The co-operative bank

2012 Annual results

21 March 2013

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Chief Executive

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Chief Financial Officer

Forward looking statements

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Agenda

- **Context**
- Financial headlines
- Core business
- Non-core business
- Action plan

Context

- Prolonged economic downturn
- Increased strains on our customers, particularly in the non-core corporate sector
- Further strengthening of the balance sheet by:
  - Building on the strength of the core business
  - De-risking non-core assets
- Announced Sale and Purchase Agreement for the life insurance business, expect to release significant capital
- Announced the intention sell our general insurance business
- Solid platform to broaden our reach and appeal in the UK banking sector, either through Verde or continued organic growth

Strong core franchise a platform for growth

- Our core business has industry-leading levels of customer service
- High degree of current account switching from other banks
- Removed sales-related performance bonuses for Retail colleagues in 2012
- Removed overdraft fees for the first three months of 2012
- £2.6bn of residential new lending and £1.3bn of new lending to corporate and business customers
- Over 100,000 customers switched in summer 2012
- 8% increase in new primary account customers over the year
- Low levels of impairment within core book

Agenda

Context

Financial headlines

Core business

Non-core business

Action plan

Banking Group financial performance

Co-operative Banking Group – financial performance

	2012 £m	2011 £m
Core business:		
Income	1,421	1,436
Operating costs	(681)	(653)
Impairment losses	(118)	(92)
Claims	(502)	(494)
Operating result - core	120	197
Operating result – non-core	(377)	4
(Loss)/profit before taxation	(647)	88

Bank financial performance

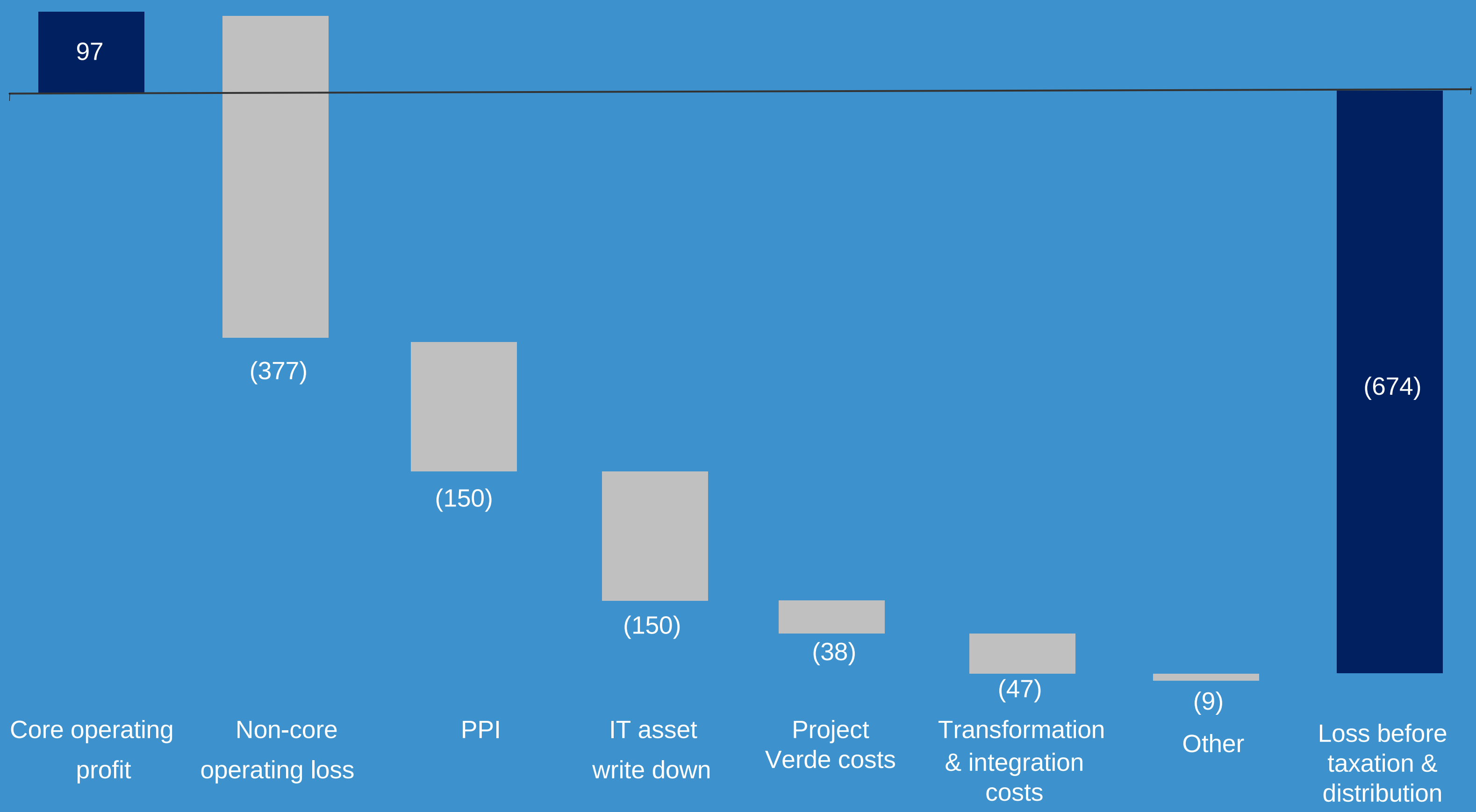
Co-operative Bank – financial performance

	2012 £m	2011 £m
Income	766	754
Operating costs	(552)	(525)
Impairment losses	(118)	(92)
Operating result - core	97	137
Operating result – non-core	(377)	4
(Loss)/profit before taxation	(674)	54
Bank net interest margin	111bps	123bps
Bank cost income ratio	74%	66%
Core tier 1 ratio	8.8%	9.6%
Pro forma CT1 ratio*	9.2%	N/A

- Core business delivered solid operating result
- Loss before tax of £674m
- Substantial increase in impairment provision
- Capital position held up through active management actions

* Pro forma capital ratio at January 2013

Significant items impacted profit



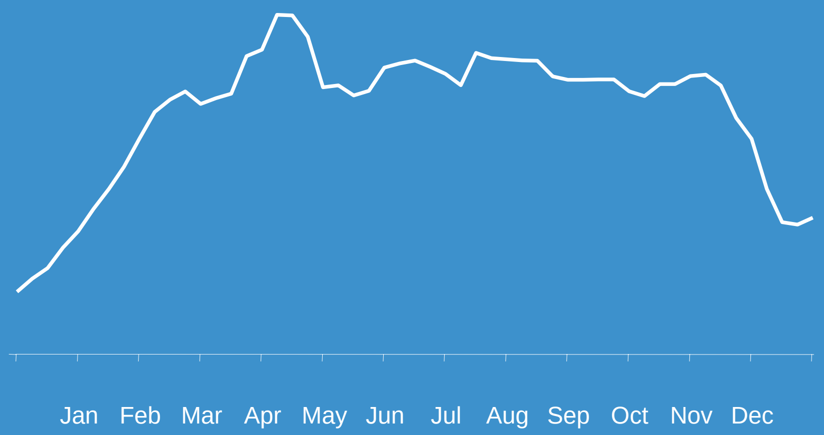
- Provision for redress relating to PPI
- Re-visiting the value ascribed to IT investments made to date in our transformation plan

The co-operative bank

PPI complaints have decreased

- Declining volume of complaints
  - Complaints received plateaued in Q3 2012, followed by a steady decline Q4
- Decrease in percentage of complaints upheld
- Decline in average redress paid

