes elects to participate in the Additional New Ordinary Shares Offer, or participates in the Sub-purchase Offer, but, in either case, fails to fund the purchase of its allocation of Additional New Ordinary Shares in accordance with the terms of the Additional New Ordinary Shares Offer, or the Sub-purchasing Commitment, as applicable, the Purchasers will also be required to subscribe for those New Ordinary Shares in accordance with the terms of the Purchase Agreement.

5. DESCRIPTION AND DELIVERY OF NEW ORDINARY SHARES AND BANK T2 NOTES

5.1 *Description of the New Ordinary Shares*

The New Ordinary Shares will comprise voting ordinary shares in the Bank (ISIN: GB00BDW0BX87; SEDOL: BDW0BX8) having a nominal value of £0.05 each.

The New Ordinary Shares will be in registered form and, subject to the provisions of the CREST Regulations, the Directors of the Bank may permit the holding of shares in any class of shares in uncertificated form and title to such shares may be transferred by means of a relevant system (as defined in the CREST Regulations).

Accordingly, it is expected that the New Ordinary Shares will be issued in CREST. With respect to New Ordinary Shares held in CREST, it will be possible to trade interests in such New Ordinary Shares indirectly in Euroclear and Clearstream, Luxembourg. In this case, the New Ordinary Shares themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the New Ordinary Shares held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

The New Ordinary Shares will not be listed upon issue.

Further detailed information relating to the Bank and the New Ordinary Shares, including a description of certain risks relating to an investment in New Ordinary Shares, is set out in the Explanatory Statement.

5.2 *Description of the Bank T2 Notes*

The Bank T2 Notes will pay a fixed rate of interest of 11 per cent. per year on their principal amount, and interest will be paid quarterly in arrear on each three-month anniversary of the issue date of the

Bank T2 Notes up to (and including) the tenth anniversary of the issue date. The Bank will be obliged to repay the principal amount of the Bank T2 Notes on the tenth anniversary of their issue date.

The Bank T2 Notes will have denominations of £10 each.

Upon issue, the Bank T2 Notes will be capable of being held in dematerialised book-entry form in CREST or in certificated form outside CREST.

With respect to Bank T2 Notes held in certificated form outside CREST (if any), Computershare (in its capacity as registrar for the Bank T2 Notes) will arrange for certificates evidencing such holding to be mailed to the relevant holders.

With respect to Bank T2 Notes held in CREST, it will be possible to trade interests in such Bank T2 Notes indirectly in Euroclear and Clearstream, Luxembourg. In this case, the Bank T2 Notes themselves will be held in a CREST account by a nominee for Euroclear or Clearstream, Luxembourg (as applicable), and Euroclear and Clearstream, Luxembourg will enable interests representing the Bank T2 Notes held in those nominee accounts to be traded in Euroclear and Clearstream, Luxembourg.

Detailed information relating to the Bank and the Bank T2 Notes, including the full terms and conditions of the Bank T2 Notes and a description of certain risks relating to an investment in Bank T2 Notes, is set out in the Bank T2 Prospectus.

The Bank has, pursuant to the Bank T2 Prospectus, made an application to the Financial Conduct Authority for the Bank T2 Notes to be admitted to the Official List maintained by the Financial Conduct Authority and to the London Stock Exchange plc for such Bank T2 Notes to be admitted to trading on its regulated market. It is intended that admission to listing and trading will become effective on the Scheme Settlement Date.

5.3 ***Delivery of the New Ordinary Shares and Bank T2 Notes***

New Ordinary Shares and Bank T2 Notes to be delivered in exchange for Dated Notes will be delivered to each Holder which has delivered to the Information Agent a valid Account Holder Letter on or before the date of the Scheme Sanction Hearing in the Euroclear or Clearstream, Luxembourg account in which the relevant Dated Notes are blocked. The New Ordinary Shares and Bank T2 Notes will be delivered to the same account in Euroclear or Clearstream, Luxembourg in which such Holder holds its Dated Notes.

If a Holder has not delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing, the New Ordinary Shares and Bank T2 Notes to which such Holder becomes entitled upon exchange of its Dated Notes will be delivered to the Holding Period Trustee.

Such Bank T2 Notes and New Ordinary Shares will be held on trust by the Holding Period Trustee pending:

(i) confirmation for or on behalf of the relevant Holder that it or its Designated Recipient is eligible to receive the Bank T2 Notes and New Ordinary Shares, at which time the Holding Period Trustee will transfer the relevant Bank T2 Notes and New Ordinary Shares to that Holder or its Designated Recipient;

(ii) confirmation for or on behalf of the relevant Holder that it is not eligible to receive the Bank T2 Notes or New Ordinary Shares, at which time the relevant Bank T2 Notes and New Ordinary Shares will be sold by or on behalf of the Holding Period Trustee and the net proceeds of sale (after deduction of all applicable taxes and expenses) will be distributed to that Holder; or

(iii) the date falling 36 months following the Scheme Settlement Date, at which time the Holding Period Trustee will sell or procure the sale of the Bank T2 Notes and New Ordinary Shares not already distributed or sold as described in (i) and (ii) above and the net proceeds of such sale (after deduction of all applicable taxes and expenses) will be distributed to the Bank.

Further detail with respect to the Holding Period arrangements are further described in the Explanatory Statement.

5.4 ***Delivery of the Dated Notes***

Upon exchange, the Dated Notes will be cancelled.

6. LOCK-UP ARRANGEMENTS

Each Holder of Dated Notes has the opportunity to enter into a lock-up arrangement (a "**Lock-up Arrangement**") with the Bank pursuant to which such Holder will agree, amongst other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.

7. REPRESENTATIONS, WARRANTIES, ACKNOWLEDGEMENTS, AGREEMENTS AND UNDERTAKINGS

Each Holder which submits, delivers or procures the delivery of an Account Holder Letter will make a number of representations, warranties, acknowledgements, agreements and undertakings set out in the Account Holder Letter.

8. THE SETTLEMENT CONDITION

8.1 The Liability Management Exercise will only be successfully completed if the entire principal amount of all Existing Securities is exchanged pursuant to the Liability Management Exercise.

8.2 In order for the entire principal amount of all Existing Securities to be exchanged pursuant to the Liability Management Exercise, all of the following must occur:

(a) the Proposal in respect of the Preference Shares must be (i) approved by the Holders of the Preference Shares at the Preference Shareholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) (and substantially the same resolution must be approved at the General Meeting also) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(b) the Proposal in respect of the 13% Bonds must be (i) approved by the Holders of the 13% Bonds at the 13% Bondholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum;

(c) the Proposal in respect of the 5.5555% Bonds must be (i) approved by the Holders of the 5.5555% Bonds at the 5.5555% Bondholders Meeting (including, if such Meeting is adjourned, at the adjourned meeting) and (ii) capable of being implemented in accordance with the terms of that Proposal as set out in this Offer Memorandum; and

(d) (i) the Scheme must be approved by the requisite majority of the Holders of the Dated Notes at the Scheme Meeting and sanctioned by the Court; (ii) an office copy of the sanction order must be delivered to the Registrar of Companies at Companies House; and (iii) the Scheme must become unconditional in accordance with its terms (subject only to satisfaction of the Settlement Condition).

The requirements of sub-paragraphs (a) to (d) (inclusive) above are collectively referred to in this document as the "**Settlement Condition**".

8.3 The occurrence of the Scheme Settlement Date is conditional upon the Settlement Condition being satisfied. The last date on which the Liability Management Exercise may successfully complete is 31 December 2013.

8.4 **<u>The Settlement Condition is not capable of being waived.</u>** Accordingly, if the Settlement Condition is not satisfied, the Liability Management Exercise will not be implemented, and no Existing Securities will be exchanged or sold (and no New Securities will be issued) pursuant to the Liability Management Exercise.

9. RECEIPT OF NEW ORDINARY SHARES AND BANK T2 NOTES

9.1 If the Scheme is implemented, the Bank will deliver (or procure the delivery of) (i) the New Ordinary Shares and Bank T2 Notes to which Holders become entitled based on their Scheme Claims, and (ii) any Additional New Ordinary Shares to be delivered pursuant to the Additional New Ordinary Shares Offer, in each case on the Scheme Settlement Date.

9.2 If a Holder has delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing, the New Ordinary Shares and Bank T2 Notes which such Holder becomes entitled to receive will be delivered in the Euroclear or Clearstream, Luxembourg account in which such Holder held its Dated Notes.

9.3 Holders should note that the Bank will procure the delivery of such New Ordinary Shares and Bank T2 Notes to the relevant Clearing System(s) on the Scheme Settlement Date. Each Clearing System will subsequently arrange for the onward transmission of those New Ordinary Shares and Bank T2 Notes to the Holders entitled thereto in accordance with its usual procedures. It is possible that certain Holders may therefore not receive their New Ordinary Shares and/or Bank T2 Notes until after the Scheme Settlement Date.

9.4 The delivery of the New Ordinary Shares and the Bank T2 Notes to the relevant Clearing System(s) on or before the Scheme Settlement Date will discharge the Bank's obligations in respect of the delivery of such New Ordinary Shares and Bank T2 Notes. Thereafter, the Holders entitled to such New Ordinary Shares and Bank T2 Notes must look to the relevant Clearing System for receipt of such New Ordinary Shares and Bank T2 Notes.

9.5 Provided that the Bank delivers the New Ordinary Shares and the Bank T2 Notes to the relevant Clearing Systems on or before the Scheme Settlement Date, the Bank will not be liable to pay any compensation or other additional amounts in the event that a Holder receives its entitlement to such New Ordinary Shares and/or Bank T2 Notes after the Scheme Settlement Date.

9.6 If a Holder has not delivered to the Information Agent a valid Account Holder Letter, with the relevant eligibility confirmations and details duly completed, on or before the date of the Scheme Sanction Hearing, the New Ordinary Shares and Bank T2 Notes which such Holder becomes entitled to receive will be delivered to the Holding Period Trustee, and such Holder will need to take certain additional steps in order to demonstrate to the reasonable satisfaction of the Bank that it was a Holder as at the Scheme Record Date and/or is eligible (or has nominated an eligible Designated Recipient) to receive such New Ordinary Shares and Bank T2 Notes, as further described in the Explanatory Statement. Provided that the Bank delivers such New Ordinary Shares and Bank T2 Notes to or to the order of the Holding Period Trustee on or before the Scheme Settlement Date, the Bank will not be liable to pay any compensation or other additional amounts to such Holder.

10. ANNOUNCEMENTS

Unless stated otherwise or as required by order of the Court, announcements in relation to the Scheme will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Account Holders; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Information Agent, the contact details for which are at the end of this Offer Memorandum.

11. IRREGULARITIES

All questions as to the validity, form and eligibility (including the time of receipt) of any Account Holder Letter or any withdrawal, revocation or revision thereof or delivery of Dated Notes will be determined by the Bank in its sole and absolution discretion, which determination will be final and binding. The Bank reserves the absolute right to reject any and all Account Holder Letters not in proper form or for which any corresponding agreement by the Bank would, in the opinion of the Bank, be unlawful. The Bank also reserves the absolute right to waive any defects in any Account Holder Letter. None of the Bank, the Group, the Dealer Managers or the Information Agent shall be under any duty to give notice to Holders, Direct Participants or any intermediaries of any irregularities in Account Holder Letters.

12. SCHEME NOT IMPLEMENTED; OTHER PURCHASES

Notwithstanding any other provision of this Offer Memorandum, if the Scheme is not implemented, the Bank, the Group and/or any of their affiliates may (subject to applicable law and regulation and the terms of the Dated Notes) at any time after termination of the Scheme exchange, purchase or otherwise acquire Dated Notes pursuant to privately agreed market transactions or any other arrangement at a price or exchange ratio which may be more or less favourable than the terms of the Scheme.

13. CALCULATIONS AND DETERMINATIONS BY THE BANK

The terms of the Scheme will provide for the Bank to make certain determinations and perform certain calculations in respect of the Scheme. All such determinations and calculations by the Bank in good faith will, in the absence of manifest error, be conclusive and binding on the Bank, the Group and the Holders.

14. RELEASE

The terms of the Scheme will include a release of certain persons, including the Bank, the Group, the Dealer Managers, the Information Agent and their respective financial and legal advisers (together in each case with their respective directors, members and representatives) from any liabilities in relation to or arising in connection with the preparation, negotiation or implementation of the Scheme, to the fullest extent permitted by law, as will be more fully described in the Explanatory Statement.

15. THIRD PARTIES

As the Scheme will be an arrangement between the Bank and the Scheme Creditors, third parties which are required to take certain steps or perform certain functions pursuant to the terms of the Scheme will be requested to provide undertakings in favour of the Bank and the Court that they will take those steps and perform those functions in accordance with the terms of the Scheme.

16. GOVERNING LAW AND SUBMISSION TO JURISDICTION

The Scheme, any Account Holder Letters and any non-contractual obligations arising out of or in connection therewith shall be governed by, and construed in accordance with, English law.

SECTION D: DATED NOTES

PART 2

INDICATIVE TIMETABLE FOR THE SCHEME OF ARRANGEMENT

The times and dates referred to below are indicative only and are subject to the right of the Bank (if required or permitted by the Court) to amend and/or withdraw the Scheme at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank as soon as reasonably practicable.

