The Co-operative Group
Annual Report & Accounts 2009

The co-operative
good for everyone

The Co-operative Group staff featured on the cover have all been recognised for achievements in 2009. Further details are given throughout this report.

2009 was an historic year for The Co-operative Group. Our Food business joined forces with Somerfield, our Financial Services business merged with Britannia, and we continued to roll out The Co-operative brand across our estate. The high street will never look the same again…

Contents

Highlights of the year

£13.7bn

Gross sales reached a new record – up 31%.

£473m

Underlying operating profit* – up 20%.

£402m

Profit before payments to and on behalf of members – equivalent to pre-tax profit in a plc – up 85%.

£1.3bn

Amount of capital expenditure in the period after netting off proceeds received from store disposals related to the Somerfield acquisition.

£107m

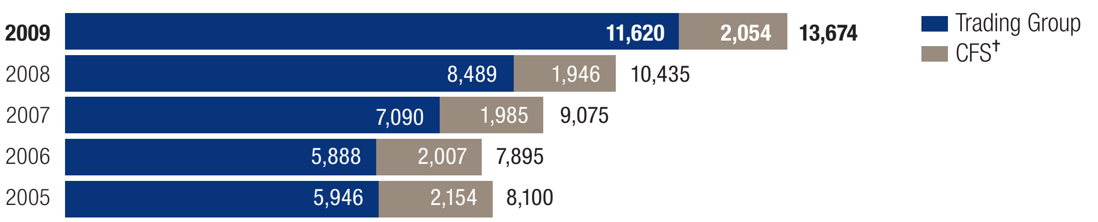
Record amount paid to members and communities.

£6.7m

We have now raised a massive £3.7m for RNID and £3m for Macmillan, the largest amount The Co-operative has ever raised for a Charity of the Year.

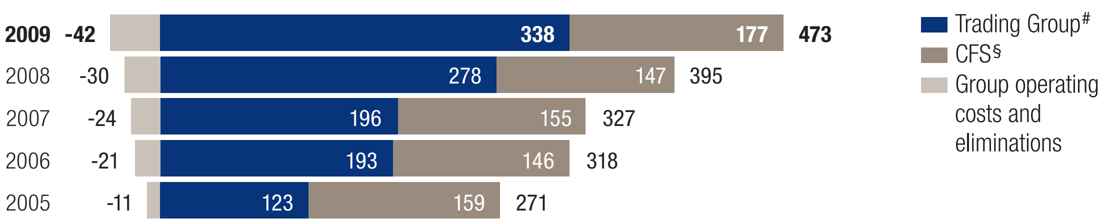
* Underlying Group operating profit comprises underlying Trading Group profit and underlying CFS profit (as defined below) less Group operating costs as presented in the segmental analysis in Note 1. It adjusts statutory operating profit for the distortive effects of certain one-off items.

Gross sales (£m)



† Gross sales figures are shown before premiums ceded to reinsurers.

Underlying operating profit (£m)



Trading Group underlying operating profit is before significant items, profit on sale of fixed assets and investment property valuation movement.