2012 PPI complaints received

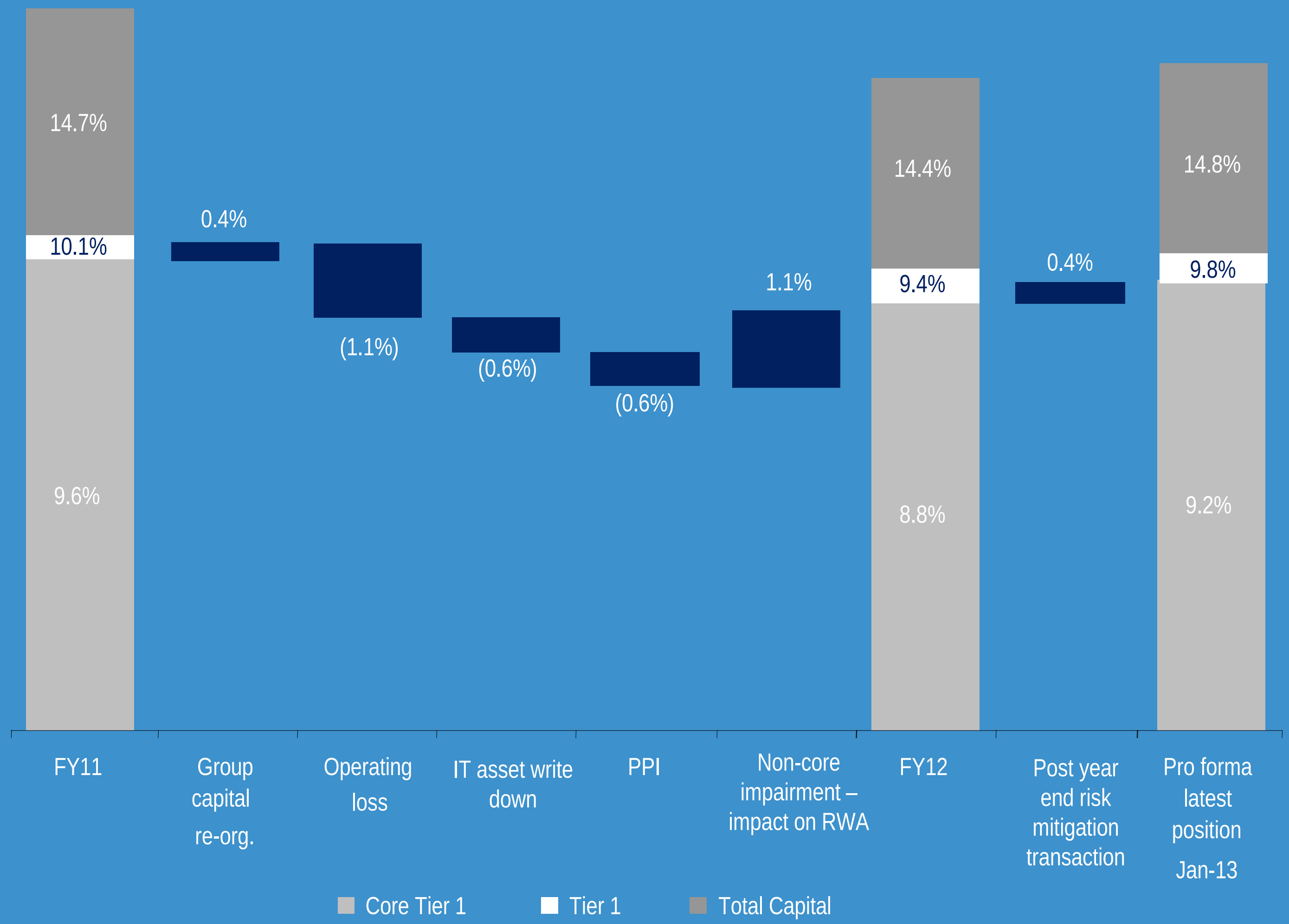


- Despite this, further provision £110m made in H2:
  - Extended scope of the past business review activity
  - Rate of decline in volumes not as significant as assumed at the half year
  - Costs of mortgage PPI redress
- Cumulative provision £244m, of which £128m paid out to date
- Remaining provision £116m

IT asset write down

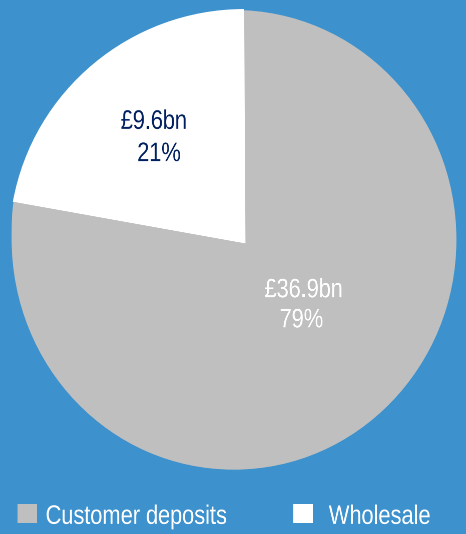
- We have slowed down spending on transformation in light of potential Verde acquisition
- The impairment reflects a worse economic scenario than in the original business case and an increased understanding of the timescales and cost to complete
  - Significant costs to complete reflect complexity
  - Worsening economics have reduced potential benefits
  - Removal of planned cross sales which could give rise to conduct risk e.g. from packaged accounts
- Annual impairment review identified the need to write-down our IT assets by £150m
- The remaining £179m of IT spend held on the balance sheet would be written off on completion of the Verde deal
- Should Verde not complete, this IT programme would be reinvigorated and we are confident of a successful implementation

Focused measures to enhance capital

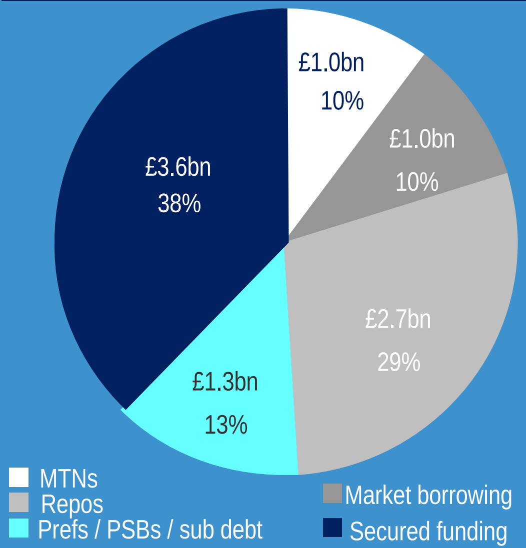


Strong liquidity & diverse funding sources

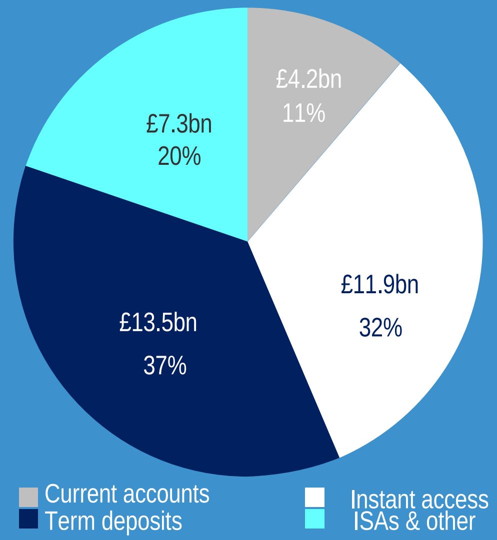
Funding mix



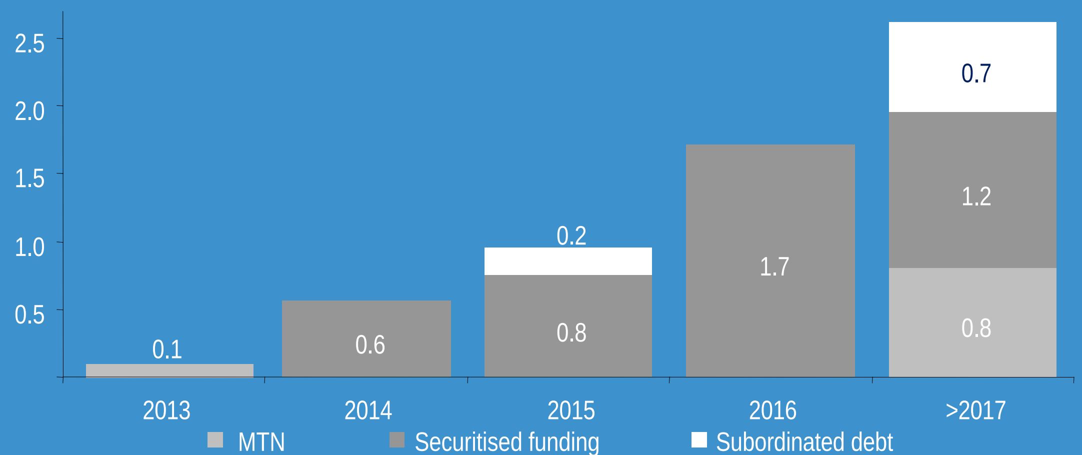
Wholesale funding



Customer deposits



External funding maturity (£bn)



Excluding perpetual debt and short term money market

Liquidity

- Loan to deposit ratio of 92%
- High quality liquid assets
- Liquid asset ratio* of 15%
- Total liquid assets of £7.2bn
- Planned FLS participation in 2013
- Low risk European exposure

* Measured as cash & gilts as a proportion of total Bank liabilities

Key actions

- Announced Sale and Purchase Agreement for the Life & Savings business, expect to release significant capital
- Announced the intention sell our general insurance business
- Segmentation of non-core business - concentrating on managing for value and targeting for run-down or exit
- Maintained profitable and low risk core business, while ensuring our balance sheet remains robust
- Further strengthening the balance sheet by:
    - Building on the strength of the core business
    - Developing a strategy for the management of the non-core portfolio to optimise the profitability and capitalisation of the Bank
- Solid platform to broaden our reach in the UK banking sector
- Taking various measures to reduce cost infrastructure

Agenda

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- Financial headlines
- **Core business**
- Non-core business
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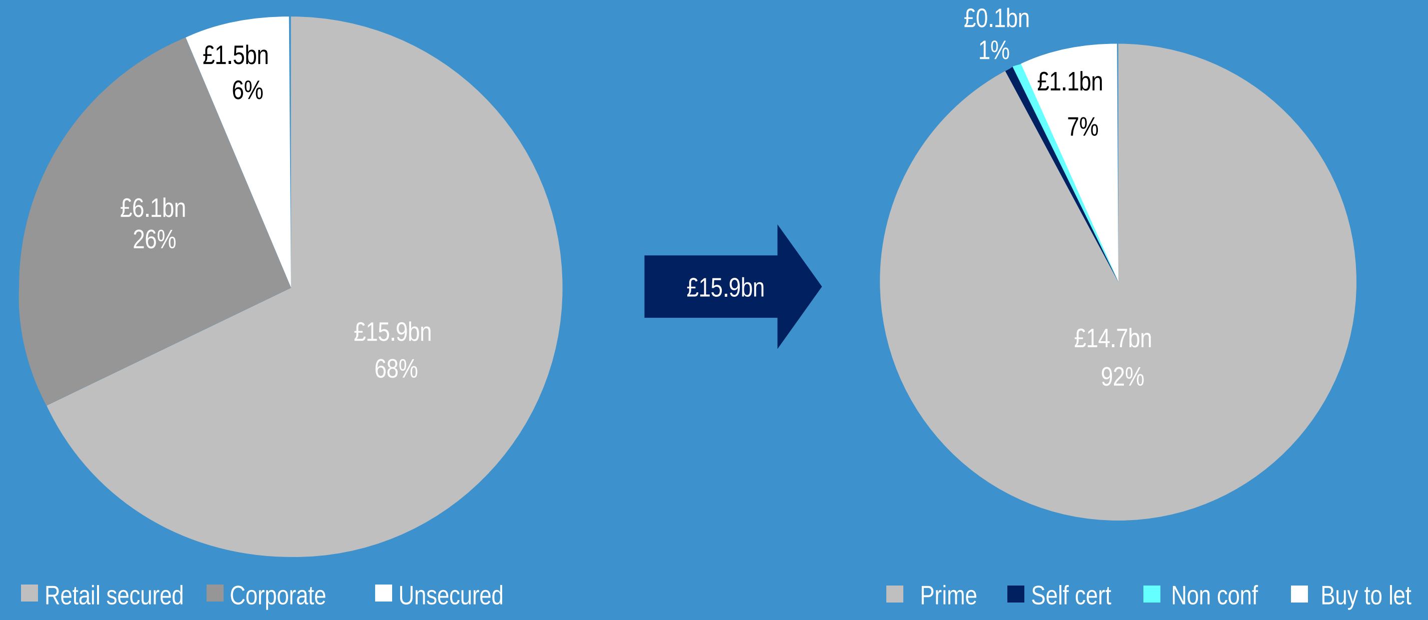
Solid result delivered in core banking business

