

# Co-operative Financial Services Interim Financial Report 2008



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# Highlights

- CFS profit before tax, significant items and investment fluctuations was £73.4m (2007: £38.0m).
- Profit before taxation was £38.0m (2007: loss £27.5m).
- Bank profits before investment write downs increased by £25.7m (56.5%).
- Bank results demonstrate low reliance on wholesale funding and strong ratio of customer deposits to loans at 105% (2007: 104%). Average deposits grew by 14% and average lending by 12%.
- General Insurance operating result improved by £31.8m.
- General Insurance combined ratio decreased by 17.7% to 109.6% (2007: 127.3%).
- CFS was awarded 'Company of the Year' by Business in the Community, one of the leading UK organisations connected with corporate social responsibility.
- Business in the Community awarded CFS 4 'Big Ticks' in recognition of the positive impact of corporate and social responsibility activities.
- CFS was 3rd, and the top financial services company, at the Sunday Times 'Best Green Companies Awards'.

# Vision and values

## Our business purpose

To be a growing, pioneering financial services business delivering benefits to customers, members and communities through commitment to value, fairness and social responsibility.

## Our CFS vision

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

## Our measures

- Profit generation to create a sustainable business
- Market leading colleague satisfaction
- Market leading customer satisfaction
- Market leading social responsibility approach
- Membership growth

## Our values

As a Co-operative business, we believe in:

### social responsibility

We are committed to leading the way on ethical, environmental and community issues.

### openness and honesty

We work hard to earn credibility and trust from our customers and each other.

### being successful

We work together to make sure that CFS is admired, profitable and sustainable.

### being customer focused

We always aim to satisfy our customers and exceed their expectations where we can.

### making work fun

We are proud of CFS and know we can contribute to making it a great place to work.

# Business and financial review

## Highlights

Total shareholder profit before tax, significant items and investment fluctuations was £73.4m compared to £38.0m in the previous year principally arising from improved results in the General Insurance business. In 2008, CFS has paid a 2007 final dividend of £25.9m to its parent, the Co-operative Group.

The first half of 2008 has seen further strong performance from our Corporate Banking sector and strong new business sales performance in the Retail Bank. Sales volumes have also increased for General Insurance, albeit at lower average premiums due to a strategic decision to reduce underwriting risk. Life and savings new business has continued to be impacted by reductions in the number of financial advisers. The Wholesale business has improved performance as continued strengthening of our balance sheet and liquidity and low reliance on wholesale funding has enabled us to generate higher interest in current markets from excess retail funding. CFS remains committed to significant future investment and the cost base has begun to benefit from initiatives to improve our operational performance and efficiency.

The banking business recorded an increased profit before tax and significant items of £46.2m compared to £45.5m in 2007 despite extremely difficult market conditions and £25m of structured investment write downs. Profit before investment write downs and significant items increased by £25.7m (56.5%) as strong balance sheet growth was achieved in both lending and deposit balances resulting in higher non and net interest income. Bad debt and operating costs have also improved on 2007.

Highlights	2008 £m	2007 £m	Change £m
Banking operating result	<b>46.2</b>	45.5	0.7
General Insurance operating result	<b>(1.5)</b>	(33.3)	31.8
Other shareholders activities (excluding STIF)	<b>28.7</b>	25.8	2.9
<b>Result before investment fluctuations</b>	<b>73.4</b>	38.0	35.4
STIF*	<b>7.8</b>	(15.3)	23.1
<b>Profit before significant items</b>	<b>81.2</b>	22.7	58.5
Shareholder significant items	<b>(43.2)</b>	(50.2)	7.0
<b>Profit before taxation</b>	<b>38.0</b>	<b>(27.5)</b>	<b>65.5</b>

\*STIF – Short-term Investment Fluctuations.

The General Insurance result has improved by £31.8m from the 2007 result, which was affected by exceptional weather related claims of around £55m. The 2008 result has been impacted by investment losses arising from turbulent market conditions and lower average premiums.

The long-term business, run in the interests of policyholders, has seen further savings in operating expenses. Sales of new policies have declined as a result of a reduction in the number of financial advisers, although numbers have now stabilised. The Field Sales Transformation Programme has been launched to transform how our Field Sales team operates. It includes addressing barriers to growth as well as supporting and enabling improved performance.

## Investment in the future

CFS started the journey to better serve its 6 million customers through transforming its business and technology capabilities just over two years ago.

CFS has commenced a substantial investment in new technology, via an Enterprise Platform Programme, to replace our retail and corporate banking IT infrastructure. This investment will allow CFS to re-engineer its customer facing and internal processes and further integration will join the Banking IT infrastructure with that of the Insurance businesses so that we can be truly customer centric in the way we sell to and serve our retail customer base. This investment will support our retail customer relationship strategy across Banking, Insurance and Investments to deliver attractive, fair, accessible products on a scaleable multi-channel basis.

### Challenging the cost base

The investments so far have delivered a number of notable successes. We are on target for a projected annualised underlying cost reduction of over £100m by the end of 2008. This has been realised through a range of activities including headcount reduction, improved procurement contracts, simplified business processes, enhanced capabilities, and an element of premises rationalisation.

People in our customer-facing roles, specifically those who deal with our customers by telephone, financial advisers and customer-facing advisers within bank branches, were unaffected by these headcount reductions and CFS has continued to re-affirm its commitment not to off-shore any of its customer-facing sales and service operations.