Events	*Dates and Times (all times are London time)*
Announcement of the Scheme Scheme announced. Practice statement letter sent to Scheme Creditors	4 November 2013
Announcement of Consideration Amounts in the Scheme Announcement of the final Consideration Amounts and New Ordinary Share Conversion Price in the Scheme.	On or around 14 November 2013
Scheme Convening Hearing Initial Court hearing for leave to convene the Scheme Meeting	18 November 2013
Explanatory Statement and Scheme Documents available Explanatory Statement and Scheme Documents available to Scheme Creditors	19 November 2013
Voting Instructions Deadline Deadline for receipt of all Account Holder Letters containing voting instructions in order for Holders to vote on the Scheme and elections to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer under the Scheme	4.30 p.m. on 10 December 2013
Scheme Record Date Only those Holders who are Scheme Creditors as at the Scheme Record Date are entitled to attend and vote at the Scheme Meeting (unless the Bank, in its sole discretion, elects to recognise, for the purposes of the Scheme, a transfer of Dated Notes after the Scheme Record Date such that the transferee becomes a Scheme Creditor)	10 December 2013
Scheme Meeting Meeting of the Scheme Creditors to vote on the Scheme. The Bank will request the Court to convene the Scheme Meeting on 11 December 2013	11 December 2013
Results Announcement Announcement of the results of the Scheme Meeting.	12 December 2013

Events	*Dates and Times (all times are London time)*
Scheme Sanction Hearing Second Court hearing for sanction of the Scheme by the Court. The Bank will announce as soon as reasonably practicable after the Scheme Sanction Hearing whether or not the Scheme is sanctioned.	16 December 2013
Filing of sanction order Sanction order (if granted) delivered to the Registrar of Companies. Scheme becomes effective in accordance with its terms	The date of the Scheme Sanction Hearing or the following business day
Scheme Settlement Date Expected settlement of the Scheme, including issue and delivery of New Ordinary Shares, Bank T2 Notes and Additional New Ordinary Shares.	18 December 2013

The above timetable may be impacted in certain respects if any of the Meetings in respect of the Preference Shares, the 13% Bonds and the 5.5555% Bonds are required to be adjourned. If any of the Meetings are required to be adjourned, the Bank currently expects that the settlement date for the Scheme will be postponed to on or around 31 December 2013.

If the timetable is changed for any reason, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

Unless stated otherwise or required by order of the Court, announcements in relation to the Scheme will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Information Agent, the contact details for which are at the end of this Offer Memorandum.

Holders are advised to check with any custodian, broker or other intermediary through which they hold their Dated Notes when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in the Scheme.

SECTION E

AMENDMENT AND TERMINATION AND REVOCATION RIGHTS

1. AMENDMENT AND TERMINATION

Notwithstanding any other provision of the Liability Management Exercise, the Bank and/or the Group may, subject to applicable law and regulation, at their option (and, if and to the extent required in the case of the Scheme, at the direction or with the permission of the Court), at any time before settlement of the Exchange Offers or the Scheme:

1.1 extend the Early Participation Deadline, Expiration Deadline, Offer Record Date, Scheme Record Date, Voting Instruction Deadline, Settlement Date, Scheme Settlement Date and/or re-open the Exchange Offers or the Scheme, in respect of the Liability Management Exercise or any component part or parts thereof (in which case all references in this Offer Memorandum to the relevant date, time or deadline shall, unless the context otherwise requires, be to the latest date and/or time to which such date, time or deadline has been so extended);

1.2 otherwise amend the Offers or the Scheme or any one or more of them in any respect (including, but not limited to, any terms and conditions of the Offers or the Scheme, any terms and conditions of the New Securities or any of them and any scheduled date for any specified event);

1.3 delay acceptance or, subject to applicable law, exchange or sale of Existing Securities validly offered for exchange or sale or otherwise to be exchanged in the Liability Management Exercise until satisfaction or waiver (where waiver is permitted) of any conditions of the Liability Management Exercise; or

1.4 terminate the Liability Management Exercise or any component part of parts thereof, including (without limitation) in respect of any one or more Series of Existing Securities, and including with respect to Exchange Instructions and/or Account Holder Letters submitted before the time of such termination.

For the avoidance of doubt, the Bank and the Group may amend the Offers in respect of any one or more Series of Existing Securities without amending the Offers in respect of any other Series of Existing Securities, and may amend the Offers or any of them without amending or terminating the Scheme and *vice versa*.

If the Settlement Date or Scheme Settlement Date is postponed at the option of the Bank or the Group, Holders shall not be entitled to revoke their Exchange Instructions (or, as the case may be, if such postponement is effected after the Voting Instruction Deadline, their Account Holder Letters), or to any compensation or other amounts in respect of such postponement, provided that the Settlement Date and Scheme Settlement Date shall not be postponed for more than 45 calendar days from the currently scheduled date of 18 December 2013.

Neither the Bank nor the Group shall be liable under any provision contained in this Offer Memorandum to any Holder in respect of any costs incurred by such Holder in connection with the Liability Management Exercise, including if the Bank amends or terminates the Liability Management Exercise or any component part or parts of it.

Publication of Supplementary Prospectuses

In the event of any significant new factor, material mistake or inaccuracy relating to information included in the Bank T2 Prospectus or the Group Notes Prospectus (including, in each case, this Offer Memorandum) which is capable of affecting the assessment of the Exchange Offers, the Proposals or any of them, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate. For the avoidance of doubt, significant new factors would include (but are not limited to) amendments to the terms and conditions of the Exchange Offers or the Proposals or any of them – see "*Revocation Rights*" below.

2. REVOCATION RIGHTS

2.1 Publication of Supplementary Prospectuses and Revocation of Exchange Instructions

Exchange Instructions shall be irrevocable except in the limited circumstances described in this sub-section.

If, at any time after commencement of the offer period and prior to the relevant Settlement Date:

(a) any material amendment to the terms and conditions of the Offers or any of them or the Scheme (including to the terms of the New Securities or any of them) is made by the Bank and/or the Group; or

(b) there arises or is noted a significant new factor, material mistake or inaccuracy relating to the information included in the Prospectuses or any of them which is capable of affecting an assessment of the Liability Management Exercise or any component part or parts thereof or an assessment of the New Securities or any of them,

the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

Upon the publication of any supplement to the Bank T2 Prospectus and/or the Group Notes Prospectus, Holders may elect to withdraw their Exchange Instructions during the period of two Business Days (or such longer period as the Bank and/or the Group may specify in the relevant supplement) commencing on (and including) the first Business Day after the date on which the relevant supplement is published.

Holders who hold their Existing Securities in Euroclear, Clearstream, Luxembourg or CREST are advised to check with such Clearing System and any broker, custodian or other intermediary through whom they hold their Existing Securities by what time such Clearing System and/or intermediary require instructions from the Holder in order for the Clearing System and/or intermediary to revoke such Holder's Exchange Instructions. The Clearing Systems and any such intermediary will require instructions in advance of the deadline for revocation specified above.

Holders wishing to exercise any such right of revocation should do so in accordance with the procedures set out in the relevant Section of this Offer Memorandum. For the avoidance of doubt, any Holder who does not exercise any such right of revocation in the circumstances and in the manner provided herein shall be deemed to have waived such right of revocation and its original Exchange Instruction will remain effective.

2.2 Revocation of Account Holder Letters

Account Holder Letters may be revoked before the Voting Instruction Deadline but are irrevocable thereafter, as will be further described in the Explanatory Statement.

SECTION F

OFFER RESTRICTIONS

RESTRICTIONS RELATING TO THE EXCHANGE OFFERS

This Offer Memorandum does not constitute an offer or an invitation to participate in the Exchange Offers in any jurisdiction in or from which, or to any person to whom, it is unlawful to make such offer or invitation under applicable laws. The distribution of this Offer Memorandum is permitted in the United Kingdom and the United States but may be restricted by law in other jurisdictions. Persons into whose possession this Offer Memorandum comes are required by each of the Bank, the Group, the Dealer Managers and the Exchange Agent to inform themselves about, and to observe, any such restrictions.

United States

The Exchange Offers are being made, and any New Securities to be issued pursuant to the Exchange Offers are being offered and will be issued, only to persons that are persons other than "U.S. persons", as that term is defined in Regulation S under the United States Securities Act of 1933 (as amended, the "**Securities Act**"), in offshore transactions in reliance upon Regulation S under the Securities Act, and only such persons are authorised to participate in the Exchange Offers.

None of the New Securities nor any guarantee in respect thereof have been or will be registered under the Securities Act, or any state securities laws. Accordingly, the New Securities will be subject to restrictions on transferability and resale and may not be transferred or resold except as permitted under the Securities Act and other applicable securities laws, pursuant to an exemption from registration. Registration rights will not be granted in favour of the New Securities. Holders who wish to participate in the Exchange Offers will be required to represent that they will not resell or otherwise transfer the New Securities during the 40 day period commencing on the Settlement Date for the Exchange Offers except outside of the United States in a transaction complying with Rule 903 or 904 of Regulation S.

None of the U.S. Securities and Exchange Commission, any state securities commission, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System nor any other regulatory body has approved or disapproved of any of the Exchange Offers or of the New Securities or determined if this Offer Memorandum is truthful or complete. Any representation to the contrary is a criminal offence.

United Kingdom

This Offer Memorandum may only be communicated to persons in the United Kingdom in circumstances where section 21(1) of the Financial Services and Markets Act 2000 does not apply. Accordingly, this Offer Memorandum is only for circulation to persons inside the United Kingdom who fall within one of the following categories:

(i) a person who is a holder of any Existing Securities; or

(ii) any other person also falling within Article 43(2) or within Article 49(2)(a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**Order**") or falling within the definition of "investment professionals" (as defined in Article 19(5) of the Order).

This Offer Memorandum is only available in the United Kingdom to such persons, and the transactions contemplated herein will be available only to, and may be engaged in only with, such persons.

This Offer Memorandum has been issued by The Co-operative Bank p.l.c. and the Co-operative Group Limited. The Bank, which has its registered address at 1 Balloon Street, Manchester M60 4EP, United Kingdom, is authorised by the Prudential Regulation Authority (the "**PRA**") and regulated by the Prudential Regulation Authority and the Financial Conduct Authority (the "**FCA**") in the United Kingdom. To the fullest extent permitted by applicable law and regulation, no person will become a client of the Bank (within the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. The Bank is acting on its own account in relation to the Liability Management Exercise and, to the fullest extent permitted by applicable law and regulation, will not be responsible to any other person for providing the protections which would be afforded to clients of the Bank or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Belgium

The Exchange Offers may not be made, and are not being made, in the Kingdom of Belgium (i) by way of an offer of securities to the public, as defined in Article 3 § 1 of the Belgian law of 16 June 2006 on the public offering of securities and the admission of securities to trading on a regulated market (*Loi relative aux offres publiques d'instruments de placement et aux admissions d'instruments de placement à la négociation sur des marchés réglementés / Wet op de openbare aanbieding van beleggingsinstrumenten en de toelating van beleggingsinstrumenten tot de verhandeling op een gereglementeerde markt*) (the "**Prospectus Law**") nor (ii) by way of a public takeover bid, as defined in Article 3 § 1 of the Belgian Law of 1 April 2007 on public takeover bids (*Loi relative aux offres publiques d'acquisition / Wet op de openbare overnamebiedingen*) (the "**Public Takeover Law**").

The Exchange Offers will be conducted in the Kingdom of Belgium under applicable private placement exemptions in accordance with the Prospectus Law and the Public Takeover Law and therefore neither the Exchange Offers nor this Offer Memorandum have been notified to the Belgian Financial Services and Markets Authority (*Autorité des services et marchés financiers / Autoriteit voor Financiële Diensten en Markten*) ("**Belgian FSMA**") nor has this Offer Memorandum or any other information circular, brochure or similar document relating to the Exchange Offers been, nor will it be, approved by the Belgian FSMA.

Accordingly the Exchange Offers are not being made, directly or indirectly, to, or for the account of, any person (individual or legal entity) other than "qualified investors" within the meaning of Article 6, paragraph 3 of the Public Takeover Law and Article 10 of the Prospectus Law.

France

The Exchange Offers are not being made, directly or indirectly, to the public in France and only (i) providers of investment services relating to portfolio management for the account of third parties ("*personnes fournissant le service d'investissement de gestion de portefeuille pour compte de tiers*"), and/or (ii) qualified investors acting for their own account ("*Investisseurs Qualifiés*") as defined in and in accordance with Articles L.411-1, L.411-2 and D.411-1 to D.411-3 of the French *Code Monétaire et Financier* are eligible to participate in the Exchange Offers described herein. Neither this Offer Memorandum nor any other offering material relating to the Exchange Offers has been submitted to the clearance of the *Autorité des marchés financiers*.

Public Offer Selling Restriction under the Prospectus Directive

This paragraph shall not apply in respect of the United Kingdom, France or Belgium, in which regard the more specific paragraphs above shall apply.

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a "**Relevant Member State**"), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "**Relevant Implementation Date**") no offer of any New Securities is being made to the public in that Relevant Member State under this Offer Memorandum, provided however that offers of New Securities may be made:

(i) to legal entities which are qualified investors as defined in the Prospectus Directive;

(ii) to fewer than 100 or, if the relevant Member State has implemented the relevant provision of Directive 2010/73/EU, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive); or

(iii) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of New Securities above shall require the Bank or the Group to publish a prospectus pursuant to Article 3 of the Prospectus Directive, or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, an offer of New Securities to the public in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the New Securities to be offered so as to enable an investor to decide to participate in the Liability Management Exercise, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State.