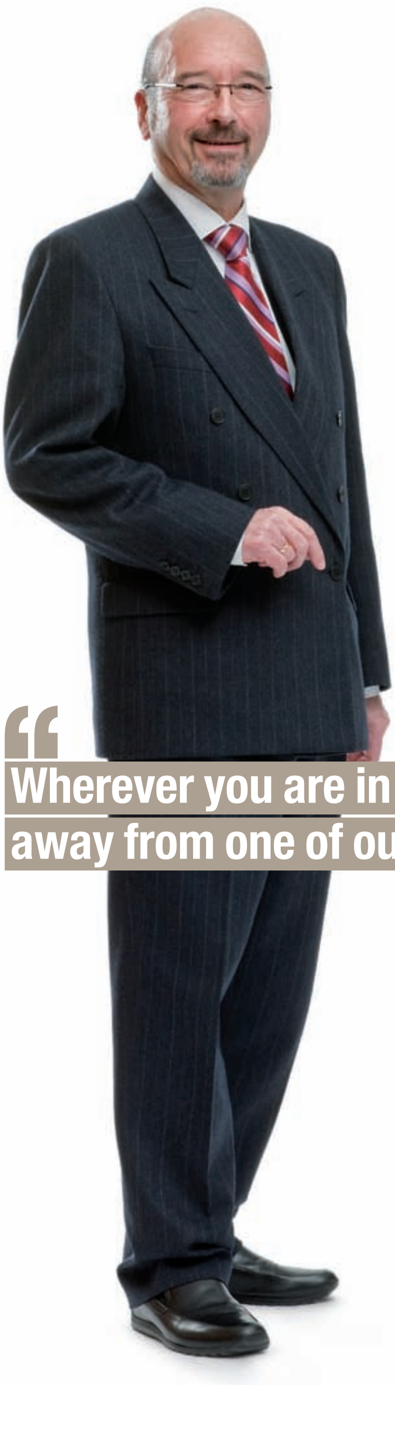
§ CFS underlying operating profit is before significant items, short-term investment fluctuations, Financial Services Compensation Scheme levy and fair value amortisation.

Chair's statement

There cannot be many businesses in a position to announce another year of record profits at the end of 2009, but The Co-operative Group is one such business. In the midst of the worst recession for around 60 years, the Group has continued to do what it does best: serving customers with excellent products and services while bringing a solid value message to the communities in which we operate.

After all, 2009 was not a year in which we were content to consolidate and stay afloat. Quite the opposite! Our Food business acquired Somerfield, to become the fifth biggest food retailer in the country, our Financial Services business merged with the Britannia Building Society to become one of the biggest names in the mutual sector and we welcomed Plymouth & South West Co-operative Society to the fold. We also launched the biggest marketing campaign in the Group's history and continued the roll-out of the brand throughout the estate, transforming food stores, travel branches, funeral homes and pharmacies, into one unified brand. Wherever you are in the UK, you're never far away from one of our new look outlets. I'd also like to thank the independent societies who have taken up the brand and helped to get this message across to an even bigger audience.

We have also done our bit to take The Co-operative Group, a predominantly national business, onto the international stage during the course of 2009. For example, together with the Group Chief Executive, I attended the opening ceremony of our new factory in China in September, developed as part of a joint venture between our Pharmacy business and the well-respected Tasly Group. In addition to supplying our own pharmacies with generic medicines, we will also be looking to supply international co-operatives in the coming year. I hope that these international partnerships can be developed further in years to come following my election to the Board of International Co-operative Alliance (ICA), in November. The ICA brings together co-operatives from all over the world and we firmly share the same values and principles. Membership of the ICA also brings home the fact that there are 800 million members of co-operatives in 237 countries across the globe. It also demonstrates that the co-operative model, which has served the Group and in particular our Financial Services business so well in the current economic turmoil, is recognised as a successful business model worldwide.



"Wherever you are in the UK, you're never far away from one of our new look outlets.

Funeralcare colleague Robin Hardy (far right) went above and beyond the call of duty in 2009 when he helped establish a bereavement support centre for clients.

Store Manager Alex Sophianou (pictured here with his wife) received a Pride of the Co-operative Award in 2009 for his work promoting the Co-operative in Longfield and Dartford, driving a massive 31% increase in sales in his store.

Given the current economic climate, businesses need to be clearer than ever about their ongoing strategies. We are indeed fortunate to have the foundation of co-operation to guide us. The Board of Directors is very clear on the purpose of The Co-operative Group, which is to serve its members by carrying on business in accordance with Co-operative values & principles. This is why the Board has embarked on an exercise to articulate our vision and how this is better applied in everything we do. It is vital we ensure that our values and principles are relevant to the organisation, to our millions of members and customers, to the markets in which many of our businesses operate and to the communities in which many of our businesses are to be found.