### Customer and membership focus

We have made a considerable investment and progress in developing our capability for managing customer information and relationships. This has allowed us to make significant improvements in our ability to offer customers products that we predict are most likely to meet their current and future financial requirements.

As part of a wider Co-operative programme, 2008 has also marked the launch of a new brand for our bank, insurance and investments brands which is an exciting step that brings our different businesses closer together, making it easier for our customers to recognise the comprehensive range of benefits and services available to them and strengthening our approach to being good with money.

The importance of growing a strong and committed membership base is an integral part of our brand. The Brand programme has delivered a number of successes including the launch of a new TV advert, attendance of 4000 colleagues at Good With Money Events, which reinforces our Brand values, and the launch of a single website for Bank, Life & Savings and Insurance offerings. The majority of branches have been re-branded, whilst ATM re-branding is in progress. Additionally, aggregator web sites, brokers and General Insurance Claims are fully re-branded.

The most significant change is to our insurance business, CIS, which is now known as The Co-operative Insurance and The Co-operative Asset Management.

Market leading customer satisfaction is one of our key business measures. As at July 2008, 64.5% of our customers claimed to be either 'Extremely' or 'Very Satisfied' with the products and service that we provide, compared to 62.5% as at December 2007. The Bank and **smile** received further recognition from the Watchdog customer survey and the Which? Survey. Watchdog awarded **smile** 2nd and Co-operative Bank 3rd for customer satisfaction ahead of all other high street banks, whilst **smile** was awarded 'Best Buy Current Account Provider' by Which?. Our service was also recognised at the 'Your Money' awards where Co-operative Insurance was awarded 'Best Online Motor Insurance' provider.

### Good with people

Investment in management training has been a major focus area with all senior managers attending a 'Leadership Challenge' event aimed at developing their understanding of their personal contribution to CFS. The Managers Toolkit has also been launched and used to increase awareness of what is meant by and expected of leadership at all levels in CFS.

CFS and the joint trades unions have also signed three new agreements to support change across CFS. These new agreements are a step forward in how we manage change affecting colleagues.

### Cost of investment

Significant items	2008 Non-recurring restructuring cost £m	2007 Non-recurring restructuring cost £m	Change £m
General Insurance	16.8	19.7	2.9
Banking	26.4	30.1	3.7
Other shareholder	—	0.4	0.4
<b>Total shareholder</b>	<b>43.2</b>	<b>50.2</b>	<b>7.0</b>
Long-term business	28.2	22.0	(6.2)
<b>Total</b>	<b>71.4</b>	<b>72.2</b>	<b>0.8</b>

### Cost of investment

As explained on pages 4 and 5, the extensive restructuring and modernisation of the business has continued to necessitate substantial investment resulting in total significant items of £71.4m in 2008 following the £72.2m charged in 2007. The 2007 costs include £35.7m in relation to future costs for job losses.

## Banking

	2008 £m	2007 £m	Change £m	Change %
Net interest income	190.9	177.6	13.3	7.5
Non-interest income	101.0	98.6	2.4	2.4
Operating costs	(175.4)	(177.5)	2.1	(1.2)
Impairment losses	(45.3)	(53.2)	7.9	(14.8)
<b>Operating profit before tax, significant items and investment write downs</b>	<b>71.2</b>	<b>45.5</b>	<b>25.7</b>	<b>56.5</b>
Structured investment write downs	(25.0)	–	(25.0)	
<b>Operating profit before tax and significant items</b>	<b>46.2</b>	<b>45.5</b>	<b>0.7</b>	<b>1.5</b>
Significant items	(26.4)	(30.1)	3.7	(12.3)
<b>Profit before tax</b>	<b>19.8</b>	<b>15.4</b>	<b>4.4</b>	<b>28.6</b>
<i>Operating profit before tax and significant items analysed by segment*</i>				
Retail	21.2	11.4	9.8	86.0
Corporate	44.1	31.9	12.2	38.2
Wholesale	5.9	2.2	3.7	168.2
<b>Total</b>	<b>71.2</b>	<b>45.5</b>	<b>25.7</b>	<b>56.5</b>
<b>Cost/Income ratio before significant items</b>	<b>60.1%</b>	<b>64.3%</b>		<b>(4.2)</b>

\*2007 Segmental analysis has been restated to ensure consistency with 2008 classification

Profit before investment write downs and significant items increased by £25.7m (56.5%) as strong balance sheet growth was achieved in both lending and deposit balances resulting in higher non and net interest income. Bad debt and operating costs have also improved on 2007. These results reflect the Bank's reduced exposure to higher wholesale funding costs and credit losses as the Bank's cautious approach to lending is primarily funded by retail deposits.

The banking business recorded an increased profit before tax and significant items of £46.2m compared to £45.5m in 2007 despite the impact of the 'credit crunch', including £25m of structured investment write downs.

### Retail Banking

Retail operating contribution reflects higher non interest income, reduced bad debts and lower costs, offset by lower net interest income. Growth in attractively priced savings and deposit products and continued progress in increasing secured lending balances has maintained our strong balance sheet and liquidity positions with a consequential reduction in margins.

### Corporate Banking

Increased corporate sector operating contribution reflects strong growth in operating income driven by higher lending and deposit balances and lower costs.