General

This Offer Memorandum is intended for the personal use of the recipient only. Under no circumstances should it be reproduced or distributed to any other persons (except that custodians or other intermediaries holding Existing Securities on behalf of a beneficial owner may forward this Offer Memorandum to such beneficial owner in accordance with applicable law and regulation). The distribution of this Offer Memorandum is permitted in the United Kingdom and the United States but may be restricted by law in certain other jurisdictions. Persons into whose possession this Offer Memorandum comes are required to inform themselves about and to observe any such restrictions. This Offer Memorandum does not constitute, and may not be used for the purpose of, an offer or solicitation to the public or to anyone in any jurisdiction in which such offer or solicitation is not authorised or to any person to whom it is unlawful to make such offer or solicitation.

Nothing contained in this Offer Memorandum is intended to constitute or should be construed as legal, financial, accounting or tax advice. This Offer Memorandum is for the information of Holders of Existing Securities only and nothing in this Offer Memorandum is intended to endorse or recommend a particular course of action. Holders of Existing Securities should consult with an appropriate professional for specific advice rendered on the basis of their particular situation.

RESTRICTIONS RELATING TO THE SCHEME

The Explanatory Statement will include details of the offer and distribution restrictions applicable in connection with the securities to be issued by the Bank pursuant to the Scheme. Holders of Dated Notes should carefully read the sections in the Explanatory Statement entitled "*Important Notice*" and "I*mportant Securities Law Notes*" once the Explanatory Statement has been made available.

SECTION G

INFORMATION ON THE BANK, THE GROUP AND THE NEW SECURITIES

Holders of the **Preference Shares** and the **13% Bonds** are directed to:

- the detailed information on the Group and the Group Notes set out in the Group Notes Prospectus

Holders of the **5.5555% Bonds** are directed to:

- the detailed information on the Bank and the Bank T2 Notes set out in the Bank T2 Prospectus

Holders of the **Dated Notes** are directed to:

- the detailed information on the Bank and the Bank T2 Notes set out in the Bank T2 Prospectus
- the detailed information on the Scheme and the New Ordinary Shares set out in the Explanatory Statement

SECTION H

RISK FACTORS AND OTHER CONSIDERATIONS

There are a number of risks and other considerations which may be relevant to a Holder's decision whether or not to participate in the Liability Management Exercise, including risks relating to the Liability Management Exercise, risks relating to an investment in the Bank and the Group and risks relating to the particular nature of the New Securities which such Holder may be eligible to receive through the Liability Management Exercise. Certain of these risks and other considerations have been described by the Bank and the Group (as applicable) in the Prospectuses they have prepared in connection with the Liability Management Exercise and the issue, offer and listing and admission to trading of the New Securities.

Holders of Existing Securities are urged to read carefully and consider those sections which are relevant to them. In particular:

Holders of the **Preference Shares** and the **13% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Group Notes Prospectus

Holders of the **5.5555% Bonds** are directed to:

- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus

Holders of the **Dated Notes** are directed to:

- Part C (*Risk Factors*) of the Explanatory Statement
- the section headed "*Risk Factors*" in Section 2 of the Bank T2 Prospectus

SECTION I

TAXATION CONSIDERATIONS

In view of the number of different jurisdictions where tax laws may apply to a Holder, this Offer Memorandum does not, save as set out below in respect of certain United Kingdom taxation matters, discuss the tax consequences for Holders arising from the exchange or sale of their Existing Securities pursuant to the Liability Management Exercise, the receipt or transfer of New Ordinary Shares, Group Notes and/or Bank T2 Notes or the receipt of Accrued Dividends or Accrued Interest.

The information regarding United Kingdom taxation set out below is intended as a general summary of certain United Kingdom tax considerations and does not purport to be a complete analysis of all potential UK tax consequences for Holders arising from the exchange or sale of their Existing Securities pursuant to the Liability Management Exercise. It is based on current UK tax law and what is understood to be the published practice of HM Revenue & Customs ("HMRC") as at the date of this Offer Memorandum, both of which are subject to change, possibly with retrospective effect. The information is intended to apply only to Holders who are resident in the UK for UK tax purposes, who hold their Existing Securities as investments (other than under an individual savings account) and who are the beneficial owners of their Existing Securities. The statements may not apply to certain classes of Holders such as dealers in securities. The information below is not exhaustive, nor is it tailored to any specific investor. Holders are also directed to the sections headed "*Taxation*" in each of the Bank T2 Prospectus and the Group Notes Prospectus and the section headed "*Taxation*" in the Explanatory Statement, which contain further information relevant to the potential UK tax consequences of holding Bank T2 Notes, New Ordinary Shares and Group Notes, respectively.

The information below does not constitute tax advice. Holders who are in any doubt as to their tax position regarding the exchange or sale of their Existing Securities in the Offers or pursuant to the Scheme are urged to consult their own professional advisers regarding the possible tax consequences under the laws of the jurisdictions that apply to them.

Holders are liable for their own taxes and have no recourse to the Bank, the Group, the Dealer Managers, the Exchange Agent, the Information Agent, the Registrars or any other entity or person named in this Offer Memorandum, with respect to taxes arising in connection with the Offers or the Scheme.

UNITED KINGDOM TAXATION CONSIDERATIONS

Preference Shares

Taxation of chargeable gains

For the purposes of UK taxation of chargeable gains, the disposal of Preference Shares pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option may, depending on the Holder's circumstances (including the availability of exemptions and reliefs) give rise to a chargeable gain or an allowable loss for the purposes of the United Kingdom taxation of chargeable gains.

For Holders who opt to sell their Preference Shares to the Group in consideration for a cash amount paid over twelve years (represented by Instalment Repayment Notes), as the consideration for the Preference Shares is payable in instalments it may be possible to pay any capital gains tax in instalments over a period not exceeding 8 years in accordance with section 280 of the Taxation of Chargeable Gains Act 1992.

Stamp duty and stamp duty reserve tax

No UK stamp duty or stamp duty reserve tax ("**SDRT**") should be payable by a Holder of Preference Shares as a result of that Holder participating in the Exchange Offers or being subject to the Mandatory Exchange Option.

Perpetual Subordinated Bonds

13% Bonds

United Kingdom Resident Individuals

On the basis that the 13% Bonds should constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal of 13% Bonds by an individual pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option should not give rise to a chargeable gain or allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the Income Tax Act 2007.

United Kingdom Corporation Tax Payers

In general, Holders of 13% Bonds which are within the charge to corporation tax should be charged to tax as income on any returns, profits or gains (whether attributable to currency fluctuations or otherwise) arising from the disposal of the 13% Bonds pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option broadly in accordance with their statutory accounting treatment.

5.5555% Bonds

United Kingdom Resident Individuals

On the basis that the 5.5555% Bonds should constitute "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal of 5.5555% Bonds by an individual in exchange for Bank T2 Notes pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option should not give rise to a chargeable gain or allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the income Tax Act 2007.

United Kingdom Corporation Tax Payers

In general, Holders of 5.5555% Bonds which are within the charge to corporation tax should be charged to tax as income on any returns, profits or gains (whether attributable to currency fluctuations or otherwise) arising from the disposal of the 5.5555% Bonds in exchange for Bank T2 Notes pursuant to the relevant Exchange Offer or on exercise of the relevant Mandatory Exchange Option broadly in accordance with their statutory accounting treatment.

Taxation of deferred interest

Upon successful completion of the Exchange Offers, the deferred interest payment in respect of the 13% Bonds originally scheduled for 31 July 2013 will be paid and the deferred interest payment in respect of the 5.5555% Bonds originally scheduled for 14 December 2013 will also be paid.

UK withholding tax

Any such deferred interest payments on the Perpetual Subordinated Bonds may be made without deduction of or withholding on account of United Kingdom income tax provided that the Perpetual Subordinated Bonds continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the "**Act**"). The London Stock Exchange is a recognised stock exchange. Perpetual Subordinated Bonds should be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Perpetual Subordinated Bonds remain so listed at the time of payment, which is expected to be the case, deferred interest on the Perpetual Subordinated Bonds will be payable without withholding or deduction on account of United Kingdom tax.

Further United Kingdom Income Tax Issues

The payment of deferred interest on the Perpetual Subordinated Bonds should constitute United Kingdom source income for tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding.

However, interest with a United Kingdom source received without deduction or withholding on account of United Kingdom tax should not be chargeable to United Kingdom tax in the hands of a Holder of Perpetual Subordinated Bonds (other than certain trustees) who is not resident for tax purposes in the United Kingdom unless that Holder carries on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency in connection with which the interest is received or to which the Perpetual Subordinated Bonds are attributable (and where that Holder is a company, unless that Holder carries on a trade in the United Kingdom through a permanent establishment in connection with which the interest is received or to which the Perpetual Subordinated Bonds are attributable). There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Holders.

Holders of Perpetual Subordinated Bonds which are within the charge to United Kingdom corporation tax should be charged to tax as income on all deferred interest broadly in accordance with their statutory accounting treatment.

Stamp duty and SDRT

No UK stamp duty or SDRT should be payable by a Holder of Perpetual Subordinated Bonds as a result of that Holder participating in the relevant Exchange Offer or being subject to the relevant Mandatory Exchange Option.

Dated Notes

Exchange of Dated Notes for New Ordinary Shares and Bank T2 Notes pursuant to the Scheme

United Kingdom Resident Individuals

The tax treatment of UK resident individual Holders of Dated Notes will depend on whether the Dated Notes that they hold constitute "qualifying corporate bonds". The Euro-denominated Dated Notes will not be "qualifying corporate bonds" for these purposes.

UK resident individual Holders of Dated Notes should consult their own tax advisers as to whether the Dated Notes that they hold constitute "qualifying corporate bonds" and the consequences of the disposal of such Dated Notes pursuant to the Scheme.

<u>Dated Notes that are "qualifying corporate bonds"</u>

Where the Dated Notes are "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal pursuant to the Scheme of those Dated Notes by an individual in exchange for New Ordinary Shares and Bank T2 Notes should not give rise to a chargeable gain or allowable loss for the purposes of the UK taxation of chargeable gains.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the income Tax Act 2007.

<u>Euro-denominated Dated Notes that are not "qualifying corporate bonds"</u>

Where the euro-denominated Dated Notes are not "qualifying corporate bonds" within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992, the disposal pursuant to the Scheme of those euro-denominated Dated Notes by an individual in exchange for New Ordinary Shares and Bank T2 Notes may, depending on the Holder's circumstances (including the availability of exemptions and reliefs) give rise to a chargeable gain or an allowable loss.

Accrued Interest may, subject to certain exemptions (including the exemption for "small holdings" not exceeding £5,000), be chargeable to tax as income under the rules of the accrued income scheme as set out in Part 12 of the income Tax Act 2007, but such Accrued Interest should be excluded when calculating the chargeable gain or allowable loss realised by such Holder.

Any gain or loss that would otherwise have arisen on a disposal of the euro-denominated Dated Notes in exchange for New Ordinary Shares should be "rolled-over" into the New Ordinary Shares so that a Holder's holding of New Ordinary Shares should be treated as the same asset, acquired at the time he acquired his euro-denominated Dated Notes and for a proportion of the same acquisition cost (under the provisions of section 132 of the Taxation of Chargeable Gains Act 1992).

Any gain or loss that would otherwise have arisen on a disposal of the euro-denominated Dated Notes in exchange for Bank T2 Notes should be deferred and treated as arising only on a subsequent disposal of the Bank T2 Notes (under the provisions of sections 132 and 116(10) of the Taxation of Chargeable Gains Act 1992).

United Kingdom Corporation Tax Payers

In general, Holders of Dated Notes which are within the charge to corporation tax should be charged to tax as income on any returns, profits or gains (whether attributable to currency fluctuations or otherwise) arising from the disposal of the Dated Notes in exchange for New Ordinary Shares and Bank T2 Notes pursuant to the Scheme broadly in accordance with their statutory accounting treatment.

Capitalisation of accrued but unpaid interest

The issue of New Ordinary Shares or Bank T2 Notes in lieu of accrued but unpaid interest on the Dated Notes should be treated as a payment of interest by Bank (under the provisions of section 380 of the Income Tax (Trading and Other Income) Act 2005 and section 413 of the Corporation Tax Act 2009).

UK withholding tax

There should be no requirement to deduct or withhold amounts for or on account of United Kingdom income tax in relation to the issue of the New Ordinary Shares or Bank T2 Notes provided that the Dated Notes continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the "Act"). The London Stock Exchange is a recognised stock exchange. Dated Notes should be treated as listed on the London Stock Exchange if they are included in the Official List (within the meaning of and in accordance with the provisions of Part 6 of the Financial Services and Markets Act 2000) and admitted to trading on the London Stock Exchange. Provided, therefore, that the Dated Notes remain so listed at the time the New Ordinary Shares or Bank T2 Notes are issued, which is expected to be the case, there should be no requirement to deduct or withhold amounts for or on account of United Kingdom tax in relation to the issue of the New Ordinary Shares or Bank T2 Notes in lieu of accrued but unpaid interest on the Dated Notes.

Further United Kingdom Income Tax Issues

The issue of New Ordinary Shares or Bank T2 Notes in lieu of accrued but unpaid interest on the Dated Notes should constitute United Kingdom source income for tax purposes and, as such, United Kingdom resident individuals may be subject to income tax by direct assessment on an amount equal to the market value of the New Ordinary Shares or Bank T2 Notes received in lieu of accrued but unpaid interest on the Dated Notes at the time of issue.