Over the next few pages you will read the thoughts of our Group Chief Executive Peter Marks on last year's performance and the challenges ahead. In November last year, he was named Orange Leader of the Year at the National Business Awards, in recognition of the outstanding achievements of the Group over the last 12 months. The Orange Leader of the Year award was voted for in equal measure by members of the wider business community and an expert panel of judges. Peter also picked up the The Grocer Cup for Outstanding Business Achievement at the IGD Food Industry Awards. This is awarded to the individual who has inspired their team to achieve exceptional results in the preceding year and has made the biggest contribution to the grocery industry, as voted for by readers of The Grocer. Peter would be the first to point out – as he did when receiving the awards – that his success is a reflection of the progress made by the Group in recent years and that this, in turn, is down to the contribution of over 120,000 staff, our thousands of active members and our millions of member customers. It's great to see the wider business world recognising that progress and that success.

Following the Constitutional Review, we established two subsidiary Boards in addition to the CFS Board, each of which has responsibility for a specific business area, namely Food and our Specialist Businesses. I would like to thank all of the Directors and other elected members for their hard work in driving continued business success and for helping to transform our governance and democratic structure into one that is fit for the 21st century.

In concluding this introduction to our 2009 annual report, I would like to thank, on behalf of the Board of Directors, all those members and employees who have helped to produce the success recorded here. Without your efforts and support, we would not have made the progress we have made in recent years. Undoubtedly the year ahead will present new challenges to the Group. We operate in an incredibly diverse array of markets and the economic climate, as we emerge from the recession, is unlikely to improve quickly. We are, however, well placed to meet the challenges presented. There will certainly be a period of consolidation ahead in which we bed down the growth and expansion of the last 12 months. I am confident, though, that the positive direction in which the Group is moving will continue.

Len Wardle

Len Wardle
Chair, The Co-operative Group

Co-operative Group Board of Directors

01 Len Wardle (r)
Age 65. Group Chair. Joined the Board in 1992. Former University Fellow, Former Head of Resources, East Sussex County Council. Member of the South East Regional Board. Director of Co-operative Food Ltd and of Co-operative Specialist Businesses Ltd. Non-Executive Director of Co-operative Financial Services Ltd, The Co-operative Bank plc, Co-operative Insurance Society Limited, and CIS General Insurance Limited. Member of the Remuneration & Appointments Committee, the Governance Working Party and a representative on the Co-operative Party NEC.

02 Chris Herries (r)
Age 63. Joined the Board in 2009. Retired Teacher/Oxfam District Manager/Horticulturalist. Member of the South & West Regional Board. Director of Co-operative Specialist Businesses Ltd. Member of the Remuneration & Appointments Committee and the Governance Working Party. Director of Co-operatives UK Ltd.

03 David Pownall (r)
Age 52. Joined the Board in 2007. Self Employed Plastering Contractor. Member of the North West & North Midlands Regional Board. Director of Co-operative Specialist Businesses Ltd. Director of Co-operative Action Ltd and Director of Co-operative Press Ltd.

04 Steven Bayes (r)
Age 48. Joined the Board in 2009. Nurse. Member of the North Regional Board. Director of Co-operative Specialist Businesses Ltd and a Director of Co-operatives UK Ltd.

05 Eric Calderwood (r)
Age 56. Joined the Board in 2006. University Lecturer/Retail Consultant. Member of the Scotland and Northern Ireland Regional Board. Director of Co-operative Food Ltd. Also Director of Co-operatives UK Ltd and The Manx Co-operative Society Ltd.

06 Paul Flowers (r)
Age 59. Joined the Board in 2008. Superintendant Methodist Minister/Bradford City Councillor. Member of the North Regional Board. Non-Executive Director of Co-operative Financial Services Ltd, The Co-operative Bank plc, Co-operative Insurance Society Limited, and CIS General Insurance Limited. Chair of the Group Remuneration and Appointments Committee and a member of the Diversity Steering Group.

07 Nigel Keane (r)
Age 49. Joined the Board in 2009. Senior Policy Adviser. Member of the Cymru/Wales Regional Board. Director of Co-operative Specialist Businesses Ltd. Member of the Audit & Risk Committee and the Political Strategy Working Group.

08 Stuart Ramsay (r)
Age 52. Joined the Board in 2009. Computer Technician. Member of the Scotland and Northern Ireland Regional Board. Director of Co-operative Specialist Businesses Food Ltd. Member of the National Values and Principles Committee and of the Governance Working Party. Also representative on the Co-operative Party NEC.