### Wholesale Banking

Improved wholesale sector performance reflects the Bank's balance sheet strength and improved wholesale margins arising from investment of the Bank's deposit base.

Additionally, £25m investment write downs reflect further deterioration in a small portfolio of structured investments arising from volatility in the credit markets. The Bank's remaining exposure to this type of higher risk investments has now been reduced to only £6.4m. The Bank also has £35m of Credit Trading Fund investments. These represent a small part of the Bank's wholesale portfolio, the rest of which is prime quality.

Net revenue increased by £15.7m (6%) reflecting a £13.3m increase in net interest income and an increase of £2.4m in non-interest income.

Higher interest income from balance sheet growth across product and business segments and improved wholesale margins arising from investment of the Bank's deposit base has been offset by lower retail margins as the Bank reduced its exposure to unsecured lending and offered market leading deposit and term products to maintain balance sheet strength. This was alongside strong growth achieved in secured mortgage and corporate lending. Mortgages and Corporate syndicated and property lending

represents a lower credit risk compared to unsecured retail lending and so attracts a lower margin. Reduced Mortgage margins also reflect highly competitive products to generate balance growth on a key relationship product. This reflects our continuing marketing strategy which is now focused towards customers who share the Co-operative values, seeking to build profitable relationships across the CFS banking and insurance products.

Growth in mortgages, which are integral to the Bank's relationship strategy, has been delivered through award-winning and market leading products, which have resulted in consistent presence in best buy tables with mortgage applications at record levels. The Bank was the winner of 'Best Remortgage' and 'Best First-Time Buyer' by Moneywise at the 2008 mortgage awards. It was also highly commended for 'Best Flexible Mortgage'. This growth has been achieved without compromising the quality of the portfolio as average loan-to-value over the last 12 months has remained constant at 52%. Additionally, in light of increased uncertainty in the property market, the maximum loan-to-value for new business was reduced from 95% to 90% in March 2008 and we substantially withdrew from new Buy-to-Let mortgages in early 2006, with complete withdrawal from early 2008. Our remaining exposure to Buy-to-Let mortgages is only around 1.1% of our customer loans.

The promising growth in corporate lending balances includes selected involvement in the syndicated lending sector and participation in PFI transactions. The Renewable Energy and Asset Finance team have been involved in funding a variety of renewable energy investments from hydro schemes, to wind farms and combined heat and power plants. These schemes help establish the Bank as a serious player within this market and demonstrate our commitment to the environment, generating significant carbon savings as well as income.

Deposit growth has been achieved through the attractiveness of the smartsaver and term deposit products, introduced to maintain the Bank's strong balance sheet position. The Bank has also delivered a new customer proposition with the new Current Account Plus, combining a current account with a linked savings product. The product provides customers with a fee-free overdraft and a savings account paying a competitive rate of interest that tracks 0.5% below the Bank of England Base Rate. It is a multi-channel product being available across the Branch network, Telephone and Internet services.

We have opened 2 new Corporate Banking Centres (South Manchester and Southampton). We now operate out of 16 Corporate Banking Centres, compared to 10 at the end of 2006.

Non-interest income increases were largely driven by growth in LINK transaction fees from the Bank's ATM network and growth in corporate commission offset by lower insurance commission from Payment Protection Insurance.

The Bank has maintained tight cost control in the period which has resulted in business-as-usual operating costs reducing by £2.1m (1.2%). This has been achieved through the cost reduction programme referred to on page 5.

Reductions in retail bad debt charges have been achieved in the first half of 2008, particularly in the unsecured retail portfolio, in spite of a weaker economic environment. The secured mortgage book continues to incur extremely low levels of default and subsequent impairment which reflects the relatively low average loan-to-value ratio.

A number of new partnerships have been launched. These include a referral service to Freedom Finance for loan requests that are borderline against our internal lending criteria.

The Bank launched an Ownhome shared equity scheme in collaboration with Places for People to allow a widening of home ownership and increase housing affordability for eligible key workers, first-time buyers and social housing tenants.

The Bank has launched four new banking outlets in the convenience stores of its sister Food business. These new concepts offer automated self-service banking for customers, such as cash withdrawals and cash and cheque deposits. In addition, there are touch screen kiosks providing product information and capturing customer details for subsequent sales and service discussions, with sales assistants in the larger stores to offer more information and support. This concept, launched in Nottingham and Sussex, moves away from the traditional high street branch to a lower cost current account banking model, with more convenience for the customer in location and hours. We will be reviewing the performance of these outlets and enhancing the offer over the coming months, with a view to a national rollout in due course.

The Bank has maintained a strong balance sheet with consistent robust liquidity and capital ratios. The capital ratio on a Basel II basis after regulatory deductions was 11.5% with a tier 1 ratio of 8.5% reflecting the quality of our capital resources.

The first half of 2008 has seen the dislocation in financial markets evolve into a wider economic slowdown. Funding markets remain volatile, with securitisation and covered bond markets effectively closed, and increased competition for customer deposits. The Bank has continued to take a prudent and disciplined approach to liquidity and funding and has maintained its detailed management of its liquidity position. The Bank has a very strong retail deposit base with customers deposits higher than customer lending such that its reliance on wholesale funding is lower than many other banks. Funding of lending by retail deposits has been maintained at a minimum of 100% through selective asset growth and development of retail deposit balances. As a result of this strength, the Bank has not been required to enter the markets at disadvantageous terms in the half year.