However, where New Ordinary Shares or Bank T2 Notes are received without deduction or withholding on account of United Kingdom tax there should be no charge to United Kingdom tax in the hands of a Holder of Dated Notes (other than certain trustees) who is not resident for tax purposes in the United Kingdom unless that Holder carries on a trade, profession or vocation in the United Kingdom through a United Kingdom branch or agency in connection with which the interest is received or to which the Dated Notes are attributable (and where that Holder is a company, unless that Holder carries on a trade in the United Kingdom through a permanent establishment in connection with which the interest is received or to which the Dated

Notes are attributable). There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers). The provisions of an applicable double taxation treaty may also be relevant for such Holders.

Holders of Dated Notes which are within the charge to United Kingdom corporation tax should be treated as receiving an amount an amount of interest equal to the market value of the New Ordinary Shares or Bank T2 Notes received in lieu of accrued but unpaid interest on the Dated Notes at the time of issue. Holders of Dated Notes which are within the charge to United Kingdom corporation tax should charged to tax as income on such interest broadly in accordance with their statutory accounting treatment.

Additional New Ordinary Shares Offer

Holders are directed to the section headed "*Taxation*" in the Explanatory Statement for further information on the Additional New Ordinary Shares available for subscription pursuant to the Scheme.

Stamp duty and SDRT

No UK stamp duty or SDRT should be payable by a Holder of Dated Notes as a result of that Holder exchanging its Dated Notes for New Ordinary Shares or Bank T2 Notes pursuant to the Scheme.

SECTION J

DEALER MANAGERS, EXCHANGE AGENT, INFORMATION AGENT AND REGISTRARS

The Bank and the Group have retained HSBC Bank plc and UBS Limited to act as Dealer Managers for the Liability Management Exercise and Lucid Issuer Services Limited to act as Exchange Agent in respect of the Offers and Information Agent in respect of the Scheme. Computershare Investor Services PLC is registrar in respect of the Preference Shares and Equiniti Limited is registrar in respect of the Perpetual Subordinated Bonds.

The Dealer Managers and their affiliates may contact Holders regarding the Liability Management Exercise and may request brokerage houses, custodians, nominees, fiduciaries and others to forward this Offer Memorandum and related materials to Holders. The Bank and the Group have entered into a Dealer Manager Agreement on or about 4 November 2013 with the Dealer Managers, which contains certain provisions regarding payment for fees, expense reimbursement and indemnity arrangements. The Dealer Managers and their respective affiliates have provided and may continue to provide certain investment banking services to the Bank and the Group for which they have received and will receive compensation that is customary for services of such nature.

None of the Dealer Managers, the Exchange Agent, the Information Agent, the Registrars and their respective directors, employees or affiliates:

(A) assumes any responsibility for the accuracy or completeness of the information contained or referred to in this Offer Memorandum concerning the Liability Management Exercise or any part thereof, the Bank, the Group, the Existing Securities or the New Securities or any of them, or for any failure by the Bank and the Group to disclose events that may have occurred and may affect the significance or accuracy of the information in this Offer Memorandum; or

(B) expresses any view on the merits of, or makes any representation or recommendation whatsoever regarding, the Liability Management Exercise or any part thereof, including (without limitation) as to whether or not Holders should participate in the Liability Management Exercise.

Each of the Dealer Managers may submit Exchange Instructions and/or Account Holder Letters and/or enter into Lock-up Agreements (i) for its own account and/or (ii) subject to the Offer Restrictions, on behalf of other Holders.

The Exchange Agent, the Information Agent and the Registrars are agents of the Bank and/or the Group, as applicable, and owe no duty to any Holder except in the limited circumstances described in this Offer Memorandum.

The Dealer Managers are acting exclusively for the Bank and the Group and for no one else in connection with the arrangements described in this Offer Memorandum. The Dealer Managers and their respective directors, employees and affiliates will not be responsible to any Holder for providing the protections afforded to customers of the Dealer Managers or for advising any other person in connection with the arrangements described in this Offer Memorandum.

SECTION K

GENERAL NOTICES AND IMPORTANT INFORMATION

Holders of Existing Securities should only rely on the information contained in this Offer Memorandum, the Prospectuses and the Scheme Documents (as applicable) and any documents incorporated herein or therein by reference. No person has been authorised to give any information or make any representations other than those contained in such documents and, if given or made, such information or representations must not be relied upon as having been so authorised.

The contents of this Offer Memorandum and any information referred to herein should not be construed as legal, financial, accounting or tax advice. This Offer Memorandum is for your information only and nothing in this Offer Memorandum is intended to endorse or recommend a particular course of action. Each Holder should consult its own accountant or legal, financial and/or tax advisers for advice.

None of the Dealer Managers, the Exchange Agent, the Information Agent or the Registrars accepts any responsibility whatsoever for the contents of this Offer Memorandum and/or the information referred to herein, including in relation to the accuracy, completeness and/or verification thereof, and/or for any other statement made or purported to be made by any of them, or on behalf of any of them, which is consistent with the contents of this Offer Memorandum in connection with the Bank, the Group, the Existing Securities, the New Securities and/or the Liability Management Exercise or any other matter referred to in this Offer Memorandum. Each of the Dealer Managers, the Exchange Agent, the Information Agent and the Registrars disclaims all and any liability whatsoever arising in tort, contract or otherwise which any of them might otherwise have in respect of this Offer Memorandum or any such statement.

Each of HSBC Bank plc and UBS Limited are authorised by the PRA and regulated by the PRA and the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of either Dealer Manager (within the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. The Dealer Managers are acting on their own account in relation to the Liability Management Exercise and, to the fullest extent permitted by applicable law and regulation, will not be responsible to any other person for providing the protections which would be afforded to clients of either Dealer Manager or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Lucid Issuer Services Limited is authorised and regulated by the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of Lucid Issuer Services Limited (within the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. Lucid Issuer Services Limited will not be responsible to any other person for providing the protections which would be afforded to clients or for providing advice in relation to the Liability Management Exercise or any component part thereof.

Canaccord Genuity Limited is authorised and regulated in the United Kingdom by the FCA. To the fullest extent permitted by applicable law and regulation, no person will become a client of Canaccord Genuity Limited (within the meaning of the FCA's rules) by virtue of receipt of this Offer Memorandum or participation in the Liability Management Exercise or any component part thereof. Canaccord Genuity Limited will not be responsible to any other person for providing the protections which would be afforded to clients or for providing advice in relation to the Liability Management Exercise or any component part thereof.

No offer is being made in connection with the Liability Management Exercise in any jurisdiction in which the making of the offer would not be in compliance with the laws or regulations of such jurisdictions. However, this is without prejudice to a Holder's rights under its Existing Securities.

The Law Debenture Trust Corporation p.l.c., as trustee for certain of the Existing Securities, has not been involved in the formulation of, and does not express any opinion on the merits of, or make any representation or recommendation whatsoever regarding the terms of, the Liability Management Exercise or any part thereof or this Offer Memorandum. Except as expressly envisaged under the trust deeds dated 1 August 2009 constituting the Perpetual Subordinated Bonds in connection with the convening of the Meetings to consider the Proposals in respect of the Perpetual Subordinated Bonds, The Law Debenture Trust Corporation p.l.c. has not approved any matters in connection with the Liability Management Exercise or any information referred to in this Offer Memorandum, and neither it nor any of its directors, officers, employees or affiliates has verified or assumes any responsibility for the accuracy, completeness, validity or correctness of any of the information contained in or referred to in this Offer Memorandum. The Law Debenture Trust Corporation p.l.c. urges Holders who are in any doubt as to the impact of the Liability Management Exercise to seek their own financial, legal and other advice as they consider appropriate.

The Co-operative Bank p.l.c. is an authorised person, authorised and regulated by the Prudential Regulation Authority under the Financial Services and Markets Act 2000. In the United Kingdom, it is a criminal offence to acquire 10 per cent. or more of the shares or voting power in an authorised person without notifying the Prudential Regulation Authority or without obtaining the prior approval of the Prudential Regulation Authority. If any Holder of Dated Notes considers that it may, as a result of the Liability Management Exercise, acquire 10 per cent. or more of the ordinary shares in the Bank, it is advised to seek independent legal advice.

Websites

Any information regarding the Bank, the Group, the Liability Management Exercise, the Existing Securities and/or the New Securities appearing on the website of the Bank, the Group or any other person is for convenience only, does not form part of this Offer Memorandum and should not be relied upon by Holders making a decision whether or not to participate in the Liability Management Exercise.

Such Holders should have regard only to the relevant Prospectuses (including this Offer Memorandum as appended to each of the Prospectuses) and, in the case of Holders of Dated Notes, the Scheme Documents, and are strongly recommended to read them carefully.

SECTION L

DEFINITIONS

The following definitions apply throughout this Offer Memorandum unless the context otherwise requires:

"**13% Bonds**"	The Bank's 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201).
"**13% Bondholders Meeting**"	The Meeting convened for the Holders of the 13% Bonds to vote on the Extraordinary Resolution proposed at such Meeting (and, if such Meeting is adjourned, shall include the adjourned meeting).
"**2016 Notes**"	The Bank's Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998).
"**5.5555% Bonds**"	The Bank's 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45).
"**5.5555% Bondholders Meeting**"	The Meeting convened for the Holders of the 5.5555% Bonds to vote on the Extraordinary Resolution proposed at such Meeting (and, if such Meeting is adjourned, shall include the adjourned meeting).
"**Acceptance Conditions**"	The conditions which must be satisfied before the Bank is able to accept offers to exchange or sell Preference Shares or Perpetual Subordinated Bonds, as described at paragraph 9 of Section C, Part 1 of this Offer Memorandum.
"**Account Holder**"	A Direct Participant holding an interest in any Dated Notes in an account with Euroclear or Clearstream, Luxembourg at the Scheme Record Date.
"**Account Holder Letter**"	A letter to be submitted by an Account Holder on behalf of a Holder of Dated Notes, substantially in the form which will be set out in the Explanatory Statement.
"**Accrued Dividends**"	In respect of any Preference Shares accepted for exchange or sale in the relevant Exchange Offer, an amount equal to any accrued and unpaid dividends to be paid on the Settlement Date in accordance with the terms of such Exchange Offer, calculated on the basis of the terms of the Preference Shares set out in the Articles of Association and on the assumption that dividends accrue from day-to-day on a non-compounding basis.
"**Accrued Interest**"	In respect of any Perpetual Subordinated Bonds accepted for exchange or sale in the relevant Exchange Offer, an amount equal to any accrued and unpaid interest (excluding, for these purposes, any interest which has been deferred on a scheduled payment date) to be paid on the Settlement Date in accordance with the terms of the relevant Exchange Offer, calculated in accordance with the terms and conditions of such Perpetual Subordinated Bonds.
"**Additional New Ordinary Shares**"	62,500,000 New Ordinary Shares to be issued by the Bank pursuant to the Additional New Ordinary Shares Offer for an aggregate consideration equal to £125 million.

"**Additional New Ordinary Shares Offer**" — The offer of the Additional New Ordinary Shares to Holders of the Dated Notes for subscription under the terms of the Scheme.

"**Additional Preference Shares**" — Additional Preference Shares allotted (or deemed to be allotted) allotted on or around 29 November 2013 in lieu of a cash dividend scheduled for 30 November 2013 (and for these purposes, 6⅛ per cent. of the aggregate nominal amount of the Preference Shares outstanding will be deemed to have been so allotted and to so constitute such amount of Additional Preference Shares).

"**Articles of Association**" — The Bank's Articles of Association.

"**Bank**" — The Co-operative Bank p.l.c. (incorporated with limited liability in England with registered number 990937).

"**Bank T2 Notes**" — New sterling-denominated 11 per cent. Subordinated Notes due 2023 (ISIN: GB00BFXW0853; SEDOL: BFXW085) which may be issued by the Bank pursuant to the Liability Management Exercise.

"**Bank T2 Prospectus**" — The prospectus dated 4 November 2013 and issued by the Bank in connection with the issue, offer and listing and admission to trading of the Bank T2 Notes, including any supplement(s) thereto (if any) which may be issued after that date.

"**beneficial owner**" — A person who is the owner of an interest in a particular nominal or principal amount of Existing Securities held in a Clearing System, as shown in the records of the relevant Clearing System or its participants.

"**Business Day**" — A day other than a Saturday or Sunday or a public holiday on which commercial banks and foreign exchange markets are open for business in London.

"**Certificated Holding Exchange Instruction**" — The form of Exchange Instruction to be submitted by Eligible Holders who hold Preference Shares or Perpetual Subordinated Bonds in certificated form outside the Clearing Systems and who wish to offer to exchange or sell their Preference Shares or Perpetual Subordinated Bonds (as the case may be) in the relevant Exchange Offer.

"**Chairman**" — The appointed Chairman at any Meeting.

"**Clearing System Notice**" — The relevant notice to be sent to Direct Participants (or, if applicable, CREST Participants) by each Clearing System on or about the date of this Offer Memorandum informing Direct Participants (or, where applicable, CREST Participants), *inter alia*, of the procedures to be followed in order to participate in the Liability Management Exercise.

"**Clearing Systems**" — Euroclear, Clearstream, Luxembourg and CREST (and each a "**Clearing System**").

"**Clearstream, Luxembourg**" — Clearstream Banking, *société anonyme*.