09 Herbert Daybell (r)
Age 62. Joined the Board in 2009. Retired Publisher. Member of Central & Eastern Regional Board. Director of Co-operative Food Ltd. Member of the National Values & Principles Committee.

10 Ursula Lidbetter (i)
Age 47. Joined the Board in 2009. Chief Executive, Lincolnshire Co-operative Ltd. Director of Co-operative Specialist Businesses Ltd. Member of the Audit & Risk Committee.

11 Steve Watts (r)
Age 58. Group Deputy Chair. Joined the Board in 2000. Pricing, Research and Information Manager. Member of Central & Eastern Regional Board. Chair of Co-operative Specialist Businesses Ltd, Chair of Co-operative Insurance Ltd. CIS General Ltd and the Co-operative Bank plc. Non-Executive Director of Co-operative Financial Services Ltd. Member of the Remuneration & Appointments Committee.

12 Allan Smith (i)
Age 62. Group Deputy Chair. Joined the Board in 2003. Head of Major Developments, The Channel Islands Co-operative Society. Chair of Co-operative Food Ltd. Member of the Remuneration & Appointments Committee.

13 Duncan Bowdler (r)
Age 51. Joined the Board in 2007. Trade Liaison Manager. Member of the North West & North Midlands Regional Board. Non-Executive Director of Co-operative Financial Services Ltd, The Co-operative Bank plc, Co-operative Insurance Society and CIS General Insurance Limited. Member of the Group Audit & Risk Committee and the Governance Working Party.

14 Richard Samson (i)
Age 56. Joined the Board in 2005. Chief Executive of East of England Co-operative Society. Director of Co-operative Food Ltd.

15 Marilynne Burbage (r)
Age 67. Joined the Board in 2009. Part-time Horticultural and Medicinal Plants Consultant. Member of the South East Regional Board. Director of Co-operative Specialist Businesses Ltd. Chair of the National Values & Principles Committee and a member of the Governance Working Party. Also a Director of The Co-operative Foundation.

16 Ben Reid (i)
Age 55. Joined the Board in 2000. Chief Executive of The Midcounties Co-operative. Non-Executive Director of Co-operative Financial Services, The Co-operative Bank plc, Co-operative Insurance Society Limited and CIS General Insurance Limited. Chair of the Group Audit & Risk Committee.

17 John Fitzgerald (i)
Age 56. Joined the Board in 2005. Chief Executive, Midlands Co-operative Society. Director of Co-operative Food Ltd.

18 Patrick Grange (r)
Age 67. Joined the Board in 2007. Farmer and Business Consultant. Member of the North West & North Midlands Regional Board. Director of Co-operative Food Ltd and a member of the Audit & Risk Committee.

19 Ray Henderson (r)
Age 63. Joined the Board in 2009. Retired Telecoms Engineer. Member of the North Regional Board. Director of Co-operative Food Ltd.

20 Jenny Barnes (r)
Age 48. Joined the Board in 2009. Civil Servant. Member of the South & West Regional Board. Director of Co-operative Food Ltd. Member of the National Values & Principles Committee and a director of Co-operative Press Ltd.

(r) regional representative
(i) independent society representative

Subsidiary Boards

Food
Allan Smith (Deputy Chair & Chair of Food Board)
Len Wardle (Group Chair)
Jenny Barnes
Eric Calderwood
Herbert Daybell
John Fitzgerald
Patrick Grange
Ray Henderson
Richard Samson
Peter Marks (Group Chief Executive)
Martyn Wates (Group Chief Financial Officer)
Tim Hurrell (Managing Director, Food)

Specialist Businesses
Steve Watts (Deputy Chair & Chair of Specialist Businesses)
Len Wardle (Group Chair)
Steven Bayes
Marilynne Burbage
Chris Herries
Nigel Keane
Ursula Lidbetter
David Pownall
Stuart Ramsay
Peter Marks (Group Chief Executive)
Martyn Wates (Group Chief Financial Officer)