In addition, the Bank of England launched its Special Liquidity Scheme (SLS) which allows banks to swap their high quality mortgage-backed and other securities for UK Treasury Bills for a defined period. The Bank is developing a Covered Bond programme to enable its access to this source of high quality liquid assets.

The Bank intends to use this facility in the future to support liquidity stress tests by way of an agreed management action.

As at July 2008, 77.7% of our customers claimed to be either 'Extremely' or 'Very Satisfied' with the products and service that we provide, compared to 62.5% as at December 2007.

## General Insurance

	2008 £m	2007 £m	Change £m
Technical profit before weather events	(1.5)	21.6	(23.1)
Exceptional weather events	–	(54.9)	54.9
<b>Operating result</b>	<b>(1.5)</b>	<b>(33.3)</b>	<b>31.8</b>

	2008 £m	2007 £m	Change £m
Gross written premiums	220.9	226.8	(5.9)
Earned premiums	206.3	227.8	(21.5)
Claims ratio	74.0%	93.5%	(19.5%)
Expense ratio (excluding non-recurring expenses)	35.6%	33.8%	1.8%
Combined ratio	109.6%	127.3%	(17.7%)

### General insurance

The performance of the General Insurance business in 2008 was affected by £9.1m of investment losses arising from turbulent market conditions and lower average premiums, whilst the 2007 result was affected by exceptional weather related claims of around £55m.

This year has seen further expansion into the direct market through the launch of our motor product onto two further aggregator sites 'Go Compare' and 'Compare The Market', in addition to the two launches at the end of 2007. Both of these additional sites have shown a good sales performance in the first half of 2008. February 2008 saw the launch of the new modular motor insurance product in the Customer Contact Centre and on the Co-operative Insurance website. The new product allows General Insurance customers to tailor their insurance to their individual needs, by offering basic cover at a low price. It also offers flexibility by allowing them to choose between a range of optional extras, such as legal expenses cover.

Gross Written Premium has decreased by £5.9m to £220.9m. This is predominantly driven by increasing sales volumes and improving retention rates being more than offset by lower average premiums, as a result of changes to our underwriting footprint. Sales volumes have increased sharply in 2008 for both Motor and Home, continuing the upwards trend seen in 2007. At the same time General Insurance has continued to move to becoming a direct writer of business, with the increase in sales mainly attributable to the direct channels, where growth has out-stripped the decline in Financial Advisor sales. Combined with the change in distribution mix, 2008 new business has also seen a change in the customer profile leading to a lower risk profile.

The General Insurance claims ratio was 74.0%, lower than 93.5% in 2007, which was impacted by exceptional weather events. In the claims area, the impact of the 2007 summer flooding, plus some localised flooding in 2008 and a higher level of attritional weather claims continues to be seen. We have proactively managed this portfolio of claims to ensure that our customers move back into their property as quickly as possible. A number of initiatives have been implemented to optimise our financial performance. These include a review of best practice in terms of case estimating, improvements to the flow of data between systems, and an on-going challenge to improve our speed of settlement.

We operate a rigorous fraud management process to ensure our performance is not jeopardised by false or exaggerated claims, and this is continuously reviewed and improved. The latest published results of the ABI fraud management comparison of the industry show that for the second year running, we have achieved some significant successes. Overall, the value of fraudulent claims we rejected, which is the best in the industry.

Further modernisation initiatives have targeted savings in operating costs, including commission charges. Although these initiatives have reduced the level of operating costs, the expense ratio of 35.6% has increased compared with 33.8% in 2007, reflecting the decline in earned premiums.

We have delivered the first stage of our journey to improve the way we manage customer correspondence. The majority of our General Insurance letters sent to customers have now been migrated to our new print platform. We are working with Xerox to establish a core image handling capability which has initially been

deployed to handle claims correspondence as images rather than paper files. This capability will be expanded and deployed across other business areas and start to include outbound correspondence over the next 12 - 18 months.

General Insurance customer satisfaction for July 2008 stands at 77.6%, an increase of 2.2% compared to December 2007 (75.4%), which remains well above the market average. Reports also demonstrate a steady improvement in the Customer Contact Centre as regards sales technique, rapport and overall call quality. These factors have then contributed to the size of the motor book increasing through the first half of 2008.

### Long-term business

The first half of 2008 has seen difficult economic conditions with the impacts of the 'Credit Crunch' reverberating around equity markets worldwide. Food and energy prices have risen sharply reflecting supply shortages, and most countries, including the UK, are experiencing significant inflationary pressures.

Sales figures remain solid for the year to date, with profitability of new business remaining on track to meet budgeted levels. Present value of New Business Premium for the first half of 2008 has fallen 4% from 2007 levels to £253.2m.

We have seen many customers taking a more cautious attitude to risk during the first half of the year and this has led to higher sales of our single premium With-Profits Bond and Investment Bond (provided by Norwich Union) and lower sales of our equity-based Unit Trusts. Across our range of products we are seeing the effects of rising inflation and tax increases, squeezing disposable income for customers who typically have lower amounts to invest than we saw last year.