"**Common Equity Tier 1 capital**" — A form of regulatory capital, having a specific meaning in prevailing prudential and capital adequacy laws and regulations applicable in England.

Banks and other financial institutions are required to maintain certain levels of regulatory capital in order to absorb losses, with a view to enabling them to better withstand financial shocks.

"**Computershare**"	Computershare Investor Services PLC.
"**Conversion Price**"	The notional price derived from the *pro rata* share of the 112,500,000 New Ordinary Shares available to Holders of Dated Notes in the Scheme in exchange for their aggregate Scheme Claims.
"**Court**"	The High Court of Justice of England and Wales.
"**CREST**"	The relevant system (as defined in the CREST Regulations) in respect of which EUI is the operator (as defined in the CREST Regulations).
"**CREST Manual**"	The rules governing the operation of CREST, consisting of the CREST Reference Manual, CREST International Manual, CREST Central Counterparty Service Manual, CREST Rules, Registrars Service Standards, Settlement Discipline Rules, CCSS Operations Manual, Daily Timetable, CREST Application Procedure and CREST Glossary of Terms (all as defined in the CREST Glossary of Terms).
"**CREST Participant**"	A person who is, in relation to CREST, a system-participant (as defined in the CREST Regulations).
"**CREST Regulations**"	The Companies Act 1996 (Uncertificated Securities) Regulations 1996 (S.I. No 68/1996) and the UK Uncertificated Securities Regulations 2001 (SI 2001No. 2001/3755), including any modifications thereof or any regulations in substitution therefor and for the time being in force.
"**Dealer Managers**"	HSBC Bank plc and UBS Limited (and each a "**Dealer Manager**").
"**Dated Notes**"	The following lower tier 2 bonds issued by the Bank: • Floating Rate Callable Step-up Dated Subordinated Notes due 2016 (ISIN: XS0254625998) • 5.875% Subordinated Callable Notes due 2019 (ISIN: XS0189539942) • 9.25% Subordinated Notes due 28 April 2021 (ISIN: XS0620315902) • Fixed/Floating Rate Subordinated Notes due November 2021 (ISIN: XS0274155984) • 7.875% Subordinated Notes due 19 December 2022 (ISIN: XS0864253868) • 5.75% Dated Callable Step-up Subordinated Notes due 2024 (ISIN: XS0188218183) • 5.875% Subordinated Notes due 2033 (ISIN: XS0145065602) (and each a "**Series**" of Dated Notes).
"**Designated Recipient**"	A person nominated by a Holder of Dated Notes in an Account Holder Letter to receive the New Ordinary Shares and Bank T2 Notes which such Holder is entitled to receive pursuant to the terms of the Scheme.

"**Direct Participant**"	Each person who is shown in the records of Euroclear or Clearstream, Luxembourg as a holder of an interest in the Existing Securities.
"**Early Consideration Amount**"	In respect of each Exchange Offer, the Early Consideration Amount set out in the summary offering table relevant to such Exchange Offer (see Section B of this Offer Memorandum).
"**Early Participation Deadline**"	4.30 p.m. (London time) on 29 November 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders).
"**Early Participation Threshold**"	Has the meaning given in paragraph 3 of Part 1 of Section C of this Offer Memorandum.
"**Eligible Holder**"	A Holder that is eligible to participate in the Liability Management Exercise, or the relevant component part thereof, in accordance with the Offer Restrictions (and "**Holder**" shall be construed accordingly unless the context otherwise admits).
"**Equiniti**"	Equiniti Limited.
"**ESA Instruction**"	An escrow account adjustment input (AESN), transaction type "ESA" (as described in the CREST Manual).
"**EUI**"	Euroclear UK & Ireland Limited (previously CRESTCo Limited).
"**euro**" or "**€**"	The lawful currency of the member states of the European Union that have adopted the single currency in accordance with the Treaty on the functioning of the European Union, as amended.
"**Euroclear**"	Euroclear Bank S.A./N.V.
"**Exchange Agent**"	Lucid Issuer Services Limited, in its capacity as exchange agent in respect of the Offers.
"**Exchange Instruction**"	An instruction pursuant to which an Eligible Holder may, by the relevant deadlines, offer to exchange or sell (as the case may be) its Preference Shares or Perpetual Subordinated Bonds in the relevant Exchange Offer, and shall more particularly mean: (i) in respect of Preference Shares and Perpetual Subordinated Bonds held through Euroclear and Clearstream, Luxembourg, the electronic exchange or tender and blocking instruction in the form specified in the Clearing System Notice for submission by Direct Participants via Euroclear or Clearstream, Luxembourg and in accordance with the requirements of Euroclear or Clearstream, Luxembourg; (ii) in respect of Preference Shares and Perpetual Subordinated Bonds held through CREST, the settlement of a TTE Instruction in respect of the Holder's Preference Shares or Perpetual Subordinated Bonds, specifying the relevant Registrar as escrow agent; and (iii) in respect of Preference Shares and Perpetual Subordinated Bonds held in certificated form outside the Clearing Systems, the appropriate form of Certificated Holding

Exchange Instruction to be mailed to relevant Holders and available from the relevant Registrar.

"**Exchange Offers**"	The invitations described in this Offer Memorandum by the Bank and the Group (as applicable) to Eligible Holders to offer to exchange or sell (as the case may be) their Preference Shares and Perpetual Subordinated Bonds and receive Final Repayment Notes, cash payable in instalments over twelve years (represented by Instalment Repayment Notes) or Bank T2 Notes (as the case may be) (and the offer in respect of each Series of Perpetual Subordinated Bonds and the Preference Shares Existing Securities each being an "**Exchange Offer**").
"**Existing Securities**"	The Preference Shares, the Perpetual Subordinated Bonds and the Dated Notes.
"**Explanatory Statement**"	The explanatory statement relating to the Scheme expected to be available by the Bank to Scheme Creditors on or around 19 November 2013.
"**Expiration Deadline**"	4.30 p.m. (London time) on 6 December 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders).
"**Extraordinary Resolution**"	In respect of the Preference Shares and each Series of Perpetual Subordinated Bonds, the extraordinary resolution to be proposed at the relevant Meeting of Holders of such securities.
"**Final Repayment Notes**"	Sterling-denominated 11 per cent. Final Repayment Subordinated Notes due 2025 (ISIN: GB00BFXW0630; SEDOL: BFXW063) which may be issued by the Group pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of the Group's subsidiaries.
"**General Meeting**"	The general meeting of the Bank convened for the holders of both the ordinary shares and the Preference Shares of the Bank to approve a resolution on substantially the same terms as the resolution proposed at the Preference Shareholders Meeting (and, if such meeting is adjourned, shall include the adjourned meeting).
"**Group**"	Co-operative Group Limited (incorporated and registered in England under the Industrial and Provident Societies Act 1965 to 2003 with registered number IP525R).
"**Group Notes**"	The Final Repayment Notes and/or the Instalment Repayment Notes, as the context admits.
"**Group Notes Prospectus**"	The prospectus dated 4 November 2013 and issued by the Group in connection with the issue, offer and listing and admission to trading of the Group Notes, including any supplement(s) thereto (if any) which may be issued after that date.
"**HMRC**"	HM Revenue & Customs.
"**Holder**"	Means (except as otherwise provided under the terms of the Scheme in respect of Holders of Dated Notes) a Holder of Existing Securities, which shall unless the context otherwise requires include:

(i) each Direct Participant or CREST Participant in respect of the Existing Securities;

(ii) any broker, dealer, commercial bank, trust company, custodian or other nominee or intermediary who holds Existing Securities on behalf of a beneficial owner; and

(iii) each beneficial owner of the Existing Securities, including Holders who hold their Existing Securities in certificated form outside the Clearing Systems and Holders who hold beneficial interests in Existing Securities through a Clearing System or another intermediary,

except that for the purposes of settling any Holder's entitlement to New Securities, Accrued Dividends, Accrued Interest and/or other amounts payable under the terms of the Liability Management Exercise, to the extent the beneficial owner of the relevant Existing Securities is not itself the direct holder of legal title to the Existing Securities, the Holder shall be the direct holder of legal title, to whom (or to whose order) delivery of the relevant New Securities and/or payment of the relevant Accrued Dividends, Accrued Interest and/or other relevant amounts will discharge the obligations of the Bank and the Group (as the case may be) in respect of such delivery and/or payment pursuant to the terms of the Liability Management Exercise.

"**Holding Period**"	The period of 36 months commencing on the Scheme Settlement Date.
"**Holding Period Trustee**"	Lucid Issuer Services Limited, as holding period trustee in respect of the Scheme.
"**Information Agent**"	Lucid Issuer Services Limited, as information agent in respect of the Scheme.
"**Instalment Repayment Notes**"	Sterling-denominated Instalment Repayment Subordinated Notes (ISIN: GB00BFXWHQ29; SEDOL: BFXWHQ2), having their last payment date in 2025, which may be issued by the Group pursuant to the Liability Management Exercise and guaranteed (on a subordinated basis) by certain of the Group's subsidiaries.
"**Late Consideration Amount**"	In respect of each Exchange Offer, the Late Consideration Amount set out in the summary offering table relevant to such Exchange Offer (see Section B of this Offer Memorandum).
"**Liability Management Exercise**"	The liability management exercise of the Bank and the Group described in this Offer Memorandum, including the Exchange Offers and Proposals in respect of the Preference Shares and the Perpetual Subordinated Bonds and the Scheme in respect of the Dated Notes.
"**Lock-up Agreement**"	An agreement between the Bank and a Holder of Dated Notes, pursuant to which that Holder has agreed, among other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.
"**Lock-up Arrangements**"	A Lock-up Agreement or a Lock-up Undertaking.

"**Lock-up Undertaking**"	An undertaking by an Account Holder given on behalf of a Holder of Dated Notes in favour of the Bank pursuant to a valid Account Holder Letter delivered to the Information Agent on behalf of that Holder, pursuant to which that Holder has agreed, among other things and subject to certain conditions, to vote the full amount of its Scheme Claim in favour of the Scheme.
"**London Stock Exchange**"	The London Stock Exchange plc.
"**Mandatory Exchange Option**"	In respect of each of the Preference Shares, the 13% Bonds and the 5.5555% Bonds, the option of the Bank (if the Extraordinary Resolution at the relevant Meeting is passed and the relevant Proposal implemented) to mandatorily effect the transfer of Preference Shares and 13% Bonds (which are not exchanged or sold pursuant to the Exchange Offers) to the Group and to mandatorily effect the exchange of 5.5555% Bonds (which are not exchanged or sold pursuant to the Exchange Offers), in each case on the same economic terms as Preference Shares, 13% Bonds and 5.5555% Bonds, respectively, are exchanged or sold (as the case may be) in the Exchange Offers.
"**Meeting**"	In respect of the Preference Shares and each Series of Perpetual Subordinated Bonds, the meeting of Holders of such securities convened to consider the relevant Extraordinary Resolution (and any adjournment thereof).
"**New Ordinary Shares**"	New voting ordinary shares in the Bank (with ISIN GB00BDW0BX87 and SEDOL number BDW0BX8) which may be issued pursuant to the Liability Management Exercise.
"**New Securities**"	The New Ordinary Shares, the Final Repayment Notes, the Instalment Repayment Notes and/or the Bank T2 Notes, as the context admits.
"**Notice of Meeting**"	The relevant notice convening each Meeting.
"**Notifying News Service**"	A recognised financial news service or services as selected by the Bank (e.g. Reuters/Bloomberg).
"**Offer Memorandum**"	This Consent and Exchange Offer Memorandum.
"**Offer Record Date**"	Expected to be 11 December 2013, unless any Meeting is required to be adjourned for want of a quorum (in which case the Offer Record Date is expected to be on or around 27 December 2013). The Offer Record Date is the last date on which Preference Shares, 13% Bonds and 5.5555% Bond can be traded.
"**Offer Restrictions**"	The offer restrictions set out in Section F of this Offer Memorandum (in respect of the Exchange Offers) and the offer restrictions set out in the Explanatory Statement (in respect of the Scheme).
"**Offers**"	The Exchange Offers and the Proposals.
"**Official List**"	The Official List maintained by the Financial Conduct Authority.
"**Perpetual Subordinated Bondholders Meeting**"	Each Meeting convened for the Holders of each Series of Perpetual Subordinated Bonds.