Financial Services
Bob Burlton (Chair)
Len Wardle (Group Chair)
Rodney Baker-Bates
Duncan Bowdler
David Davies
Paul Flowers
Peter Harvey
Paul Hewitt
Chris Jones
Stephen Kingsley
Peter Marks (Group Chief Executive)
Bob Newton
Ben Reid
Martyn Wates (Group Chief Financial Officer)
Steve Watts
Piers Williamson
Neville Richardson (Chief Executive – CFS)
Rod Bulmer (Managing Director Retail – CFS)
Tim Franklin (Chief Operating Officer – CFS)
Phil Lee (Integration & Change Director – CFS)
John Reizenstein (Managing Director, Corporate & Markets – CFS)
Barry Tootell (Chief Financial Officer – CFS)

It is no understatement to say that 2009 has been a transformational year for The Co-operative Group and an historic one for the Co-operative Movement as a whole. Consider some of the things we have achieved in the past 12 months: the acquisition of Somerfield, the merger with Britannia, the merger with Plymouth & South West Co-operative Society (itself following hard on the heels of the merger with Lothian Borders & Angus), the launch of our brand advertising campaign and the ongoing transformation of our entire estate. Taken individually, each of these events would mark a significant change for any business. Taken together, they demonstrate that 2009 saw the greatest change to the business in its entire history.

These achievements, however, are merely the tip of the iceberg.

Colleagues from The Co-operative Food and Somerfield, Madeline Bowers and Tomeika Shell, were selected as the faces of a new advertising campaign designed to give customers a clear message that the two businesses are now part of the same family.

Colleagues from the Stafford branches of The Co-operative Bank and Britannia celebrate the coming together of the two businesses.

"2009 saw the greatest change to the business in its entire history.

£13.7bn

Gross sales in 2009.

£473m

Underlying operating profit.

The bringing together of Somerfield with our existing Food business has, for instance, involved an enormous amount of work behind the scenes to establish a combined Food business with almost 3,000 stores the length and breadth of the United Kingdom. This work has been undertaken whilst maintaining business as usual, ensuring that we continue to place the utmost importance on great products and great services. It is to the credit of everyone involved that our new and existing customers now view the Group as a totally revitalised business.

2009 then, has been a year of growth – both in terms of our core businesses and in terms of how the Group is viewed by the outside world thanks to the roll-out of the brand advertising campaign and the transformation of our family of businesses. The Co-operative is once again a respected brand on the high streets of the communities in which we operate. We have taken the Big 4 and created the Big 5. This is how we come to be reporting another year of excellent figures, with gross sales up 31% from £10.4bn to £13.7bn and Group revenue before reinsurance premiums up 33% from £9.4bn in 2008 to £12.5bn. Profit before payments to and on behalf of members – equivalent to pre-tax profits in a plc – rose by 85% from £218m to £402m. However, this included a £99m benefit from the fair value amortisation relating to the Britannia merger and significant improvements in the performance of our investment property portfolio, offset by a reduction in the one-off gains in the disposal of fixed assets. Excluding these, underlying operating profits of £473m were 20% up on last year. Our net borrowings increased from £648m to £1.6bn, largely as a result of the Somerfield acquisition and our investment in the brand roll-out. This resulted in a net debt to EBITDA ratio of 2.4 compared with 1.4 in 2008. Members' funds also rose during the year by 15.2% to £4.5bn.

These would be impressive figures in a normal year – in the midst of a severe recession and in a period of significant change, they are little short of remarkable. I would like to add my thanks to those of the Directors, to everyone who has done such a fantastic job over the past few years.

Each of our businesses is covered on the following pages.

Our first national advertising campaign was launched on 16 February 2009. To date, over 98% of the UK has seen the ad at least once.

Our Food business delivered an excellent result with sales including Somerfield up 66% from £4.5bn to £7.5bn and trading profit up 31% to £286m from £219m the previous year. Like-for-like sales increased by 5.5% compared to a market average of 3.7% for the same period. Following a strong Christmas in 2009, we have now delivered 16 successive quarters of like-for-like growth in a fiercely competitive marketplace and a difficult economic climate. Against the backdrop of financial pressures on household budgets, rising unemployment and increases in fuel prices and extreme wintry conditions, our focus on great deals and community-based stores helped boost sales.