We are continuing our initiative to expand the distribution of our Unit Trusts to IFA's and other intermediaries in the wider investment market, and believe this represents an exciting opportunity for The Co-operative Asset Management over the medium to long term.

Gross earned insurance premiums for life and pensions business in the first half of 2008 was £274.4m compared to £290.8m for the corresponding period last year. The fall in gross premium income is due to a reduction in regular premium from in-force with-profits business as policies reach maturity or retirement, partly offset by new business.

The first half of 2008 has seen negative returns on all major asset classes. The FTSE All-share return produced a return of minus 10.9%, whilst the FTSE World index produced minus 9.4%. Property returns were poor with the IPD Property index yielding minus 6.9% over the period. Fixed interest assets also performed poorly, and the widening of spreads on corporate bonds saw these stocks also yield negative returns.

Co-operative Insurance has nearly 3 million with-profits policies in force. Co-operative Insurance continues to add value for its with-profits policyholders and to ensure that a competitive return is achieved on their savings. In determining bonuses that are payable on with-profits policies, directors follow the Principles and Practices of Financial Management (PPFM). The latest version of the PPFM can be found on our website. Returns for with-profits policyholders were minus 7.1% for the first half of the year, reflecting the difficult economic conditions. However, traditional with-profits policyholders continue to benefit from the smoothing of investment returns as well as in some cases having guaranteed benefits or cost-effective life cover. In the first half of 2008, the smoothed investment return credited to policyholder asset shares, on which payouts are based, was 3.0%.

The amount of money managed on behalf of long-term business customers fell from around £19 billion to around £17.7 billion, as a result of the negative returns in the period and the run-off of the with-profits portfolio.

Despite tough economic conditions, the performance of the UK Growth and UK Income with Growth trusts has remained strong with both funds being first quartile over a rolling one year period.

The CIS Sustainable Leaders Trust, Co-operative Insurance's flagship Socially Responsible Investment (SRI) fund, recorded second quartile performance for the last 12 months and continues to be in the first quartile for the 3 years ending 30 June 2008, despite the absence of exposure, for environmental reasons, to the strongly performing mining and oil sectors.

All surpluses arising on the business are applied for the sole benefit of policyholders by transfer from the income statement to the unallocated divisible surplus (UDS). During the period, the amount of free surplus represented by the UDS remained relatively robust to the downturn in

markets, and the UDS fell by £48m. Swaption asset values held to back guaranteed annuity options on with-profits personal pension policies have increased relative to liabilities they are matching, as a result of long-term swap spreads falling. There has also been a release of technical provisions to the UDS in respect of reduced future expense inflation risk, resulting from the implementation of the administration outsourcing deal with Capita arranged in 2007. These increases have partly offset any losses that were made from negative investment returns.

At 26 July 2008 the realistic working capital within the Co-operative Insurance long-term business fund, being the excess of the realistic value of assets over the realistic value of liabilities stood at £974m compared to £1,009m at the start of the financial year. Excluding the effect of gilt repos, this represents a working capital ratio of 6.1%, compared to 5.7% at 12 January 2008. The decrease has arisen primarily from an increase in provisions for with-profit policies, as a result of increased volatility in the equity markets and an increase in the expected life of pension policyholders.

Strong progress has been made on embedding the arrangement with Capita for them to provide administration services with the relocation of colleagues to new Capita premises in Manchester, and the migration of all print and post handling services to Capita's central UK hub. As we move forward this deal will deliver improved service propositions, a more contemporary product range and a reduced overall cost base.

### **Social responsibility**

Business in the Community, one of the leading UK organisations connected with corporate social responsibility, crowned CFS its 'Company of the Year', the blue riband award for our impact on society.

Business in the Community also awarded CFS 4 'Big Ticks' in recognition of the positive impact of corporate and social responsibility activities. These included an award for an education and training programme run by the Bank's Customer Service Centre in Skelmersdale. This has enabled over 1,600 pupils from 17 local schools to learn about the world of work, gain skills and qualifications and improve their links with industry.

CFS was also 3rd, and the top financial services company, at the Sunday Times 'Best Green Companies Awards'.

Over 50 MPs signed a House of Commons Early Day Motion supporting the Bank's position against sovereign wealth funds linked to oppressive regimes as the Bank turned away loan applications worth more than £20m from sovereign wealth funds because they were sponsored by regimes that fail to uphold basic rights. The annual ethical audit report showed that income foregone by the Bank due to ethical and ecological reasons was £14m at the end of 2007.

The Bank took first place in the 'Cause Related Marketing' category at the Marketing Society's Awards for Excellence for its two year 'Combating Climate Change' campaign, in partnership with Friends of the Earth.

### **Outlook**

Total shareholder profit before tax, significant items and investment fluctuations was £73.4m compared to £38.0m in the previous year. The growth in profit was principally due to improved Banking income and bad debts and 2007 exceptional weather related events in the General Insurance business offset by investment losses due to difficult market conditions.

CFS is continuing the journey on its significant investment programme to transform our processes, organisational structure and culture. After two years of successful implementation of the journey to date CFS is already seeing benefits enabling us to start the reinvigoration of revenue growth, see significant improvement of our costs, and build towards our vision to be the UK's most admired financial services business.