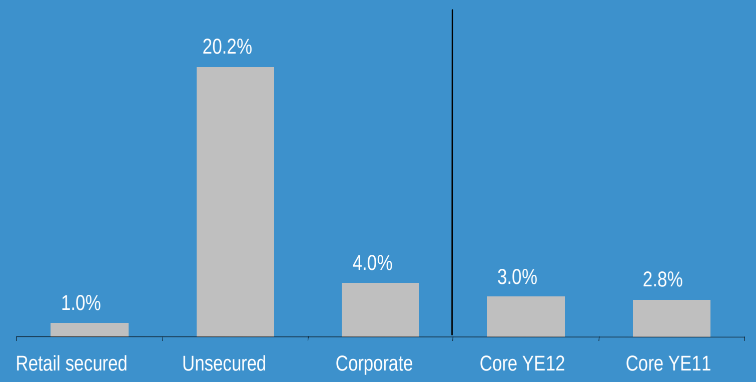
Co-operative Bank – core financial performance	2012 £m	2011 £m
Net interest income	559	535
Non-interest income	207	219
Income	766	754
Operating costs	(552)	(525)
Impairment losses	(118)	(92)
Operating result – core Bank	97	137
Net interest margin	1.68%	1.72%
Cost income ratio	70%	68%
Non-performing loans ratio	3%	3%
Non-performing loans coverage	58%	54%

Low risk core business

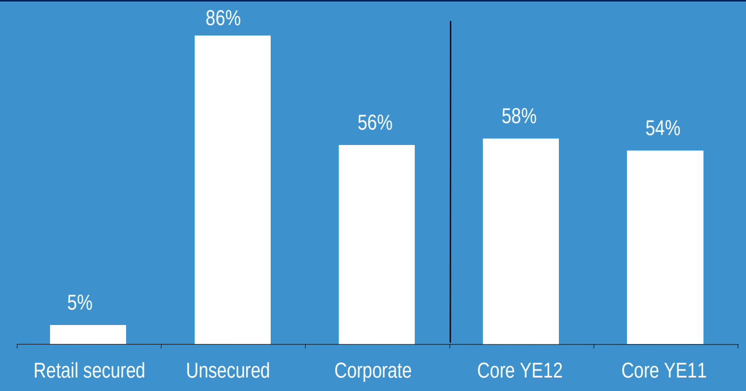
Core gross customer balances £23.5bn



Core impaired loans ratio



Core coverage ratio



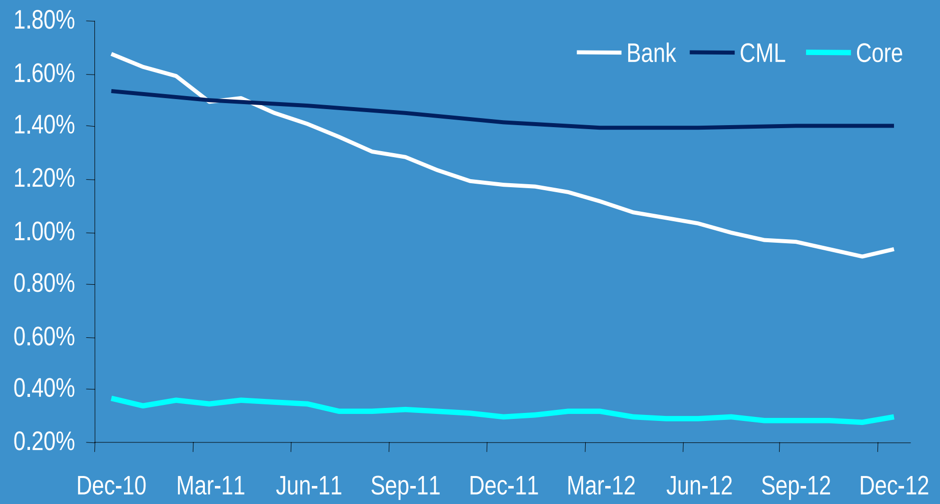
The co-operative bank

Core retail secured portfolio

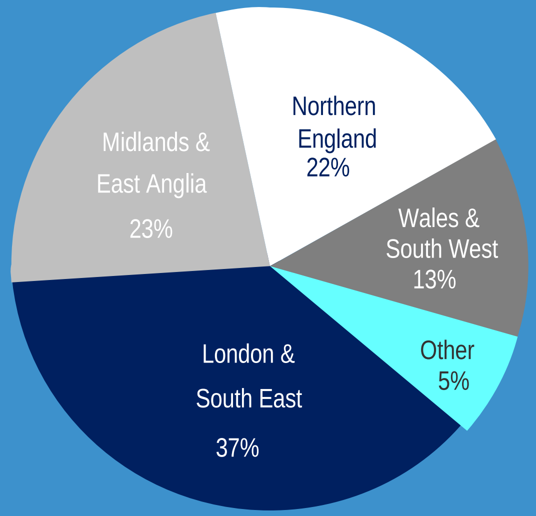
Banded LTV by product

	Core book						Total Bank	
	Prime	Buy to let	Self cert	Non conf	Dec-12	Dec-11	Dec-12	Dec-11
Average LTVs	43%	63%	44%	56%	44%	43%	54%	53%
New business LTVs	61%	63%	n/a	57%	61%	60%	61%	60%
Book by indexed LTV								
<=50%	36%	11%	38%	23%	34%	36%	25%	26%
<=75%	38%	79%	56%	71%	41%	38%	34%	32%
<=100%	24%	10%	7%	6%	23%	23%	31%	32%
>100%	3%	0%	0%	0%	2%	3%	10%	10%
Gross customer balances (£bn)	14.7	1.1	0.1	0.1	15.9	15.8	23.4	23.7
New lending (excl further advances)	2.1	0.5	n/a	0.0	2.6	1.4	2.6	1.4
% accounts with >2.5% arrears	0.30%	0.02%	0.00%	3.46%	0.30%	0.30%	0.93%	1.18%

Core arrears vs. CML

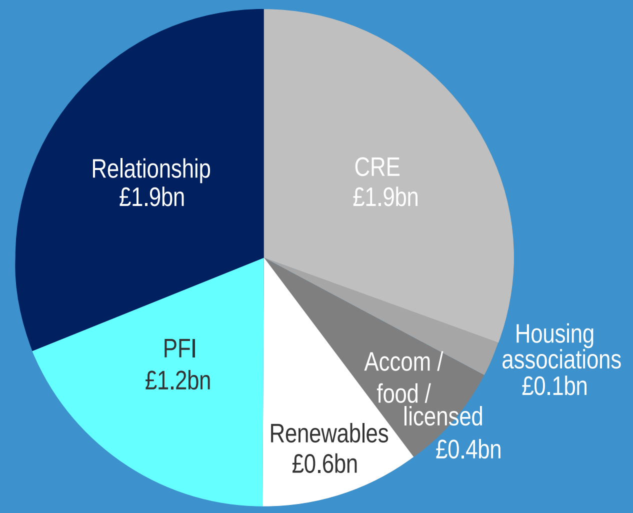


Core regional analysis

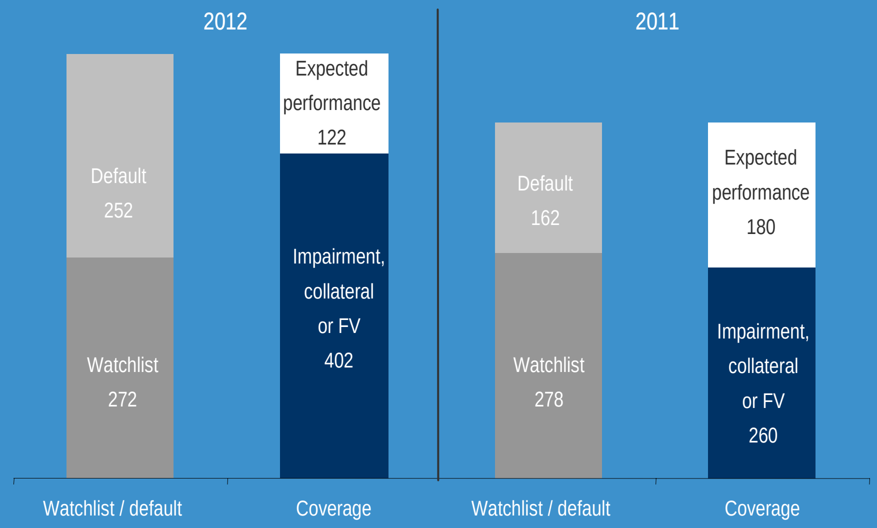


Core corporate portfolio

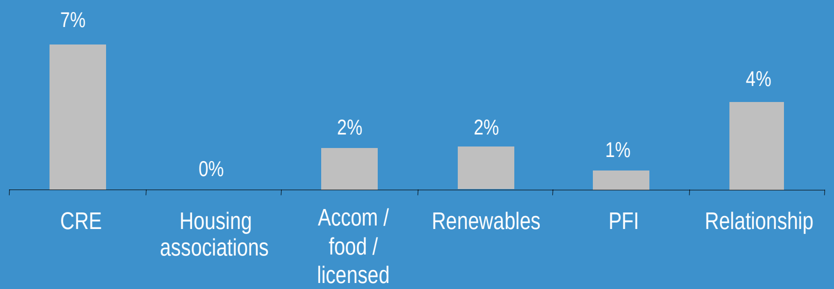
Core gross book balance - £6.1bn



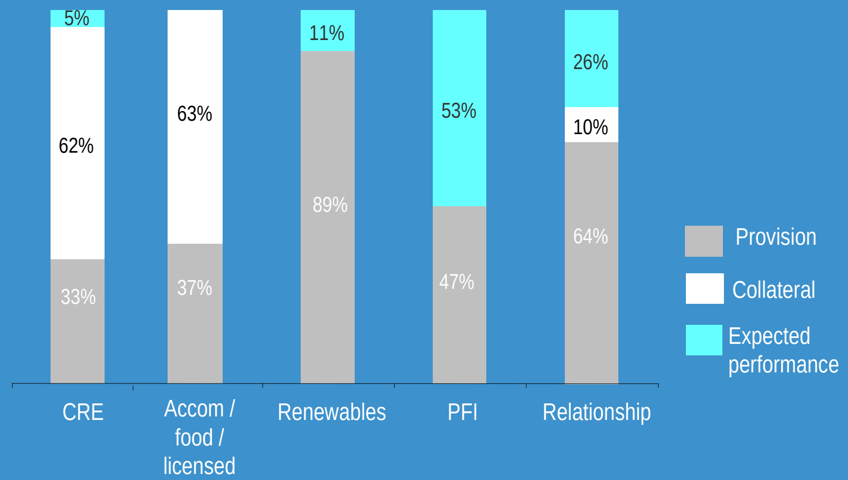
Watch list and default exposure (£m)