"**Perpetual Subordinated Bonds**"	The following bonds issued by the Bank: • 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) • 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) (and each a "**Series**" of Perpetual Subordinated Bonds). *The Perpetual Subordinated Bonds were issued by the Bank in replacement of Britannia Building Society permanent interest bearing shares on its merger with Britannia on 1 August 2009.*
"**PRA**"	The Prudential Regulation Authority.
"**Preference Shareholders Meeting**"	The Meeting convened for the Holders of the Preference Shares to vote on the Extraordinary Resolution proposed at such Meeting (and, if such Meeting is adjourned, shall include the adjourned meeting).
"**Preference Shares**"	The Bank's 9.25 per cent. Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516).
"**Proposals**"	The proposals inviting Holders of Preference Shares and Perpetual Subordinated Bonds to vote on the Extraordinary Resolutions at the Meetings, in order to (amongst other things) approve modifications to the terms and conditions of the relevant Series (and each proposal being a "**Proposal**").
"**Prospectus Directive**"	Directive 2003/71/EC, as amended (including by Directive 2010/73/EU), of the European Parliament and Council and, where the context admits, includes any relevant implementing measure in any Member State of the European Economic Area.
"**Prospectuses**"	The Group Notes Prospectus and the Bank T2 Prospectus, and each a "**Prospectus**".
"**Recapitalisation Plan**"	The recapitalisation plan originally announced on 17 June 2013 by the Bank and the Group to strengthen the Bank's capital base.
"**Registrars**"	Computershare (in respect of the Preference Shares) and Equiniti (in respect of each Series of Perpetual Subordinated Bonds), and references to the "**relevant Registrar**" shall be construed accordingly.
"**Regulation S**"	Regulation S under the Securities Act.
"**RNS**"	Regulatory News Service operated by the London Stock Exchange.
"**Scheme**" or "**Scheme of Arrangement**"	The Bank's proposed scheme of arrangement in respect of the Dated Notes under Part 26 of the Companies Act 2006.
"**Scheme Chairman**"	The appointed Chairman at the Scheme Meeting.
"**Scheme Claim**"	The claim of a Holder of Dated Notes in the Scheme, being an amount equal to the sum of (i) the aggregate principal amount outstanding of such Holder's Dated Notes and (ii) the accrued and unpaid interest on such Dated Notes up to (and including) the Scheme Record Date; provided that a Holder's Scheme Claim in respect of 2016 Notes (which are denominated in euro) shall be the

	Sterling-Equivalent of such sum, calculated on the basis of the Scheme FX Rate.
"**Scheme Consideration**"	The consideration to be provided to Holders of Dated Notes exchanged pursuant to the Scheme, as more fully described at paragraph 3 of Part 1 of Section D of this Offer Memorandum.
"**Scheme Convening Hearing**"	The initial Court hearing at which the Bank will seek leave to convene the Scheme Meeting, and which is expected to be held on 18 November 2013.
"**Scheme Creditors**"	The Holders of the Dated Notes.
"**Scheme Documents**"	The Explanatory Statement and other accompanying documents which will be made available to Scheme Creditors following the Scheme Convening Hearing at: http://www.co-operative.coop/bondholders.
"**Scheme Effective Date**"	The date upon which the sanction order relating to the Scheme is delivered to the registrar of companies at Companies House (at which point, the Scheme will become effective), which is currently expected to be on or around 17 December 2013.
"**Scheme FX Rate**"	£0.85644 per €1.00. *The Scheme FX Rate was determined on 30 October 2013 as the spot rate of exchange between euro and sterling appearing on or derived from the Bloomberg service designated as the "FXC" page for the purpose of displaying the euro/sterling exchange rate.*
"**Scheme Meeting**"	The meeting convened for Scheme Creditors to vote in favour of the proposals under the Scheme.
"**Scheme Record Date**"	10 December 2013.
"**Scheme Sanction Hearing**"	The second Court hearing, at which the Bank will request the sanction of the Scheme by the Court, and which is expected to be held on 16 December 2013.
"**Scheme Settlement Date**"	The date on which the Scheme settles, currently expected to be 18 December 2013.
"**Securities Act**"	The United States Securities Act of 1933, as amended.
"**Series**"	One or more series of Existing Securities (as the context admits).
"**Settlement Condition**"	The condition which must be satisfied in order for the Liability Management Exercise to settle, as more fully described in paragraph 8 of Part 1 of Section C to this Offer Memorandum.
"**Settlement Date**"	The date on which the Liability Management Exercise settles, currently expected to be 18 December 2013 (subject to the right of the Bank and/or the Group to amend such date upon notice to Holders).
"**Sterling**" or "**£**"	Pounds sterling, the lawful currency of the United Kingdom.
"**Sterling-Equivalent**"	The sterling-equivalent amount of euro amounts in respect of the 2016 Notes, determined by reference to the Scheme FX Rate.

"**Trustee**"	The Law Debenture Trust Corporation p.l.c. as trustee in respect of certain of the Existing Securities.
"**TTE Instruction**"	The "transfer to escrow" instruction pursuant to which CREST Participants may offer to exchange or sell Preference Shares and Perpetual Subordinated Bonds held in CREST pursuant to the terms of the Exchange Offers.
"**United Kingdom**" or "**UK**"	United Kingdom of Great Britain and Northern Ireland.
"**U.S. Holder**"	A Holder who is located or resident in the United States or who is a U.S. person.
"**U.S. person**"	A "U.S. person" as defined in Regulation S under the Securities Act.
"**Voting Instruction Deadline**"	The voting deadline in respect of the Scheme, which is expected to be 4.30 p.m. (London time) on 10 December 2013.

Interpretation of "offered for exchange", "exchange" and similar expressions:

There are a number of references in this document to Existing Securities being "offered for exchange", "exchanged" and similar expressions. Where these expressions are used in the context of holders of Preference Shares or 13% Bonds who elect the Instalment Repayment Notes option, such expressions are used for the Holders' convenience only in understanding what is being proposed, and must not be treated as a technical legal description of the mechanism through which they will receive the Instalment Repayment Notes. As set out in Part 1 of Section C of this Offer Memorandum, Holders of Preference Shares and 13% Bonds who opt for Instalment Repayment Notes will actually be selling their Preference Shares or 13% Bonds (as the case may be) to the Group in return for the cash consideration which will be payable in twelve equal instalments and it is these instalment payments which will be represented by the Instalment Repayment Notes.

SECTION M

INDICATIVE TIMETABLE FOR THE LIABILITY MANAGEMENT EXERCISE

The indicative timetable in this Section collates the indicative timetables for the Offers in respect of the Preference Shares, 13% Bonds and 5.5555% Bonds and the Scheme in respect of the Dated Notes.

The times and dates referred to below are indicative only and are subject to the right of the Bank and/or the Group to extend, re-open, amend and/or terminate the Exchange Offers or any of them at any time and the right of the Bank (if required or permitted by the Court) to amend and/or withdraw the Scheme at any time. Accordingly, the actual timetable may differ significantly from the expected timetable set out below.

If any of the below times and/or dates change, the revised time(s) and/or date(s) will be announced by the Bank and/or the Group as soon as reasonably practicable.

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
Announcement of the Scheme	**4 November 2013**	**Announcement of the Exchange Offers**
Scheme announced.		Exchange Offers announced. Prospectuses published.
Practice statement letter sent to Scheme Creditors.		Offer period commences. Eligible Holders of Preference Shares, 13% Bonds or 5.5555% Bonds can offer to exchange or sell their Existing Securities and/or vote in respect of the Proposals.
Announcement of Consideration Amounts in the Scheme	**On or around 14 November 2013**	
Announcement of the final Consideration Amounts and New Ordinary Shares Conversion Price.		
Scheme Convening Hearing	**18 November 2013**	
Initial Court hearing for leave to convene the Scheme Meeting		
Explanatory Statement and Scheme Documents available	**19 November 2013**	
Explanatory Statement and Scheme Documents available to Scheme Creditors		

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
	4.30 p.m. on 29 November 2013	**Early Participation Deadline** The deadline by which the Early Participation Threshold must be achieved in order for Preference Shares, 13% Bond and 5.5555% Bonds to be exchanged or sold on the basis of the Early Consideration Amounts for such Existing Securities.
	4.30 p.m. on 6 December 2013	**Expiration Deadline** Deadline for receipt of all Exchange Instructions from Eligible Holders in respect of Preference Shares, 13% Bonds and 5.5555% Bonds.
Voting Instructions Deadline Deadline for receipt of all Account Holder Letters containing voting instructions in order for Holders to vote on the Scheme and elections to subscribe for Additional New Ordinary Shares pursuant to the Additional New Ordinary Shares Offer in the Scheme.	**4.30 p.m. on 10 December 2013**	
Scheme Record Date Only those Holders who are Scheme Creditors as at the Scheme Record Date are entitled to attend and vote at the Scheme Meeting (unless the Bank, in its sole discretion, elects to recognise, for the purposes of the Scheme, a transfer of Dated Notes after the Scheme Record Date such that the transferee becomes a Scheme Creditor)	**10 December 2013**	

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
Scheme Meeting	**11 December 2013**	**Meetings**
Meeting of the Scheme Creditors to vote on the Scheme The Bank will request the Court to convene the Scheme Meeting on 11 December 2013		Meetings of the Holders of the Preference Shares, 13% Bonds and 5.5555% Bonds held to consider the Extraordinary Resolutions pursuant to the Proposals. 1.00 p.m. in respect of the Preference Shares 2.00 p.m. in respect of the 13% Bonds 3.00 p.m. in respect of the 5.5555% Bonds
	11 December 2013	**Offer Record Date**
		The record date for the purposes of ceasing trading in the Preference Shares, 13% Bonds and 5.5555% Bonds, and for determining entitlement to receive the relevant Group Notes, Bank T2 Notes, Accrued Dividends, Accrued Interest and other amounts payable under the terms of the Liability Management Exercise (if successfully completed).
Results Announcement	**12 December 2013**	**Results Announcement**
Announcement of the results of the Liability Management Exercise		Announcement of the results of the Liability Management Exercise
Scheme Sanction Hearing	**16 December 2013**	
Second Court hearing for sanction of the Scheme by the Court. The Bank will announce as soon as reasonably practicable after the Scheme Sanction Hearing whether or not the Scheme is sanctioned.		

Scheme Events	*Dates and Times (all times are London time)*	*Offer Events*
Filing of sanction order	**The date of the Scheme Sanction Hearing or the following business day**	
Sanction order (if granted) delivered to the Registrar of Companies. Scheme becomes effective in accordance with its terms		
Settlement Date / Scheme Settlement Date	**18 December 2013**	**Settlement Date / Scheme Settlement Date**
Expected settlement of the Scheme (subject to satisfaction of the Settlement Condition), including issue and delivery of New Ordinary Shares, Bank T2 Notes and Additional New Ordinary Shares.		Expected settlement of the Offers (subject to satisfaction of the Settlement Condition), including issue and delivery of Bank T2 Notes and Group Notes and payment of Accrued Dividends, Accrued Interest and other relevant amounts.

The above timetable may be impacted in certain respects if any of the Meetings in respect of the Preference Shares, the 13% Bonds and the 5.5555% Bonds are required to be adjourned. If the timetable is changed for any reason, the Bank will prepare and publish a supplement to the Bank T2 Prospectus and/or the Group will prepare and publish a supplement to the Group Notes Prospectus, as appropriate.

If any of the Meetings are required to be adjourned, the Bank currently expects that the adjourned meeting(s) would be held on or around 27 December 2013 and the settlement date for the Offers and the Scheme will be postponed to on or around 31 December 2013. In such event, the Bank will announce the new dates via the Regulatory News Service (RNS) operated by the London Stock Exchange.

Unless stated otherwise or required by order of the Court, announcements in relation to the Liability Management Exercise will be made: (i) by the issue of a press release to a Notifying News Service; (ii) by the delivery of notices to Euroclear and Clearstream, Luxembourg for communication to Direct Participants; (iii) via the Regulatory News Service (RNS) operated by the London Stock Exchange; and (iv) as otherwise required by the rules of the London Stock Exchange. Copies of all announcements, notices and press releases can also be obtained from the Exchange Agent and Information Agent, the contact details for which are at the end of this Offer Memorandum.

Holders are advised to check with any custodian, broker or other intermediary through which they hold their Existing Securities when such intermediary needs to receive instructions from a Holder in order for such Holder to participate in the Liability Management Exercise.

SECTION N

CANACCORD GENUITY LIMITED FAIRNESS OPINIONS

The Bank has sought an independent opinion from Canaccord Genuity Limited ("**Canaccord Genuity**") on the fairness of the Liability Management Exercise from a financial value perspective to the holders of the Preference Shares, the 13% Bonds and the 5.5555% Bonds. Canaccord Genuity is regulated in the United Kingdom by the Financial Conduct Authority. Canaccord Genuity's fairness opinions are set out in this Section N.

Canaccord Genuity's fairness opinions have been produced at the request of the Bank and are included, in the form and context in which they are included, with the consent of Canaccord Genuity who has authorised the contents of this Section N for the purposes of item 5.5.4R(2)(f) of the Prospectus Rules.

Save for any responsibility arising under Prospectus Rule 5.5.4R(2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law Canaccord Genuity does not assume any responsibility and will not accept any liability to any person for any loss suffered by any such other person as a result of, arising out of, or in accordance with the fairness opinions contained in this Section N.

This Section N contains the following parts:

- Part 1: Canaccord Genuity's consent letter
- Part 2: Canaccord Genuity's Fairness Opinion relating to the Preference Shares
- Part 3: Canaccord Genuity's Fairness Opinion relating to the 13% Bonds
- Part 4: Canaccord Genuity's Fairness Opinion relating to the 5.5555% Bonds

Holders should note that these opinions do not constitute financial or legal advice. By consenting to the inclusion of its opinions in this document, Canaccord Genuity is not providing any advice or recommendation to any Holder as to what action it should take in respect of the Liability Management Exercise. Canaccord Genuity will not be responsible or liable to any Holder for that Holder's decisions in respect of the Liability Management Exercise.