## Consolidated income statement

For the period ended 26 July 2008 (unaudited)

All amounts are stated in £m unless otherwise indicated

	General insurance	Banking	Other shareholder	Total shareholder return before significant items	Significant items	Total shareholder return	Long-term business (1)
<b>2008</b>							
Gross earned insurance premiums	216.1	–	–	<b>216.1</b>	–	<b>216.1</b>	274.4
Premiums ceded to reinsurers	(9.8)	–	–	<b>(9.8)</b>	–	<b>(9.8)</b>	(12.3)
Interest and investment income	31.4	445.5	21.4	<b>498.3</b>	–	<b>498.3</b>	368.9
Commissions and fees receivable	0.8	117.2	(0.2)	<b>117.8</b>	–	<b>117.8</b>	22.7
Gains less losses from traded investments	(9.1)	2.2	9.7	<b>2.8</b>	–	<b>2.8</b>	(1,037.5)
Other	–	–	1.4	<b>1.4</b>	–	<b>1.4</b>	2.7
Interest paid	(3.9)	(254.6)	8.5	<b>(250.0)</b>	–	<b>(250.0)</b>	–
Commission and fees	(5.1)	(18.4)	–	<b>(23.5)</b>	–	<b>(23.5)</b>	(12.1)
<b>Net revenue</b>	<b>220.4</b>	<b>291.9</b>	<b>40.8</b>	<b>553.1</b>	<b>–</b>	<b>553.1</b>	<b>(393.2)</b>
Net claims incurred	(152.7)	–	–	<b>(152.7)</b>	–	<b>(152.7)</b>	(723.6)
Changes in insurance contracts	–	–	–	–	–	–	1,107.2
Impairment losses on structured investments	–	(25.0)	–	<b>(25.0)</b>	–	<b>(25.0)</b>	–
Impairment losses on loans and advances	–	(45.3)	–	<b>(45.3)</b>	–	<b>(45.3)</b>	–
	67.7	221.6	40.8	<b>330.1</b>	–	<b>330.1</b>	(9.6)
Change in unallocated divisible surplus	–	–	–	–	–	–	46.2
Tax attributable to policyholders	–	–	–	–	–	–	58.5
Operating expenses	(69.2)	(175.4)	(4.3)	<b>(248.9)</b>	(43.2)	<b>(292.1)</b>	(95.1)
<b>Profit/(loss) before taxation</b>	<b>(1.5)</b>	<b>46.2</b>	<b>36.5</b>	<b>81.2</b>	<b>(43.2)</b>	<b>38.0</b>	<b>–</b>
Income tax expense	0.4	(14.1)	(7.1)	<b>(20.8)</b>	12.3	<b>(8.5)</b>	–
Minority interests	–	(1.8)	–	<b>(1.8)</b>	–	<b>(1.8)</b>	–
<b>Net profit/(loss) for the period</b>	<b>(1.1)</b>	<b>30.3</b>	<b>29.4</b>	<b>58.6</b>	<b>(30.9)</b>	<b>27.7</b>	<b>–</b>

(1) Long-term business operating expenses include £28.2m of significant items relating to non-recurring restructuring costs.

## Consolidated income statement

For the period ended 28 July 2007 (unaudited)  
All amounts are stated in £m unless otherwise indicated

	General insurance	Banking	Other shareholder	Total shareholder return before significant items	Significant items	Total shareholder return	Long-term business (1)
<b>2007</b>							
Gross earned insurance premiums	238.7	–	–	<b>238.7</b>	–	<b>238.7</b>	290.8
Premiums ceded to reinsurers	(10.9)	–	–	<b>(10.9)</b>	–	<b>(10.9)</b>	(10.0)
Interest and investment income	34.3	416.2	22.8	<b>473.3</b>	–	<b>473.3</b>	418.0
Commissions and fees receivable	0.5	113.3	–	<b>113.8</b>	–	<b>113.8</b>	30.6
Gains less losses from traded investments	(1.8)	2.7	(10.3)	<b>(9.4)</b>	–	<b>(9.4)</b>	(420.7)
Other	–	–	–	–	–	–	1.5
Interest paid	(2.6)	(238.6)	5.0	<b>(236.2)</b>	–	<b>(236.2)</b>	–
Commission and fees payable	(6.6)	(17.4)	–	<b>(24.0)</b>	–	<b>(24.0)</b>	(9.7)
<b>Net revenue</b>	<b>251.6</b>	<b>276.2</b>	<b>17.5</b>	<b>545.3</b>	–	<b>545.3</b>	<b>300.5</b>
Net claims incurred	(213.0)	–	–	<b>(213.0)</b>	–	<b>(213.0)</b>	(812.7)
Changes in insurance contracts	–	–	–	–	–	–	318.2
Impairment losses on structured investment	–	–	–	–	–	–	–
Impairment losses on loans and advances	–	(53.2)	–	<b>(53.2)</b>	–	<b>(53.2)</b>	–
	38.6	223.0	17.5	<b>279.1</b>	–	<b>279.1</b>	(194.0)
Change in unallocated divisible surplus	–	–	–	–	–	–	294.6
Tax attributable to policyholders	–	–	–	–	–	–	17.6
Operating expenses	(71.9)	(177.5)	(7.0)	<b>(256.4)</b>	(50.2)	<b>(306.6)</b>	(118.2)
<b>Profit/(loss) before taxation</b>	<b>(33.3)</b>	<b>45.5</b>	<b>10.5</b>	<b>22.7</b>	<b>(50.2)</b>	<b>(27.5)</b>	–
Income tax expense	9.5	(14.5)	17.4	<b>12.4</b>	15.1	<b>27.5</b>	–
Minority interests	–	(1.2)	–	<b>(1.2)</b>	–	<b>(1.2)</b>	–
<b>Net profit/(loss) for the period</b>	<b>(23.8)</b>	<b>29.8</b>	<b>27.9</b>	<b>33.9</b>	<b>(35.1)</b>	<b>(1.2)</b>	–

(1) Long-term business operating expenses include £22.0m of significant items relating to non-recurring restructuring costs.