Core corporate impaired loan ratio



Core corporate – total coverage ratio



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Financial headlines

Core business

Non-core business

Action plan

Definition of non-core business

- Defined as businesses which are not consistent with our strategy and risk appetite
- The non-core business is managed to maximise value, either by:
  - Implementing an exit strategy or
  - Actively driving the management of the portfolios to deliver financial performance whilst remaining within our prudential and conduct risk appetite
- The non-core business principally relates to the non-member business of Britannia:
  - Corporate non-core portfolio
    - Non-core CRE loans
    - RSL loans
  - Optimum portfolio
    - Prime residential, buy to let and non-conforming mortgages acquired by Britannia Treasury Services
    - Originated by Platform prior to 2009 comprising prime residential, buy to let and non-conforming residential mortgages
  - Illius residential property company

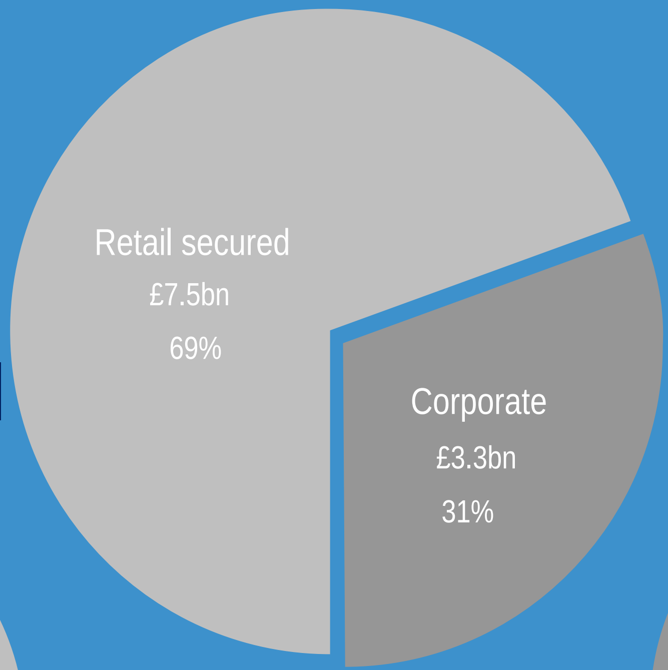
Non-core contains majority of impairment risk

Co-operative Bank – non-core financial performance

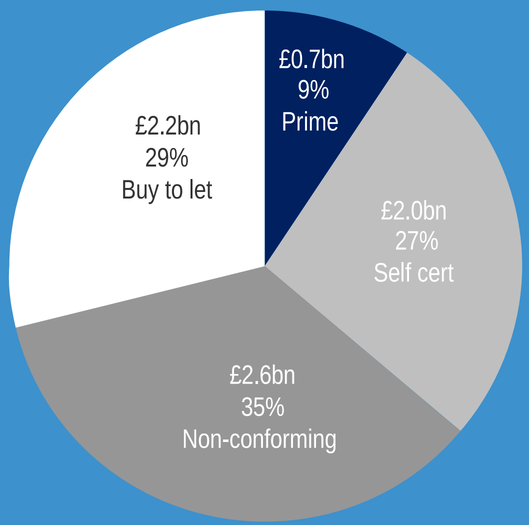
	2012 £m	2011 £m
Net interest income	(13)	46
Non-interest income	18	17
Income	5	63
Operating costs	(31)	(37)
Impairment losses	(351)	(23)
Operating result – non-core Bank	(377)	4

Managed for value, targeted for run-down or exit

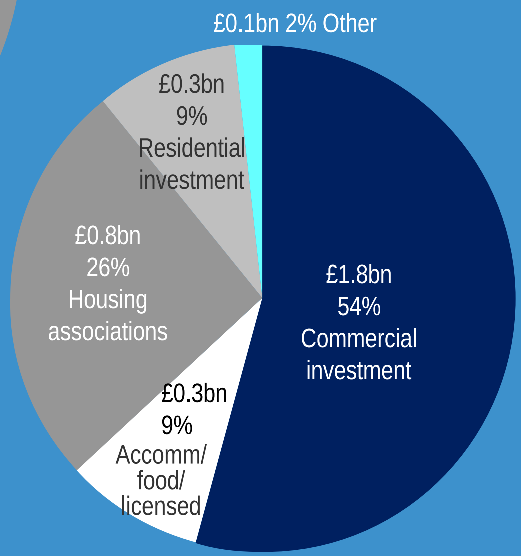
Non-core business, total £10.8bn



Retail secured £7.5bn



Corporate £3.3bn

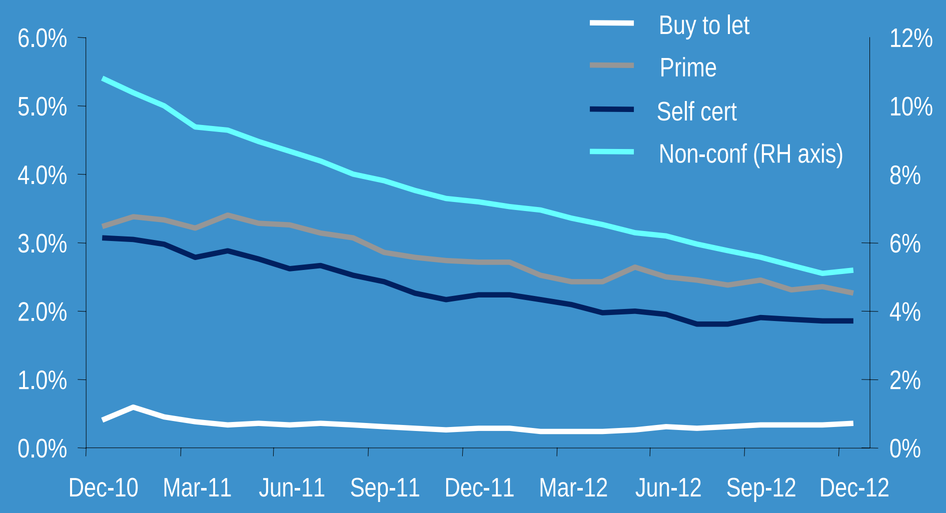


Non-core retail secured portfolio

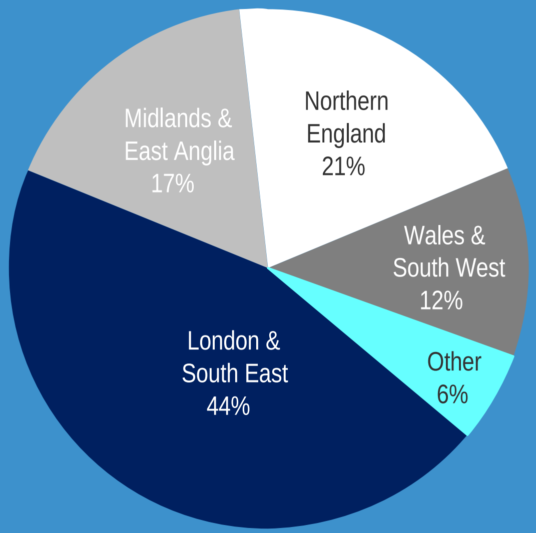
Banded LTV by product

	Non-core book						Total Bank	
	Prime	Buy to let	Self cert	Non-conf	Dec-12	Dec-11	Dec-12	Dec-11
Average LTVs	79%	80%	78%	82%	80%	79%	54%	53%
New business LTVs	n/a	n/a	n/a	n/a	n/a	n/a	61%	60%
Book by indexed LTV								
<=50%	7%	5%	7%	5%	6%	6%	25%	26%
<=75%	10%	26%	21%	15%	20%	19%	34%	32%
<=100%	46%	51%	50%	43%	48%	49%	31%	32%
>100%	36%	17%	21%	36%	27%	26%	10%	10%
Gross customer balances (£bn)	0.7	2.2	2.0	2.6	7.5	7.9	23.4	23.7
% accounts with >2.5% arrears	2.26%	0.36%	1.86%	5.21%	2.72%	3.59%	0.93%	1.18%