PART 1:

CANACCORD GENUITY'S CONSENT LETTER

CANACCORD Genuity

CANACCORD GENUITY LIMITED

88 Wood Street
London
EC2V 7QR
United Kingdom

+44 (0)20 7523 8000

www.canaccordgenuity.com

PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

The Board of Directors
Co-operative Group Limited
1 Angel Square
Manchester
M60 0AG

Dear Sirs

Liability Management Exercise

We refer to the Consent and Exchange Offer Memorandum dated 4 November 2013 prepared by The Co-operative Bank p.l.c. ("**Bank**") and Co-operative Group Limited ("**Group**") and which is appended to, and forms part of (i) the Prospectus dated 4 November 2013 published by the Bank relating to fixed rate Subordinated Notes (the "**Bank T2 Prospectus**") and (ii) the Prospectus dated 4 November 2013 published by the Group relating to fixed rate Final Repayment Subordinated Notes and Instalment Repayment Subordinated Notes (the "**Group Notes Prospectus**").

The Consent and Exchange Offer Memorandum describes the Bank's and the Group's liability management exercise in respect of certain securities issued by Bank and more particularly set out in Appendix I to this letter (the "**Securities**").

Consent

In accordance with Annex IV.16.1 of the Prospectus Directive Regulation, we hereby consent to the inclusion in the Group Notes Prospectus of our fairness opinion letters dated 4 November 2013 relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds and of the references to ourselves in the form and context in which they are included.

In accordance with Annex XI.13.1 of the Prospectus Directive Regulation, we hereby consent to the inclusion in the Bank T2 Prospectus of our fairness opinion letters dated 4 November 2013 relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds and of the references to ourselves in the form and context in which they are included.

For the purposes of Prospectus Rule 5.5.4R (2)(f) we are responsible for the fairness opinion letters dated 4 November 2013 relating to the Preference Shares, the 13% Bonds and the 5.5555% Bonds as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in the fairness opinion letters is, to the best of our knowledge, in accordance with the facts and contains no omissions likely to affect its import. This declaration is included in the Prospectus in compliance with paragraph 1.2 of Annex XI and paragraph 1.2 of Annex IV (as applicable) of the Prospectus Directive Regulation.

Other Matters

We confirm that we are authorised and regulated in the United Kingdom by the Financial Conduct Authority

Yours faithfully

Canaccord Genuity

Canaccord Genuity Limited

Appendix I

Security Name	ISIN
9.25% Non-Cumulative Irredeemable Preference Shares (the "**Preference Shares**")	GB0002224516
13% Perpetual Subordinated Bonds (the "**13% Bonds**")	GB00B3VH4201
5.5555% Perpetual Subordinated Bonds (the "**5.5555% Bonds**")	GB00B3VMBW45
Floating Rate Callable Step-up Dated Subordinated Notes due 2016	XS0254625998
5.875% Subordinated Callable Notes due 2019	XS0189539942
9.25% Subordinated Notes due 28 April 2021	XS0620315902
Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984
7.875% Subordinated Notes due 19 December 2022	XS0864253868
5.75% Dated Callable Step-up Subordinated Noted due 2024	XS0188218183
5.875% Subordinated Notes due 2033	XS0145065602

PART 2:

CANACCORD GENUITY'S FAIRNESS OPINION RELATING TO THE PREFERENCE SHARES

CANACCORD Genuity

CANACCORD GENUITY LIMITED

88 Wood Street
London
EC2V 7QR
United Kingdom

+44 (0)20 7523 8000

www.canaccordgenuity.com

PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dear Sirs

Further to our letter of engagement dated 25 October 2013 (the "**Engagement Letter**") we have been instructed by you to provide an assessment of whether the proposed restructuring of The Co-operative Bank p.l.c. (the "**Bank**"), as more particularly set out in the public announcement of the Bank on 4 November 2013 (the "**Announcement**" or together the "**Proposed Restructuring**"), is fair from a financial value perspective to the holders of the 9.25% Non-Cumulative Irredeemable Preference Shares (ISIN: GB0002224516) in the Bank (the "**Preference Shares**") when compared with the alternative scenarios described below.

Proposed Restructuring
Under the Proposed Restructuring the holders of Preference Shares will receive a choice between Final Repayment Notes and Instalment Repayment Notes in exchange for their Preference Shares. Further details of the exchange can be found in the Announcement.

Scope of Work
In reaching our assessment of whether the Proposed Restructuring is fair from a financial value perspective to the holders of the Preference Shares we have considered the financial outcome to the holders of the Preference Shares in three particular scenarios as outlined below (the "**Assessment**").

The three scenarios considered included:

1. the Proposed Restructuring being implemented in full as outlined in the Announcement, including receipt of all necessary regulatory approvals;
2. the Proposed Restructuring failing to complete for whatever reason and the Bank entering into a Special Resolution Regime (as defined by the Banking Act 2009) ("**SRR**"). In analysing the various possible ultimate outcomes in this scenario we have reviewed third party reports provided by the Bank and its advisers which considered such possible outcomes including the Bank entering into a formal insolvency process. We have not considered alternative possible outcomes from SRR or the probability of such outcomes occurring; and
3. the restructuring option being considered by the Board of the Bank at the time of the Banks' public announcement on 17 June 2013.

We have not considered the net financial impact on individual holders of the Preference Shares, each of whose particular circumstances, including tax position, is unique.

United Kingdom
Ireland
France
Germany
Italy
Canada
United States
China
Singapore
Australia

Information Reviewed and Relied Upon

In performing our work we have reviewed and relied upon:

1. certain information about the Bank provided to us;
2. the Bank's business plan as at 24 October 2013, the final form of which was approved by the Board of Directors on 1 November 2013 without material amendment;
3. the details of the proposed financial restructuring of the Bank; and
4. the various SRR scenarios considered by the Bank and its advisers.

We also had the opportunity to discuss the contents of this letter with both senior management of the Bank and members of the ad hoc steering committee formed to informally represent the retail holders of the Preference Shares.

We have relied upon the completeness, accuracy and fair presentation of all of the financial and other information, data, documents, advice, opinions, representations and other materials, whether in written, electronic or oral form, obtained by us from public sources or provided to us by the Bank or any of its senior management, associates, affiliates, consultants, agents and advisors or otherwise, and we have assumed that this information did not omit to state any material fact or any fact necessary to be stated to make such information not misleading. The Assessment is necessarily conditional upon the completeness, accuracy and fair presentation of such information. Subject to the exercise of professional judgement, we have not, nor attempted to independently verify and have assumed the completeness, accuracy and fair presentation of any such information. With respect to the Bank's financial forecasts, projections or estimates provided to us by management of the Bank and used in the analysis of supporting the Assessment, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgements of management of the Bank as to the matters covered thereby and which, in the good faith opinion of the Bank, after careful consideration, are (or were at the time of preparation and continue to be) reasonable in the circumstances. By rendering the Assessment we (a) express no view as to the reasonableness of such forecasts, projections or estimates or the assumptions on which they are based and (b) have not taken into consideration the impact future events (such as, without limitation, market fluctuation and/or litigation risk and third party claims) may have on our Assessment. We have not, to the best of our knowledge, been denied access by the Bank to any information requested by us. We also have assumed that obtaining all regulatory and other approvals and third party consents required for consummation of the Proposed Restructuring (if any) will not have an adverse impact our Assessment, and we have assumed that the Proposed Restructuring will be consummated in accordance with the Announcement and without waiver or modification of any of the material terms or conditions contained therein by any party thereto.

Assumptions and Limitations

We have not prepared a formal valuation or appraisal of the Bank or the Preference Shares and the Assessment should not be construed as such. We have, however, conducted such analyses as we considered necessary in the circumstances. In addition, the Assessment is not, and should not be construed as, advice as to the future value of the Bank at any future date. The Assessment addresses only the fairness, from a financial value perspective point of view of the Preference Shares and subject to the terms of this letter, of the impact of the Proposed Restructuring of the Bank on the holders of the Preference Shares when compared with the alternative scenarios described above and does not address any other aspect or implication of the Proposed Restructuring.

We are not legal, tax or accounting advisors or experts, have not been engaged to review any legal, tax or accounting aspects of the Proposed Restructuring and express no opinion concerning any legal, tax or accounting matters concerning the Proposed Restructuring.

The Assessment is rendered on the basis of economic, financial and general business conditions prevailing as of the date of this letter and the conditions and prospects, financial and otherwise, of the Bank and its subsidiaries and affiliates, as they were reflected in the information provided to us and which we deem relevant to the Assessment. In our analyses and in preparing the Assessment, we made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond our control or any party involved in the Proposed Restructuring.

This letter has been provided for the sole use and benefit of the Board of the Bank in connection with, and for the purpose of, its consideration of the Proposed Restructuring and its impact on the holders of the Preference Shares and may not be used or relied upon by any other person or for any other purpose without our prior written consent. This letter may however be made available on a non-reliance basis to the holders of the Preference Shares in its complete form.

The Assessment does not address the relative merits of the Proposed Restructuring as compared to other possible restructuring options not provided to us by the Bank. In considering fairness from a financial value perspective we considered the Proposed Restructuring from the perspective of the holders of the Preference Shares generally and did not consider the specific circumstances of any particular holder of the Preference Shares including, without limitation, with regard to their individual tax positions.

The Assessment is given as at the date of the letter and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting the Assessment which may come, or be brought, to our attention after the date of this letter. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the Assessment after the date of this letter, including, without limitation, the terms and conditions of the Proposed Restructuring, or if we learn that the information relied upon in rendering the Assessment was inaccurate, incomplete or misleading in any material respect, we reserve the right (but are not obliged) to change, modify or withdraw the Assessment.

Conclusion
We note the difference in treatment between the various classes of debt and equity instruments despite their respective ranking. However, notwithstanding this and based upon and subject to the foregoing and such other matters we considered relevant, it is our view that the Proposed Restructuring is fair from a financial value perspective to the holders of the Preference Shares as at the date of this letter.

This Assessment is provided strictly in pursuant to our Engagement Letter. All terms and conditions of the Engagement Letter are deemed to apply to this letter.

This letter will be governed by and construed exclusively in accordance with English law, and, save in respect of Canaccord Genuity Limited's affiliates, it shall confer no rights on a third party pursuant to the Contract (Rights of Third Parties) Act of 1999.

Yours faithfully

Canaccord Genuity

Canaccord Genuity Limited

PART 3:

CANACCORD GENUITY'S FAIRNESS OPINION RELATING TO THE 13% BONDS

CANACCORD Genuity

CANACCORD GENUITY LIMITED

88 Wood Street
London
EC2V 7QR
United Kingdom

+44 (0)20 7523 8000

www.canaccordgenuity.com

PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dear Sirs

Further to our letter of engagement dated 25 October 2013 (the "**Engagement Letter**") we have been instructed by you to provide an assessment of whether the proposed restructuring of The Co-operative Bank p.l.c. (the "**Bank**"), as more particularly set out in the public announcement of the Bank on 4 November 2013 (the "**Announcement**" or together the "**Proposed Restructuring**"), is fair from a financial value perspective to the holders of the 13% Perpetual Subordinated Bonds (ISIN: GB00B3VH4201) in the Bank (the "**13% Bonds**") when compared with the alternative scenarios described below.

Proposed Restructuring
Under the Proposed Restructuring the holders of the 13% Bonds will receive a choice between Final Repayment Notes and Instalment Repayment Notes in exchange for their 13% Bonds. Further details of the exchange can be found in the Announcement.

Scope of Work
In reaching our assessment of whether the Proposed Restructuring is fair from a financial value perspective to the holders of the 13% Bonds we have considered the financial outcome to the holders of the 13% Bonds in three particular scenarios as outlined below (the "**Assessment**").
The three scenarios considered included:

1. the Proposed Restructuring being implemented in full as outlined in the Announcement, including receipt of all necessary regulatory approvals;
2. the Proposed Restructuring failing to complete for whatever reason and the Bank entering into a Special Resolution Regime (as defined by the Banking Act 2009) ("**SRR**"). In analysing the various possible ultimate outcomes in this scenario we have reviewed third party reports provided by the Bank and its advisers which considered such possible outcomes including the Bank entering into a formal insolvency process. We have not considered alternative possible outcomes from SRR or the probability of such outcomes occurring; and
3. the restructuring option being considered by the Board of the Bank at the time of the Banks' public announcement on 17 June 2013.

We have not considered the net financial impact on individual holders of the 13% Bonds, each of whose particular circumstances, including tax position, is unique.

United Kingdom
Ireland
France
Germany
Italy
Canada
United States
China
Singapore
Australia

Information Reviewed and Relied Upon

In performing our work we have reviewed and relied upon:

1. certain information about the Bank provided to us;
2. the Bank's business plan as at 24 October 2013, the final form of which was approved by the Board of Directors on 1 November 2013 without material amendment;
3. the details of the proposed financial restructuring of the Bank; and
4. the various SRR scenarios considered by the Bank and its advisers.

We also had the opportunity to discuss the contents of this letter with both senior management of the Bank and members of the ad hoc steering committee formed to informally represent the retail holders of the 13% Bonds.

We have relied upon the completeness, accuracy and fair presentation of all of the financial and other information, data, documents, advice, opinions, representations and other materials, whether in written, electronic or oral form, obtained by us from public sources or provided to us by the Bank or any of its senior management, associates, affiliates, consultants, agents and advisors or otherwise, and we have assumed that this information did not omit to state any material fact or any fact necessary to be stated to make such information not misleading. The Assessment is necessarily conditional upon the completeness, accuracy and fair presentation of such information. Subject to the exercise of professional judgement, we have not, nor attempted to independently verify and have assumed the completeness, accuracy and fair presentation of any such information. With respect to the Bank's financial forecasts, projections or estimates provided to us by management of the Bank and used in the analysis of supporting the Assessment, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgements of management of the Bank as to the matters covered thereby and which, in the good faith opinion of the Bank, after careful consideration, are (or were at the time of preparation and continue to be) reasonable in the circumstances. By rendering the Assessment we (a) express no view as to the reasonableness of such forecasts, projections or estimates or the assumptions on which they are based and (b) have not taken into consideration the impact future events (such as, without limitation, market fluctuation and/or litigation risk and third party claims) may have on our Assessment. We have not, to the best of our knowledge, been denied access by the Bank to any information requested by us. We also have assumed that obtaining all regulatory and other approvals and third party consents required for consummation of the Proposed Restructuring (if any) will not have an adverse impact our Assessment, and we have assumed that the Proposed Restructuring will be consummated in accordance with the Announcement and without waiver or modification of any of the material terms or conditions contained therein by any party thereto.