## Consolidated balance sheet

At 26 July 2008 (unaudited)

All amounts are stated in £m unless otherwise indicated

	General insurance	Banking	Other shareholder	Total shareholder	Long-term business	Eliminations	Total
<b>2008</b>							
<b>Assets</b>							
Cash	–	174.6	–	<b>174.6</b>	0.5	(0.5)	<b>174.6</b>
Derivative financial instruments	–	63.1	57.0	<b>120.1</b>	671.5	–	<b>791.6</b>
Loans and advances to banks	–	1,741.1	–	<b>1,741.1</b>	–	–	<b>1,741.1</b>
Loans and advances to customers	–	9,960.6	(2.2)	<b>9,958.4</b>	10.8	–	<b>9,969.2</b>
Investments	1,030.1	2,354.0	773.4	<b>4,157.5</b>	16,080.8	(38.9)	<b>20,199.4</b>
Investment property	–	–	–	<b>–</b>	1,839.4	–	<b>1,839.4</b>
Reinsurers' share of technical provisions	40.1	–	–	<b>40.1</b>	2,962.9	–	<b>3,003.0</b>
Intangible assets	30.3	3.5	30.6	<b>64.4</b>	16.3	–	<b>80.7</b>
Property, plant & equipment	–	70.0	19.6	<b>89.6</b>	38.9	–	<b>128.5</b>
Prepayments and other receivables	226.3	58.7	54.3	<b>339.3</b>	280.7	(9.2)	<b>610.8</b>
<b>Total assets</b>	<b>1,326.8</b>	<b>14,425.6</b>	<b>932.7</b>	<b>16,685.1</b>	<b>21,901.8</b>	<b>(48.6)</b>	<b>38,538.3</b>
<b>Liabilities and equity</b>							
Amounts due to credit institutions	10.7	872.8	9.3	<b>892.8</b>	2,199.3	–	<b>3,092.1</b>
Amounts owed to customers	–	11,374.4	(164.9)	<b>11,209.5</b>	–	(39.4)	<b>11,170.1</b>
Debt securities in issue	–	892.2	–	<b>892.2</b>	–	–	<b>892.2</b>
Derivative financial instruments	–	93.2	10.1	<b>103.3</b>	3.6	–	<b>106.9</b>
Insurance contracts	931.9	–	–	<b>931.9</b>	16,448.4	–	<b>17,380.3</b>
Investment contracts liabilities	–	–	–	<b>–</b>	209.0	–	<b>209.0</b>
Unallocated divisible surplus	–	–	–	<b>–</b>	997.1	–	<b>997.1</b>
Other borrowed funds	105.0	358.3	(105.0)	<b>358.3</b>	–	–	<b>358.3</b>
Other liabilities and accruals	40.4	134.5	166.1	<b>341.0</b>	1,975.4	(9.2)	<b>2,307.2</b>
Deferred tax	2.8	(3.9)	105.7	<b>104.6</b>	62.3	–	<b>166.9</b>
Provisions	0.1	6.0	7.3	<b>13.4</b>	6.7	–	<b>20.1</b>
Minority interests	–	27.0	–	<b>27.0</b>	–	–	<b>27.0</b>
Equity	235.9	671.1	904.1	<b>1,811.1</b>	–	–	<b>1,811.1</b>
<b>Total liabilities and equity</b>	<b>1,326.8</b>	<b>14,425.6</b>	<b>932.7</b>	<b>16,685.1</b>	<b>21,901.8</b>	<b>(48.6)</b>	<b>38,538.3</b>

# Consolidated balance sheet

At 28 July 2007 (unaudited)