Arrears trends

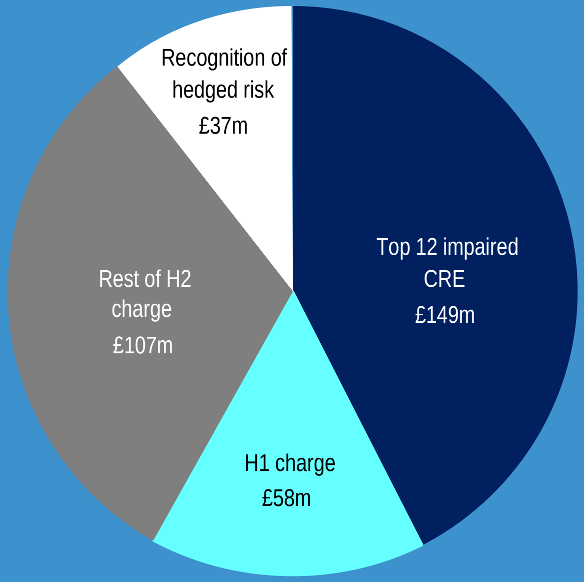


Regional analysis

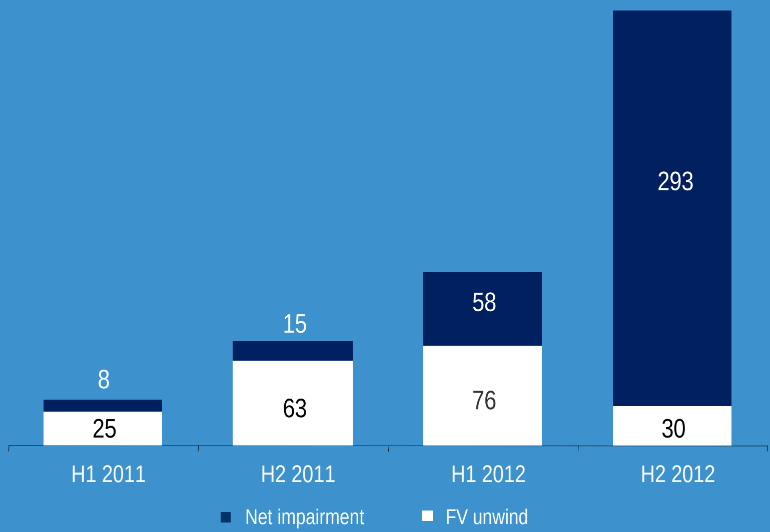


Non-core impairment

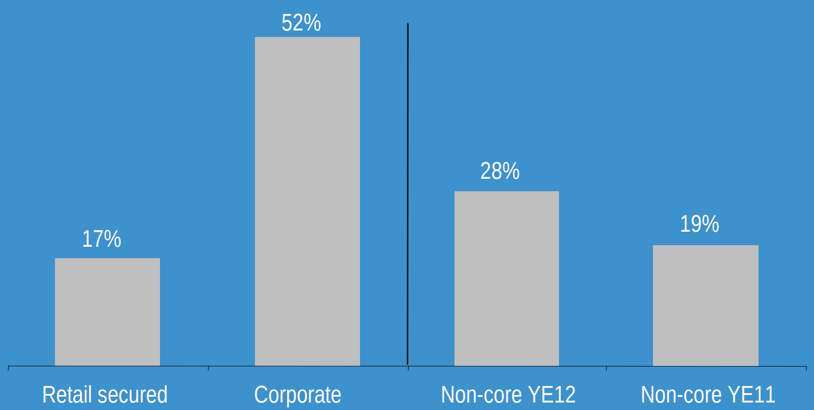
Non-core net impairment charge for 2012 (£351m)



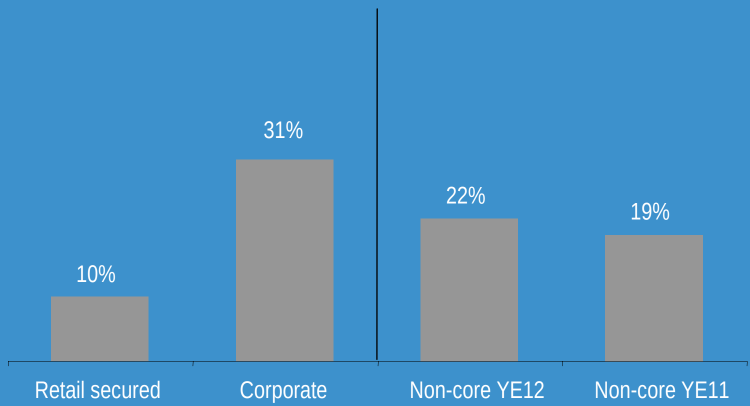
Gross & net impairment charge (£m)



Non-core impaired loans ratio



Non-core coverage ratio



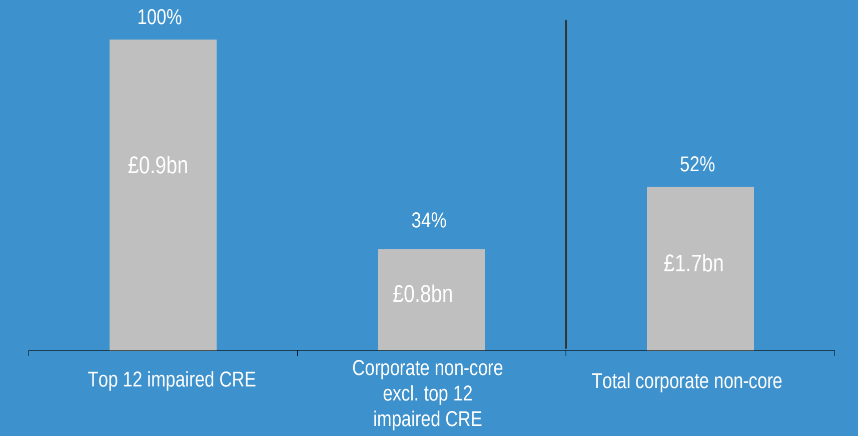
Non-core corporate – coverage & collateral

	Drawn bal £'m	Provision £'m	Provision coverage	Collateral £'m	FY12 Coverage incl. collateral	Expected performance	FY11 Coverage incl. collateral
Top 12 impaired CRE loans	936	193	21%	696	95%	47	
Rest of non-core corporate impaired loans	803	341	43%	305	80%	157	
Non-core corporate - total impaired loans	1,739	535	31%	1,001	88%	203	83%

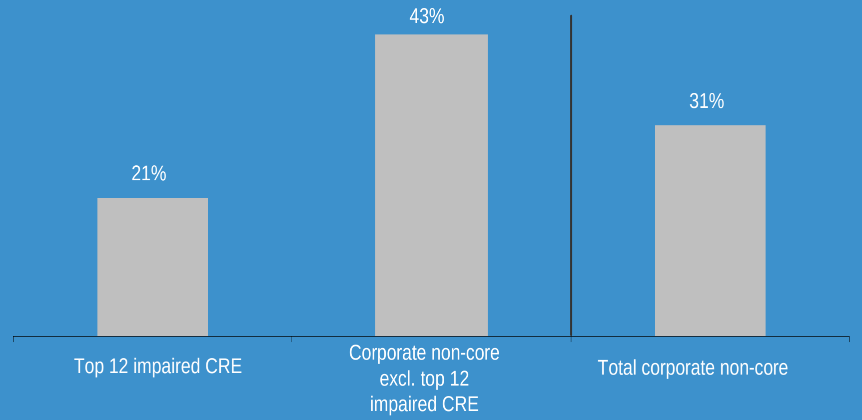
31% coverage ratio on the corporate non-core portfolio. Of this:

- Top 12 impaired CRE loans require coverage of 21%, based on careful individual assessments. Including collateral held against these loans, total coverage increases to 95%, with 5% of expected performance
- The rest of the non-core corporate portfolio had an average coverage ratio of 43%. This is in line with expectations and market peers

Non-core impaired loans ratio



Non-core coverage ratio



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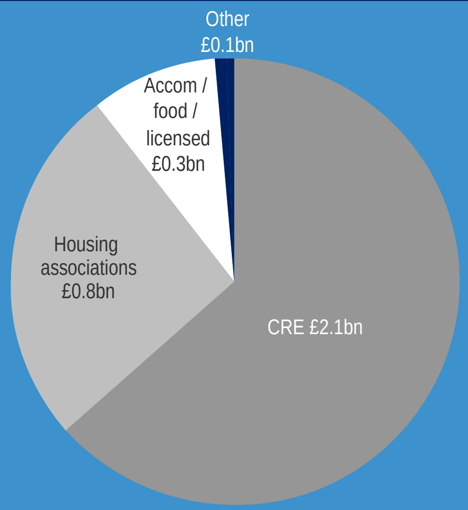
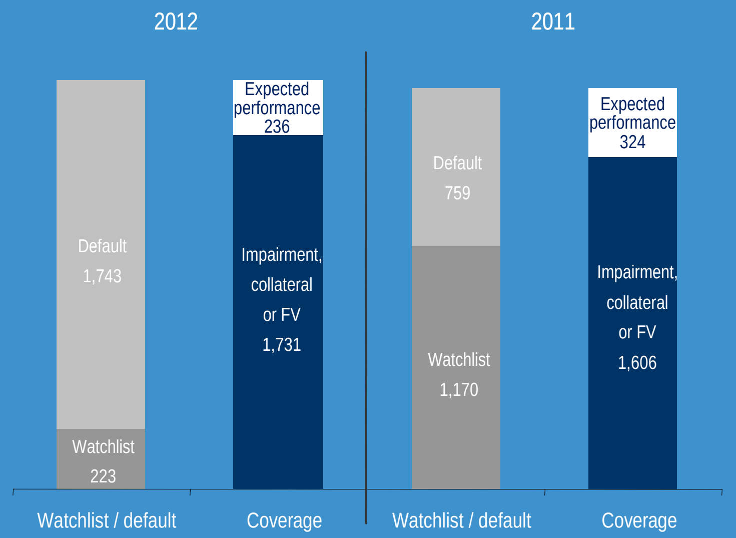
Non-core corporate coverage