The big story of 2009 for the Food business, however, has been the Somerfield acquisition and the fact that three years of planned growth has been completed in a single, decisive move. We now operate almost 3,000 local community stores. Each week, we serve 21 million customers and we have a store in every single postal area in the UK bar one. What the Somerfield acquisition has also done is change our Food business from being focused very much on the convenience store sector alone to one which combines that expertise with a strong presence in the local small supermarket arena. The challenge now is to become the market leader in that sector, just as we are in the convenience store sector. Our heritage and support for the UK was highlighted throughout our store estate with the launch of the customer journey campaign flying the national flag and reminding customers we have been at the heart of the community serving Britain for 165 years.

Amanda Rush (second from left), a store manager from Cornwall, won the Customer Promises in Action Award at the Good with Food Awards, which means she really puts the customer experience first.

66%

Sales up 66% from £4.5bn to £7.5bn.

In 2009, we rebranded 778 stores, including 181 Somerfields.

In the wake of the Somerfield acquisition, we placed a greater emphasis on promoting value.

During 2009, 778 stores were rebranded and upgraded, 597 Co-operative and 181 Somerfield stores converted to The Co-operative brand which means that 65% of the total estate, including Somerfield, has now been rebranded and modernised, providing a progressive modern shopping experience for our customers. Crucially, sales from rebranded stores have increased by 12% year-on-year.

We have placed value right at the centre of our customer message this year with the Great Deal Locally campaign, which focused on the fact that our stores are located in the heart of local communities, so are best placed to deliver great savings to customers without the need to travel to big superstores. Great Deal Locally focused on price cuts, helping customers buy what they actually needed. We introduced Bulk Stacks of show-stopping deals on products that are meal or household essentials, supported with significant television, in-store and leaflet communication.

Our most important diet and health initiative this year has been the Green Dot campaign, highlighting healthier choices with a simple prominent green dot on the front of our packaging. Customers of our Healthy Living and Reduced ranges and those buying fruit and vegetables were already familiar with this approach. All Green Dot messages are based on approved nutrition claims. The Green Dot campaign has been an unreserved success with these 850 healthier Green Dot products making up 25% of our own brand offering, and accounting for 15% of sales. Our Simply Value range has been another great success, with an 85% increase in sales year-on-year. Other highlights included our Meal Deal campaign – which focused on providing customers with great value family meals – and our Christmas Smart Coupon campaign.

At the Scottish Retail Excellence Awards, The Co-operative won the prestigious title of Retailer of the Year. Judges said the Group demonstrated leading performance across all aspects of its business in Scotland, including clear brand values, commitment to product and store innovation and active involvement in the communities it serves. The Co-operative also picked up the Green Retailer of the Year award for the second year running.

As far as 2010 is concerned, although the marketplace remains challenging, both in terms of the economic climate and the increased competition from other retailers, we are confident our offer is distinct enough to retain customers and drive further growth in the year ahead.

During the year, we expanded our 'Grown by us' range to include carrots, sweetcorn and turkeys.

One of the 'Best of the best' learnings we took from Somerfield was their enormously popular Home Delivery service.

Despite continued economic uncertainty, during which the credit crunch became a global recession, The Co-operative Financial Services has taken a significant step towards its vision of being the UK's most admired financial services provider. The historic merger of The Co-operative Financial Services and Britannia Building Society has created the most diversified mutual in UK financial services, uniquely positioned to present a member-owned, customer-led and ethically guided alternative to the shareholder-owned or government-owned model.

Total operating results (ie operating profit before tax, FSCS levy, significant items, short-term investment fluctuations and fair value amortisation) for 2009 was £177m compared with £147m in 2008 (an increase of 21%). These results reflect the business' success in maintaining profitability despite the continuing weakness of the market.