All amounts are stated in £m unless otherwise indicated

	General insurance	Banking	Other shareholder	Total shareholder	Long-term business	Eliminations	Total
<b>2007</b>							
<b>Assets</b>							
Cash	–	203.2	1.8	<b>205.0</b>	43.2	(43.2)	<b>205.0</b>
Derivative financial instruments	–	90.5	–	<b>90.5</b>	503.3	–	<b>593.8</b>
Loans and advances to banks	–	1,283.2	–	<b>1,283.2</b>	–	–	<b>1,283.2</b>
Loans and advances to customers	–	8,424.9	79.9	<b>8,504.8</b>	13.8	–	<b>8,518.6</b>
Investments	1,188.8	2,429.3	934.4	<b>4,552.5</b>	19,236.1	(9.1)	<b>23,779.5</b>
Investment property	–	–	–	<b>–</b>	2,331.9	–	<b>2,331.9</b>
Reinsurers' share of technical provisions	–	–	–	<b>–</b>	1,078.0	–	<b>1,078.0</b>
Intangible assets	26.7	6.2	27.3	<b>60.2</b>	21.2	–	<b>81.4</b>
Property, plant & equipment	–	90.3	20.2	<b>110.5</b>	45.8	–	<b>156.3</b>
Prepayments and other receivables	282.2	91.5	16.4	<b>390.1</b>	371.3	(24.8)	<b>736.6</b>
<b>Total assets</b>	<b>1,497.7</b>	<b>12,619.1</b>	<b>1,080.0</b>	<b>15,196.8</b>	<b>23,644.6</b>	<b>(77.1)</b>	<b>38,764.3</b>
<b>Liabilities and equity</b>							
Amounts due to credit institutions	28.9	608.2	15.3	<b>652.4</b>	4,449.9	–	<b>5,102.3</b>
Amounts owed to customers	–	9,982.6	(36.8)	<b>9,945.8</b>	–	(43.5)	<b>9,902.3</b>
Debt securities in issue	–	623.7	–	<b>623.7</b>	–	–	<b>623.7</b>
Derivative financial instruments	–	143.6	18.9	<b>162.5</b>	1.5	–	<b>164.0</b>
Insurance contracts	1,125.7	–	–	<b>1,125.7</b>	17,786.8	–	<b>18,912.5</b>
Investment contracts liabilities	–	–	–	<b>–</b>	206.0	–	<b>206.0</b>
Unallocated divisible surplus	–	–	–	<b>–</b>	861.2	–	<b>861.2</b>
Other borrowed funds	75.0	388.0	(75.0)	<b>388.0</b>	–	(8.8)	<b>379.2</b>
Other liabilities and accruals	42.1	178.1	143.7	<b>363.9</b>	171.8	(24.8)	<b>510.9</b>
Deferred tax	1.0	(8.6)	140.2	<b>132.6</b>	154.2	–	<b>286.8</b>
Provisions	1.7	23.9	21.9	<b>47.5</b>	13.2	–	<b>60.7</b>
Minority interests	–	24.1	–	<b>24.1</b>	–	–	<b>24.1</b>
Equity	223.3	655.5	851.8	<b>1,730.6</b>	–	–	<b>1,730.6</b>
<b>Total liabilities and equity</b>	<b>1,497.7</b>	<b>12,619.1</b>	<b>1,080.0</b>	<b>15,196.8</b>	<b>23,644.6</b>	<b>(77.1)</b>	<b>38,764.3</b>

## Statement of recognised income and expense

For the period ended 26 July 2008 (unaudited)

All amounts are stated in £m unless otherwise indicated

	General insurance	Banking	Other shareholder	Total shareholder return before significant items	Significant items	Total shareholder return	Long-term business
<b>2008</b>							
Changes in available for sale investments	(29.9)	(12.1)	–	<b>(42.0)</b>	–	<b>(42.0)</b>	–
Changes in cash flow hedges	–	(31.3)	(17.8)	<b>(49.1)</b>	–	<b>(49.1)</b>	–
Revaluation of self occupied properties	–	–	–	–	–	–	2.3
Tax on items taken directly to equity	8.5	12.2	5.1	<b>25.8</b>	–	<b>25.8</b>	–
	(21.4)	(31.2)	(12.7)	<b>(65.3)</b>	–	<b>(65.3)</b>	2.3
Attributable to policy holders	–	–	–	–	–	–	(2.3)
Attributable to minority interests	–	0.8	–	<b>0.8</b>	–	0.8	–
<b>Net income recognised directly in equity</b>	<b>(21.4)</b>	<b>(30.4)</b>	<b>(12.7)</b>	<b>(64.5)</b>	–	<b>(64.5)</b>	–
Profit for the period	(1.1)	30.3	29.4	<b>58.6</b>	(30.9)	<b>27.7</b>	–
<b>Total recognised income and expense</b>	<b>(22.5)</b>	<b>(0.1)</b>	<b>16.7</b>	<b>(5.9)</b>	<b>(30.9)</b>	<b>(36.8)</b>	–
<b>2007</b>							
Changes in available for sale investments	(7.2)	(2.1)	–	<b>(9.3)</b>	–	<b>(9.3)</b>	–
Changes in cash flow hedges	–	(26.0)	(7.7)	<b>(33.7)</b>	–	<b>(33.7)</b>	–
Revaluation of self occupied properties	–	–	–	–	–	–	0.4
Tax on items taken directly to equity	2.2	8.4	2.3	<b>12.9</b>	–	<b>12.9</b>	–
	<b>(5.0)</b>	<b>(19.7)</b>	<b>(5.4)</b>	<b>(30.1)</b>	–	<b>(30.1)</b>	<b>0.4</b>
Attributable to policy holders	–	–	–	–	–	–	(0.4)
Attributable to minority interests	–	0.7	–	0.7	–	<b>0.7</b>	–
<b>Net income recognised directly in equity</b>	<b>(5.0)</b>	<b>(19.0)</b>	<b>(5.4)</b>	<b>(29.4)</b>	–	<b>(29.4)</b>	–
Profit for the period	(23.8)	29.8	27.9	<b>33.9</b>	(35.1)	<b>(1.2)</b>	–
<b>Total recognised income and expense</b>	<b>(28.8)</b>	<b>10.8</b>	<b>22.5</b>	<b>4.5</b>	<b>(35.1)</b>	<b>(30.6)</b>	–







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