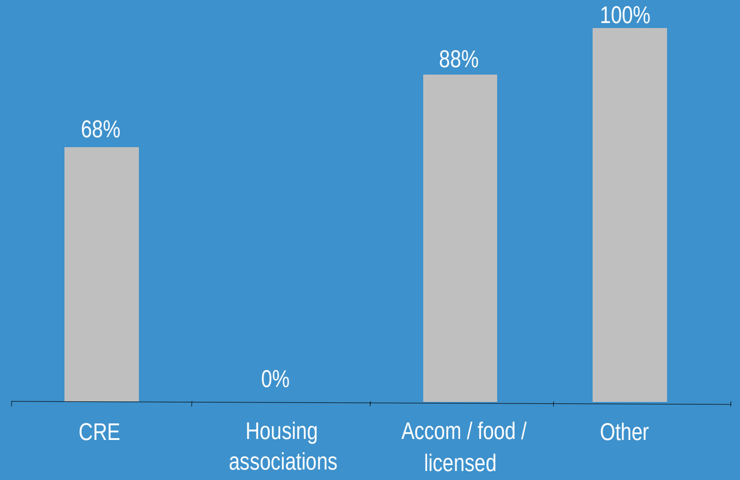
Non-core corporate book gross balance £3.3bn



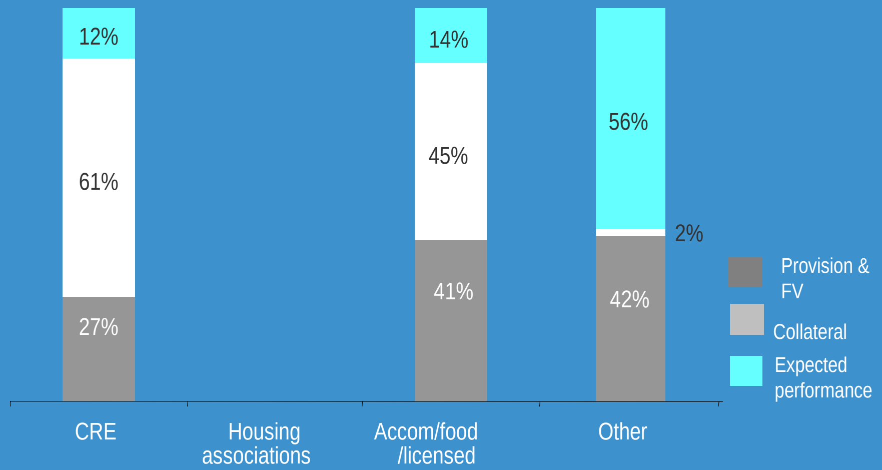
Watchlist and default exposure (£m)



Non-core corporate - impaired loan ratio



Non-core corporate - total coverage ratio



De-risking the non-core corporate portfolio

De-risking the portfolio:

We are developing a strategy to optimise capital consumption and profitability through a variety of deleverage, risk transfer and asset sale options.

- Identified portfolios for sale in 2013 to further reduce RWAs, enhance liquidity and strengthen capital resources
- Targeted disposals continue to de-risk vulnerable sector concentrations and portfolios
- Investment bank carrying out a review of core and non-core asset portfolios as part of a larger strategic review to improve the profitability and capitalisation of the Bank
- Following significant levels of impairment charges in 2012 we expect the medium term impairment outlook to be more moderate.
- De-risking the balance sheet is likely to give rise to further adjustments to value which are expected to be capital neutral

Agenda

Context

Financial headlines

Core business

Non-core business

Action plan

Clear strategic direction - core

Core business

- Delivered solid result
- Industry leading levels of customer service
- Announced Sale & Purchase Agreement for the life insurance business
- Announced the intention to sell our general insurance business
- High degree of current account switching from other banks
- The Co-operative's unique customer-led ethical policy
- Selective, high quality new lending
- Low levels of impairment

Simplification agenda | **Long term growth strategy** | **Conservative credit risk appetite**

Compelling Co-operative Alternative

Non-core business

- Majority of impairment risk
- Non-core director to lead and intensify focus
- Range of balance sheet deleverage options
- Investment bank conducting review of non core asset portfolios

De-leveraging

Strengthen capital ratios

A solid platform for growth - Verde

- The Board remain committed to our strategic intent of signing a sale and purchase agreement by end Q2 and completion by end Q4 2013
- We remain in active discussions with Lloyds Banking Group
- The deal has strong backing from the Government and other stakeholders
- We are simplifying and restructuring our core business
- We are currently de-risking our integration and migration risks
- We have a solid platform to broaden our reach and appeal through Verde or organic growth

The go forward plan – core business

The Bank has a robust go forward plan which focuses on three key areas:

- Building a simpler, customer focussed bank - by focusing on core relationship banking, for example through the disposal of our life insurance and general insurance business
- Making the bank easier to do business with
- Establishing lower cost infrastructure e.g. by rationalising the 2,500 existing IT applications to provide a simpler, more customer-centric experience

- This plan is being driven forward by a strengthened management team

In summary

- We are simplifying the business
- We have a strong core franchise which remains profitable and we are well-positioned for growth
- We remain committed to the Verde deal
- Continued focus on core business
- We have clear plans for continued de-risking our non-core assets
- We have strengthened the management team
- Our strategy is designed to build on the strength of the Bank's core relationship banking business

Appendices

Banking Group financial performance

Co-operative Banking Group – financial performance

	2012 £m	2011
Income	1,426	1,499
Operating costs	(713)	(689)
Claims	(502)	(494)
Impairment losses	(469)	(115)
Operating result	(257)	201
- Core	120	197
- Non-core	(377)	4
Transformation & integration costs	(57)	(90)
IT asset write down	(150)	-
Project Verde costs	(38)	-
PPI provision	(150)	(90)
Other	(25)	(16)
Fair value amortisation	15	86
Membership dividend	-	(18)
Discontinued operations	14	15
(Loss)/profit before taxation	(647)	88

Bank financial performance

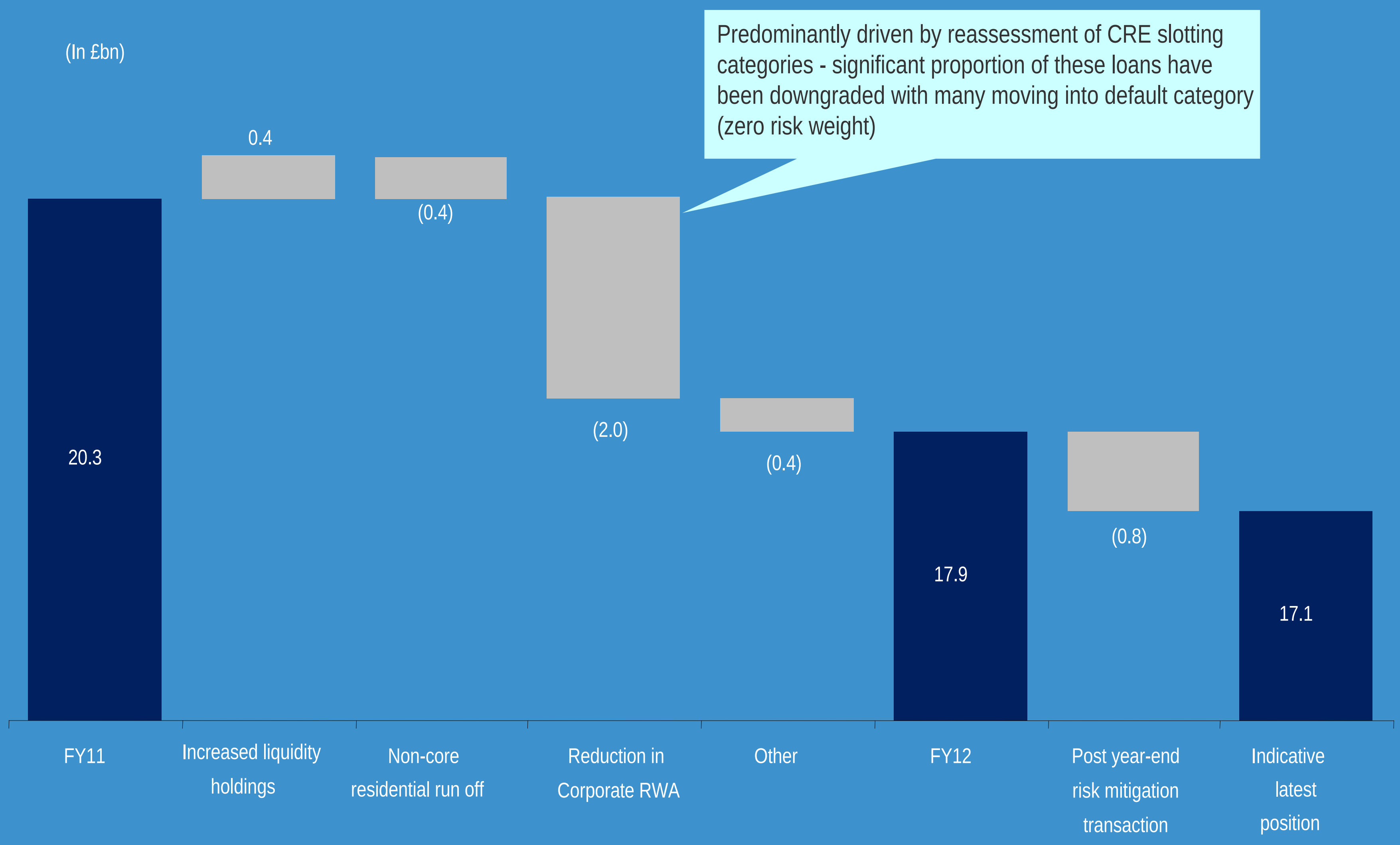
Co-operative Bank – financial performance

	2012 £m	2011
Income	771	818
Operating costs	(583)	(562)
Impairment losses	(469)	(115)
Operating result	(281)	141
- Core	97	137
- Non-core	(377)	4
Transformation & integration costs	(47)	(53)
Project Verde costs	(38)	-
IT asset write down	(150)	-
PPI provision	(150)	(90)
Other	(24)	(14)
Fair value amortisation	15	86
Membership dividend	-	(16)
(Loss)/profit before taxation	(674)	54