Assumptions and Limitations

We have not prepared a formal valuation or appraisal of the Bank or the 13% Bonds and the Assessment should not be construed as such. We have, however, conducted such analyses as we considered necessary in the circumstances. In addition, the Assessment is not, and should not be construed as, advice as to the future value of the Bank at any future date. The Assessment addresses only the fairness, from a financial value perspective point of view of the 13% Bonds and subject to the terms of this letter, of the impact of the Proposed Restructuring of the Bank on the holders of the 13% Bonds when compared with the alternative scenarios described above and does not address any other aspect or implication of the Proposed Restructuring.

We are not legal, tax or accounting advisors or experts, have not been engaged to review any legal, tax or accounting aspects of the Proposed Restructuring and express no opinion concerning any legal, tax or accounting matters concerning the Proposed Restructuring.

The Assessment is rendered on the basis of economic, financial and general business conditions prevailing as of the date of this letter and the conditions and prospects, financial and otherwise, of the Bank and its subsidiaries and affiliates, as they were reflected in the information provided to us and which we deem relevant to the Assessment. In our analyses and in preparing the Assessment, we made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond our control or any party involved in the Proposed Restructuring.

This letter has been provided for the sole use and benefit of the Board of the Bank in connection with, and for the purpose of, its consideration of the Proposed Restructuring and its impact on the holders of the 13% Bonds and may not be used or relied upon by any other person or for any other purpose without our prior written consent. This letter may however be made available on a non-reliance basis to the holders of the 13% Bonds in its complete form.

The Assessment does not address the relative merits of the Proposed Restructuring as compared to other possible restructuring options not provided to us by the Bank. In considering fairness from a financial value perspective we considered the Proposed Restructuring from the perspective of the holders of the 13% Bonds generally and did not consider the specific circumstances of any particular holder of the 13% Bonds including, without limitation, with regard to their individual tax positions.

The Assessment is given as at the date of the letter and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting the Assessment which may come, or be brought, to our attention after the date of this letter. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the Assessment after the date of this letter, including, without limitation, the terms and conditions of the Proposed Restructuring, or if we learn that the information relied upon in rendering the Assessment was inaccurate, incomplete or misleading in any material respect, we reserve the right (but are not obliged) to change, modify or withdraw the Assessment.

Conclusion

We note the difference in treatment between the various classes of debt and equity instruments despite their respective ranking. However, notwithstanding this and based upon and subject to the foregoing and such other matters we considered relevant, it is our view that the Proposed Restructuring is fair from a financial value perspective to the holders of the 13% Bonds as at the date of this letter.

This Assessment is provided strictly in pursuant to our Engagement Letter. All terms and conditions of the Engagement Letter are deemed to apply to this letter.

This letter will be governed by and construed exclusively in accordance with English law, and, save in respect of Canaccord Genuity Limited's affiliates, it shall confer no rights on a third party pursuant to the Contract (Rights of Third Parties) Act of 1999.

Yours faithfully

Canaccord Genuity

Canaccord Genuity Limited

PART 4:

CANACCORD GENUITY'S FAIRNESS OPINION RELATING TO THE 5.5555% BONDS

CANACCORD Genuity

CANACCORD GENUITY LIMITED

88 Wood Street
London
EC2V 7QR
United Kingdom

+44 (0)20 7523 8000

www.canaccordgenuity.com

PRIVATE & CONFIDENTIAL

4 November 2013

The Board of Directors
The Co-operative Bank p.l.c.
1 Balloon Street
Manchester
M60 4EP

Dear Sirs

Further to our letter of engagement dated 25 October 2013 (the "**Engagement Letter**") we have been instructed by you to provide an assessment of whether the proposed restructuring of The Co-operative Bank p.l.c. (the "**Bank**"), as more particularly set out in the public announcement of the Bank on 4 November 205.5555 (the "**Announcement**" or together the "**Proposed Restructuring**"), is fair from a financial value perspective to the holders of the 5.5555% Perpetual Subordinated Bonds (ISIN: GB00B3VMBW45) in the Bank (the "**5.5555% Bonds**") when compared with the alternative scenarios described below.

Proposed Restructuring
Under the Proposed Restructuring the holders of the 5.5555% Bonds will receive Bank T2 Notes in exchange for their 5.5555% Bonds. Further details of the exchange can be found in the Announcement.

Scope of Work
In reaching our assessment of whether the Proposed Restructuring is fair from a financial value perspective to the holders of the 5.5555% Bonds we have considered the financial outcome to the holders of the 5.5555% Bonds in three particular scenarios as outlined below (the "**Assessment**").

The three scenarios considered included:

1. the Proposed Restructuring being implemented in full as outlined in the Announcement, including receipt of all necessary regulatory approvals;
2. the Proposed Restructuring failing to complete for whatever reason and the Bank entering into a Special Resolution Regime (as defined by the Banking Act 2009) ("**SRR**"). In analysing the various possible ultimate outcomes in this scenario we have reviewed third party reports provided by the Bank and its advisers which considered such possible outcomes including the Bank entering into a formal insolvency process. We have not considered alternative possible outcomes from SRR or the probability of such outcomes occurring; and
3. the restructuring option being considered by the Board of the Bank at the time of the Banks' public announcement on 17 June 2013.

We have not considered the net financial impact on individual holders of the 5.5555% Bonds, each of whose particular circumstances, including tax position, is unique.

Information Reviewed and Relied Upon

In performing our work we have reviewed and relied upon:

1. certain information about the Bank provided to us;
2. the Bank's business plan as at 24 October 2013, the final form of which was approved by the Board of Directors on 1 November 2013 without material amendment;
3. the details of the proposed financial restructuring of the Bank; and
4. the various SRR scenarios considered by the Bank and its advisers.

We also had the opportunity to discuss the contents of this letter with both senior management of the Bank and members of the ad hoc steering committee formed to informally represent the retail holders of the 5.5555% Bonds.

We have relied upon the completeness, accuracy and fair presentation of all of the financial and other information, data, documents, advice, opinions, representations and other materials, whether in written, electronic or oral form, obtained by us from public sources or provided to us by the Bank or any of its senior management, associates, affiliates, consultants, agents and advisors or otherwise, and we have assumed that this information did not omit to state any material fact or any fact necessary to be stated to make such information not misleading. The Assessment is necessarily conditional upon the completeness, accuracy and fair presentation of such information. Subject to the exercise of professional judgement, we have not, nor attempted to independently verify and have assumed the completeness, accuracy and fair presentation of any such information. With respect to the Bank's financial forecasts, projections or estimates provided to us by management of the Bank and used in the analysis of supporting the Assessment, we have assumed that they have been reasonably prepared on bases reflecting the best currently available estimates and judgements of management of the Bank as to the matters covered thereby and which, in the good faith opinion of the Bank, after careful consideration, are (or were at the time of preparation and continue to be) reasonable in the circumstances. By rendering the Assessment we (a) express no view as to the reasonableness of such forecasts, projections or estimates or the assumptions on which they are based and (b) have not taken into consideration the impact future events (such as, without limitation, market fluctuation and/or litigation risk and third party claims) may have on our Assessment. We have not, to the best of our knowledge, been denied access by the Bank to any information requested by us. We also have assumed that obtaining all regulatory and other approvals and third party consents required for consummation of the Proposed Restructuring (if any) will not have an adverse impact our Assessment, and we have assumed that the Proposed Restructuring will be consummated in accordance with the Announcement and without waiver or modification of any of the material terms or conditions contained therein by any party thereto.

Assumptions and Limitations

We have not prepared a formal valuation or appraisal of the Bank or the 5.5555% Bonds and the Assessment should not be construed as such. We have, however, conducted such analyses as we considered necessary in the circumstances. In addition, the Assessment is not, and should not be construed as, advice as to the future value of the Bank at any future date. The Assessment addresses only the fairness, from a financial value perspective point of view of the 5.5555% Bonds and subject to the terms of this letter, of the impact of the Proposed Restructuring of the Bank on the holders of the 5.5555% Bonds when compared with the alternative scenarios described above and does not address any other aspect or implication of the Proposed Restructuring.

We are not legal, tax or accounting advisors or experts, have not been engaged to review any legal, tax or accounting aspects of the Proposed Restructuring and express no opinion concerning any legal, tax or accounting matters concerning the Proposed Restructuring.

The Assessment is rendered on the basis of economic, financial and general business conditions prevailing as of the date of this letter and the conditions and prospects, financial and otherwise, of the Bank and its subsidiaries and affiliates, as they were reflected in the information provided to us and which we deem relevant to the Assessment. In our analyses and in preparing the Assessment, we made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond our control or any party involved in the Proposed Restructuring.

This letter has been provided for the sole use and benefit of the Board of the Bank in connection with, and for the purpose of, its consideration of the Proposed Restructuring and its impact on the holders of the 5.5555% Bonds and may not be used or relied upon by any other person or for any other purpose without our prior written consent. This letter may however be made available on a non-reliance basis to the holders of the 5.5555% Bonds in its complete form.

The Assessment does not address the relative merits of the Proposed Restructuring as compared to other possible restructuring options not provided to us by the Bank. In considering fairness from a financial value perspective we considered the Proposed Restructuring from the perspective of the holders of the 5.5555% Bonds generally and did not consider the specific circumstances of any particular holder of the 5.5555% Bonds including, without limitation, with regard to their individual tax positions.

The Assessment is given as at the date of the letter and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting the Assessment which may come, or be brought, to our attention after the date of this letter. Without limiting the foregoing, in the event that there is any material change in any fact or matter affecting the Assessment after the date of this letter, including, without limitation, the terms and conditions of the Proposed Restructuring, or if we learn that the information relied upon in rendering the Assessment was inaccurate, incomplete or misleading in any material respect, we reserve the right (but are not obliged) to change, modify or withdraw the Assessment.

Conclusion

We note the difference in treatment between the various classes of debt and equity instruments despite their respective ranking. However, notwithstanding this and based upon and subject to the foregoing and such other matters we considered relevant, it is our view that the Proposed Restructuring is fair from a financial value perspective to the holders of the 5.5555% Bonds as at the date of this letter.

This Assessment is provided strictly in pursuant to our Engagement Letter. All terms and conditions of the Engagement Letter are deemed to apply to this letter.

This letter will be governed by and construed exclusively in accordance with English law, and, save in respect of Canaccord Genuity Limited's affiliates, it shall confer no rights on a third party pursuant to the Contract (Rights of Third Parties) Act of 1999.

Yours faithfully

Canaccord Genuity

Canaccord Genuity Limited

THE BANK

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester M60 4EP
United Kingdom

THE GROUP

Co-operative Group Limited
1 Angel Square
Manchester M60 0AG
United Kingdom

DEALER MANAGERS

HSBC Bank plc
8 Canada Square
London E14 45HQ
United Kingdom

Telephone: +44 20 7992 6237
Attention: Liability Management Group
Email: coop.exchange@hsbcib.com

UBS Limited
1 Finsbury Avenue
London EC2M 2PP
United Kingdom

Telephone: +44 20 7567 0525
Attention: Liability Management Group
Email: mark-t.watkins@ubs.com/
mahmoud.abdelaal@ubs.com

EXCHANGE AGENT AND INFORMATION AGENT

Lucid Issuer Services Limited
436 Essex Road
London N1 3QP
United Kingdom

Telephone: 0800 279 7346
(if calling from outside the UK: +44 20 7704 0880)

Fax: +44 20 7067 9098
Attention: Sunjeeve Patel / David Shilson / Yves Theis
Email: co-op@lucid-is.com

REGISTRARS

In respect of the Preference Shares
Computershare Investor Services PLC
Bridgwater Road
Bristol BS99 6ZZ
United Kingdom

In respect of the Perpetual Subordinated Bonds
Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex BN99 6DA
United Kingdom

LEGAL ADVISERS

To the Group and the Bank as to English and United States law
Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom

To the Dealer Managers as to English and United States law
Linklaters LLP
One Silk Street
London EC2Y 8HQ
United Kingdom

ISSUER

The Co-operative Bank p.l.c.
1 Balloon Street
Manchester M60 4EP

TRUSTEE

Law Debenture Trustees Limited
Fifth Floor
100 Wood Street
London EC2V 7EX

REGISTRAR AND PAYING AGENT

Computershare Investor Services PLC
Bristol BS99 6AH
United Kingdom

LEGAL ADVISERS

To the Issuer as to English law
Allen & Overy LLP
One Bishops Square
London E1 6AD

To the Dealer Managers and the Trustee as trustee in respect of the Notes as to English law
Linklaters LLP
One Silk Street
London EC2Y 8HQ

AUDITORS TO THE ISSUER

KPMG Audit Plc
15 Canada Square
London E14 5GL

sterling 162122