Meanwhile CFS' underlying capital and liquidity positions continue to provide the foundations for stable growth. Our liquidity position remains strong with a customer funding ratio of 104% (excluding securitised assets). We have also maintained rigorous cost control, with pro-forma 12-month operational costs down by 1%. These figures reflect a business determined to achieve commercial success within a framework of financial prudence and strength.

Our focus in 2009 was on delivering a ground-breaking merger while maintaining 'business as usual'. It is to the credit of all colleagues that profits have improved, with underlying like-for-like profits up 3% to £174.3m. Customer loans have increased significantly to £34.1bn (2008: £10.2bn) as a result of the merger.

Our liquidity has also been supported by strong growth in customer deposits as consumers continue to be attracted to the CFS mutual and ethical position and competitive pricing.

Customer deposits have consequently increased significantly to £32.5bn (2008: £11.7bn) which, on a like-for-like basis, represents a growth of 2.6%.

Retail results

The Retail business remained profitable despite the low interest rate environment and the economic recession which saw like-for-like profits fall from £110m to £12.2m.

The general insurance business delivered £424.3m in gross written premiums, an increase of 8% on 2008. The long-term business, run in the interests of policyholders, delivered a strongly improved performance in 2009 with new business profitability reaching £10.3m compared to only £1.6m in 2008.

With the addition of the Britannia branch network, the Co-operative Bank's high street presence has nearly quadrupled.

Co-operative Bank voted 'Best Direct Mortgage Lender 2009' by Your Mortgage.

CAM results
2009 saw profits increasing on a like-for-like basis to £113.2m from a loss of £4.7m in 2008. Corporate & Markets (CAM) net income rose year-on-year reflecting growth in the corporate book and a strong performance in the other operating segments. Impairment in the CAM business fell as there was a lower impact in 2009 on charges against Treasury assets only partly offset by an increase in Corporate impairments. The business remained vigilant in controlling its operating costs, allowing a small increase in cost base of only £0.3m year-on-year.

Performance highlights
During 2009, we were widely recognised as a champion of co-operative principles, named Best Financial Provider by Which? Magazine and receiving the UK Customer Experience Award as 'best large company'. The Co-operative Bank and smile took two of the top three spots at Which's inaugural People's Choice awards, while the Co-operative Insurance won a platinum award for Motor Claims customer satisfaction from Consumer Intelligence. Platform was named Best Intermediate Lender by Your Mortgage Magazine and our Corporate Banking operation was named small/mid-sized debt provider of the year. Crucially, as a business that seeks to take both personal and social responsibility, The Co-operative Financial Services also became one of only seven businesses to be awarded the new 'platinum plus' rating from Business in the Community.

These awards have helped bring us to wider consumer attention. Current account sales have seen a 38% uplift at a time when many competitors are struggling to keep existing customers. Meanwhile, life & savings new business premiums for 2009 were 30% higher than 2008.

To support our people in delivering our customer promise, and to lay the foundations for sustainable long-term growth, we are investing significantly in the transformation of our systems and process infrastructure. 2010 will see the first phase implementation of a major programme to transform our banking systems infrastructure with the launch of a new, more customer-centred business banking service. We will continue to focus on stability and core strength rather than opportunism; building on strong performance in 2009 to deliver further benefits for members, customers and society. Above all, we will continue to offer consumers a viable alternative to traditional financial services – a model that is fair, easy, responsible and personal.

Current account openings increased by 38% as consumers become increasingly attracted by 'the co-operative difference'.

The Co-operative Insurance was voted 'Best Direct Motor Insurance Provider 2009' by Your Money.

Business review
Pharmacy

Despite extremely tough trading conditions during the course of 2009, and continued pressures on the market driven by further cuts to pharmacy funding from the Department of Health (DoH), our Pharmacy business has delivered a creditable performance, with sales up from £744m in 2008 to £745m. However, operating profits were down 21% from £37.8m to £29.9m due to the DoH action mentioned above.