Robust balance sheet

Bank balance sheet	FY 2012 £bn	FY 2011 £bn
Loans and advances to customers	34.0	34.3
Cash and balances at central banks	5.4	6.7
Loans and advances to banks	1.9	2.0
Investment securities	6.9	4.6
Other assets	1.4	1.4
Total assets	49.6	49.0
Amounts owed to customers	36.9	36.6
Wholesale liabilities	3.6	3.3
Debt securities in issue	4.7	4.2
Other liabilities	1.3	1.4
Other borrowed funds	1.3	1.3
Equity	1.8	2.2
Total liabilities & equity	49.6	49.0
Loan to deposit ratio	92%	94%

Continued reduction in RWA through de-risking



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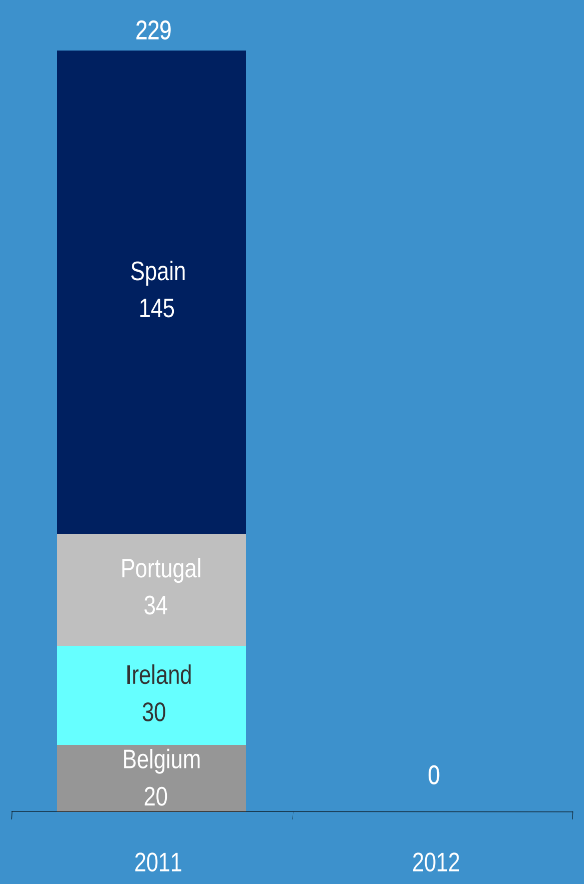
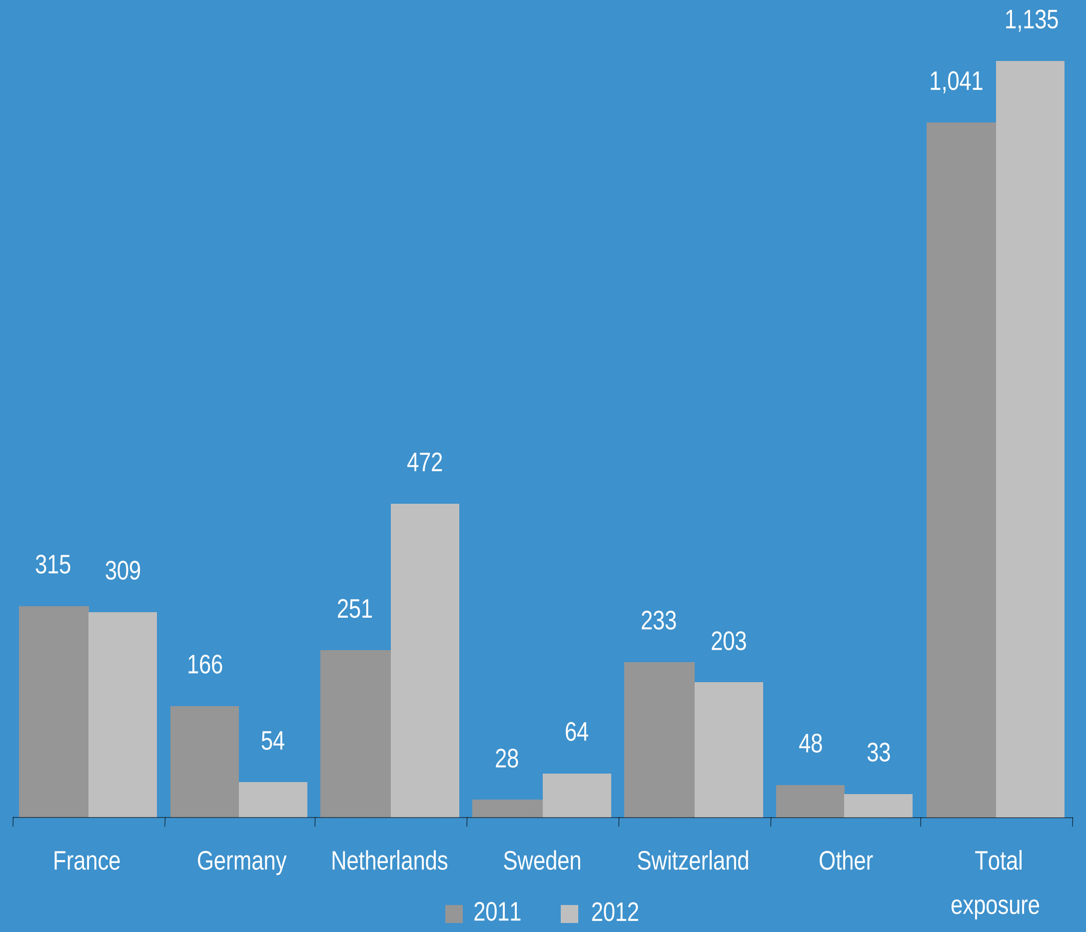
European exposure – financial institutions

Peripheral European exposure (£m)



Other European exposure (£m)



*all figures net of credit risk mitigation

Gross customer balance and credit protection

		Gross balance	Impaired balance	Impaired loan ratio	Credit FV protection	Impairment provision	Total credit protection	Coverage
Core	Retail secured	15,931	156	1.0%	5	3	8	5%
	Unsecured*	1,489	301	20.2%	-	260	260	86%
	Corporate	6,130	243	4.0%	-	137	137	56%
	Core YE12	23,550	700	3.0%	5	400	405	58%
Non Core	Optimum	7,492	1,289	17%	116	11	127	10%
	Corporate	3,318	1,739	52%	216	319	535	31%
	Non-core YE12	10,810	3,028	28%	332	330	662	22%
	Total YE 2012	34,360	3,728	11%	337	730	1,067	29%

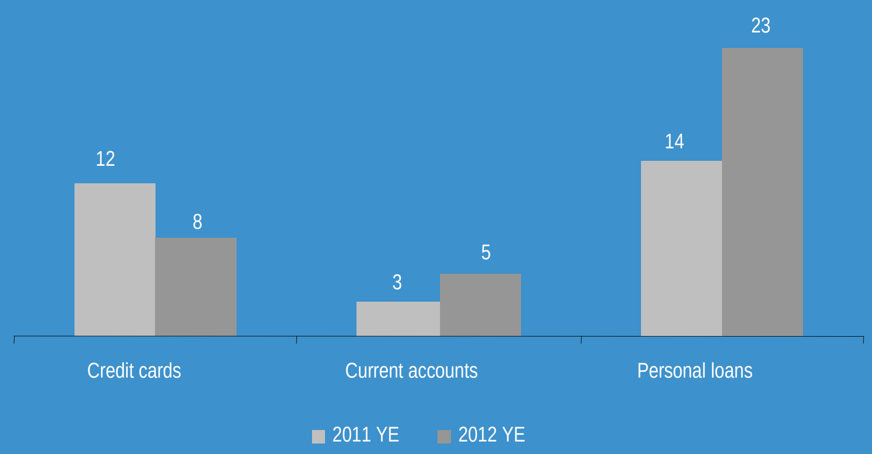
	Core YE11	22,833	639	2.8%	7	339	346	54%
	Non-core YE11	11,574	2,235	19%	390	42	432	19%
	YE 2011	34,406	2,874	8.4%	396	382	778	27%

*includes debt collection agency balances

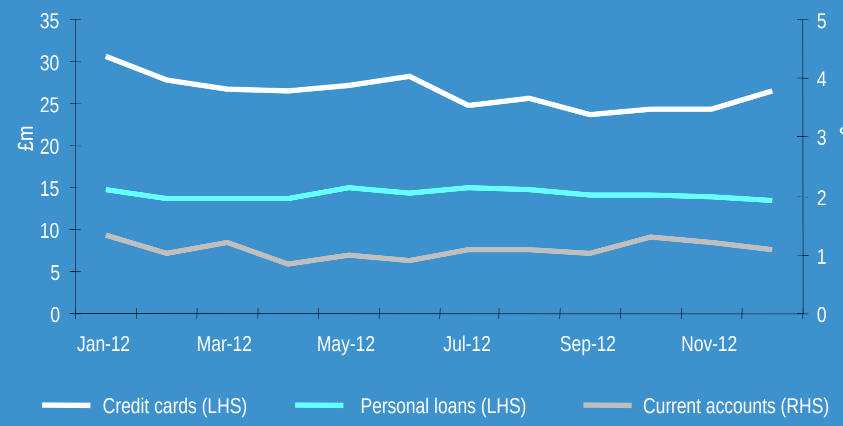
The co-operative bank

Unsecured lending – risk profile (core)

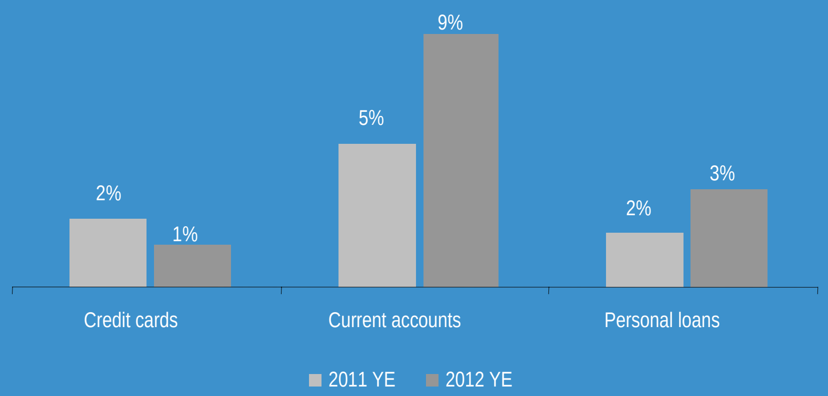
Impairment charge (£m)



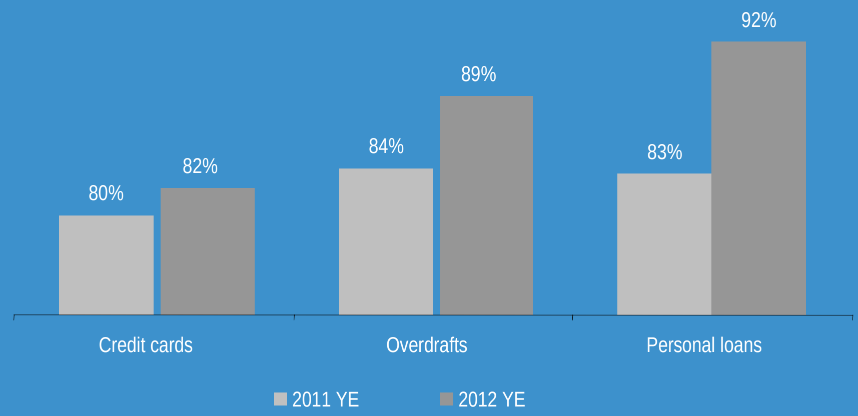
Balances entering arrears



Net charge ratio (NCR)

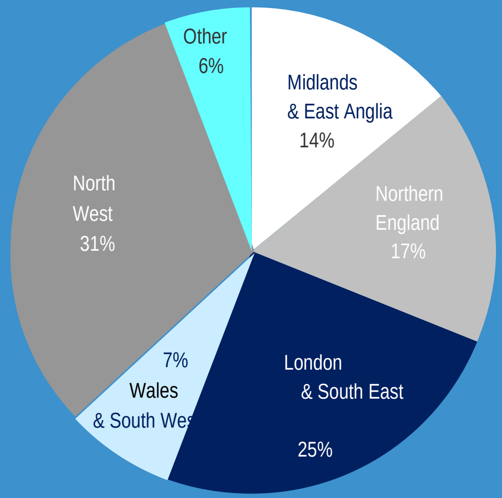


Credit protection as % of impaired balances

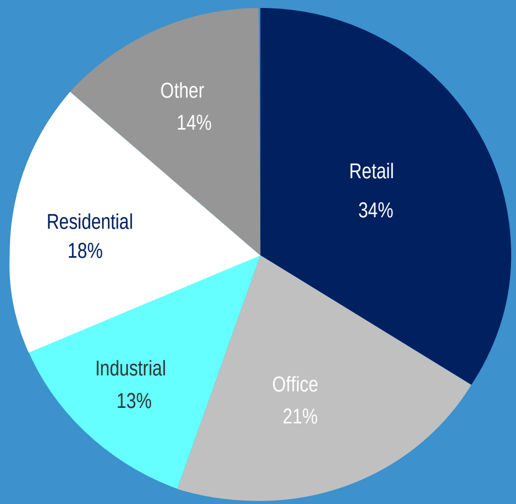


Core CRE lending

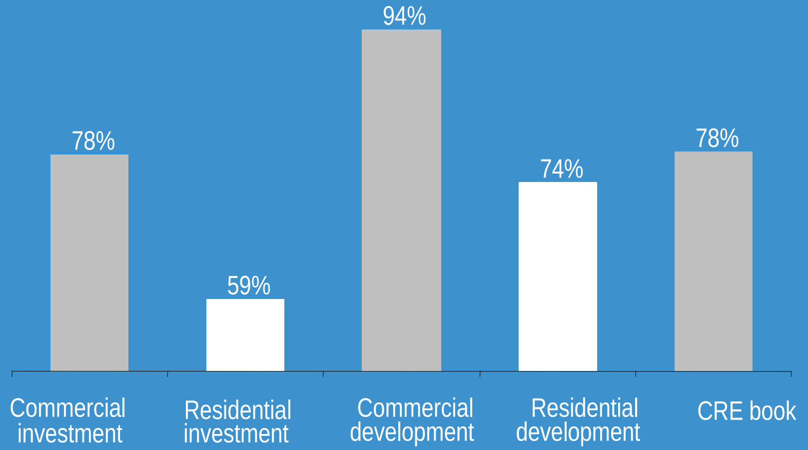
Geographic segments – total £1.9bn



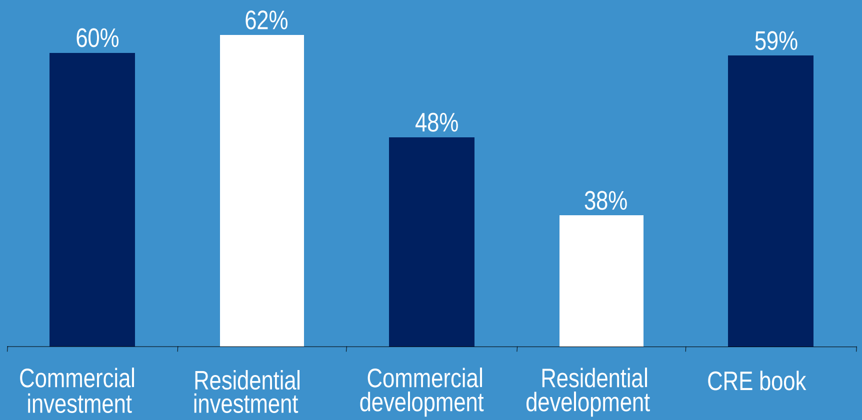
Industry segments – total £1.9bn



Core average LTV by type



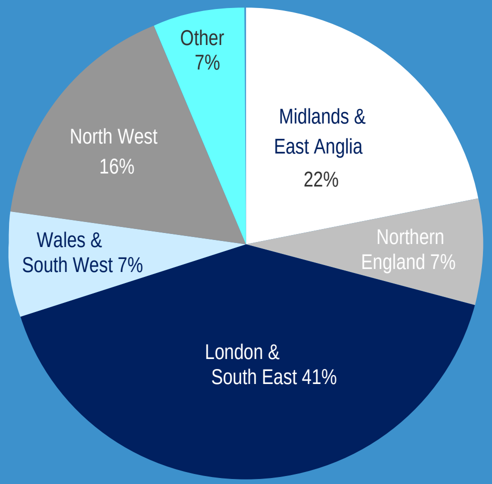
New business average by type



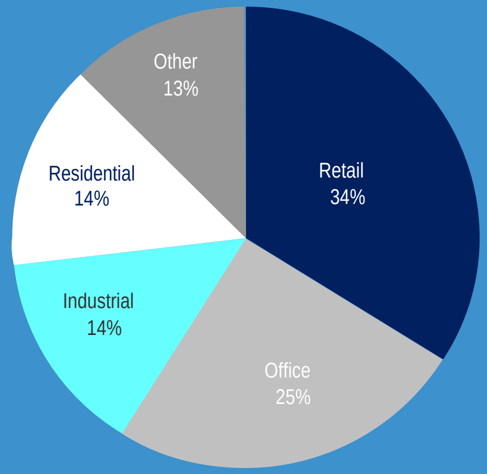
The co-operative bank

Non-core CRE lending

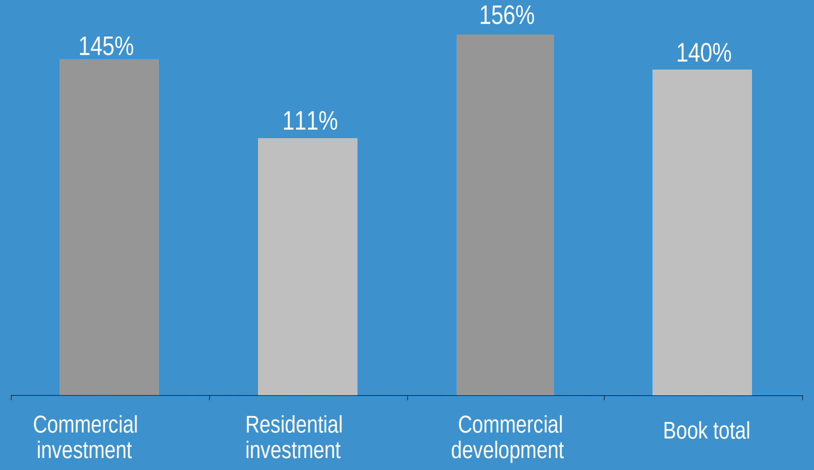
Geographic segments - £2.1bn



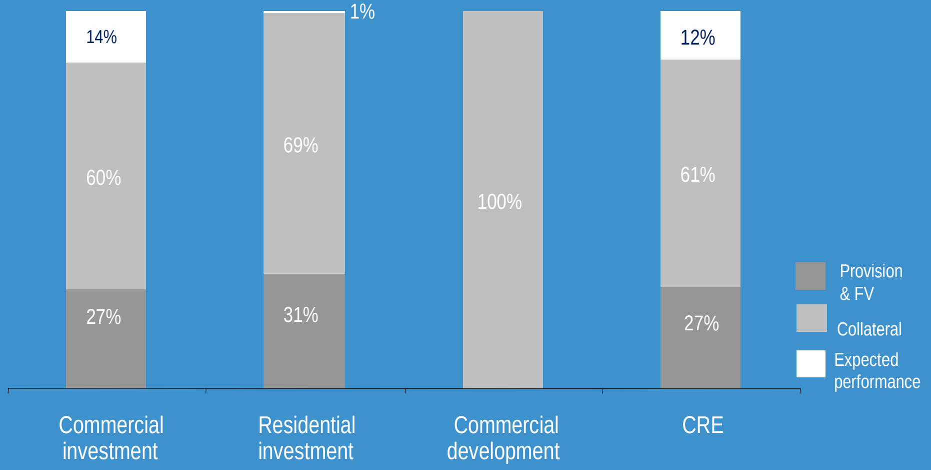
Industry segments - £2.1bn



Average LTV by type



Coverage



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