Despite this, there have been a number of significant achievements during the year ranging from the launch of a new National Distribution Centre which will improve stock availability for customers in over 750 pharmacies and give us improved control on our procurement, to sizeable investment in our IT infrastructure, which includes the introduction of a new financial management system and the roll-out of a new EPOS In Control platform to all branches. 2009 has also seen us take great strides as far as the rebranding of the business is concerned, with 221 branches newly refurbished and 12 branches positioned either closer or actually within primary care trusts, which enables our customers to collect their prescriptions with the minimum of fuss. Other highlights of the year include the launch of our Healthy Heart initiative within health centres, improvements to our membership offer such as the rewards available for the Prescription Collection Service and the completion of Phase 1 of our joint venture in China. Our medicines use reviews have also gone from strength to strength, growing 48% year-on-year and now delivered in 635 branches in England and Wales. Going forward, 2010 is going to be a key year in the development of the industry, with the conclusion of negotiations between the Pharmaceutical Services Negotiating Committee (PSNC) and the DoH regarding the new pharmacy contract and corresponding funding allocation. Within the Pharmacy business itself, we will need to ensure that we are equipped to take the full benefit of the national implementation of the electronic prescription service, a step that will see further investment in our patient medication record systems in branch. Our joint venture in China should be in production towards the end of the year and the first generic medicines should start to be distributed to pharmacies, adding to the continued strengthening of our own-label medicines and the improvement of our 'over the counter' offer.

Paul Barry, a Pharmacy colleague who helped a customer lose eight stone in eight months, was named Primary Care Pharmacist of the Year at the Pharma Awards.

The Co-operative Pharmacy is an expanding force in community healthcare with nearly 800 branches and over 6,000 employees, providing dispensing services, health and lifestyle advice.

Our new National Distribution Centre, which was opened in Stoke on 28 October, is set to enhance business performance.

Over the past year we have continued our branch refurbishment programme with a further 221 branches adopting the new brand.

The Co-operative Funeralcare has once again delivered an outstanding performance during 2009 with sales during the year up from £274m to £287m. Operating profit before significant items increased by 11.5% from £39.2m to £43.7m.

In delivering these results, providing exceptional client service remains central to Funeralcare's strategy. Significant investment in Funeralcare's premises, vehicles and staff has continued throughout the year; in turn standards audit scores and client feedback scores continue to rise and Funeralcare proudly achieved the best mystery shopping results across the entire Co-operative Group family of businesses.

At the beginning of the year, Funeralcare launched its first ever national TV advertising campaign and also launched several highly successful PR initiatives to raise awareness of the options and choices available when arranging a funeral such as the funeral music charts, a story which achieved national media coverage. Following the success of the story, Funeralcare went on to record 'Songs of Solace' with the Glasgow Phoenix Choir and The Co-operative Funeralcare brass band – both sponsored by the business. This compilation CD of the tunes most played at funerals proved to be popular and went on to be awarded a silver disc!

The business is also a proud sponsor of the World Bowls Tour and was title sponsor of the World Matchplay Event televised live on Sky and the Scottish International Open Championship televised on BBC Scotland. These sponsorships provide valuable support for the bowls sport and raises awareness of the Funeralcare brand.

Teams from across the business have carried out over 4,500 community marketing activities and have invested significantly in local communities helping to build valuable links with the communities it serves, raise positive brand awareness and promote our co-operative difference.

During the summer, Funeralcare attended a number of county shows, helping to make Funeralcare more accessible to the general public as they can feel more comfortable approaching teams and discussing a very difficult subject in this more informal setting rather than at a funeral home. Funeralcare also continues to work closely with the Royal British Legion and this year donated air fresheners for them to sell online raising a massive £35,000 for the charity.

Funeralcare continues to expand its business portfolio following the merger with Plymouth & South West Co-operative Society with a further 32 funeral homes joining The Co-operative Group. The business also acquired a new woodland burial site, Mayfields, located on the Wirral, Merseyside.

2010 is set to be another challenging year; the business remains focused and determined to build on its 2009 achievements and realise its aim of becoming the best funeral director in the world.

Last year we held over 550 woodland burials across our three beautiful woodland sites.

Funeralcare is a proud sponsor of the World Bowls Tour and supports a number of local and regional bowls clubs, leagues and tournaments across the UK.

Travel

In the worst recession for 60 years and the most challenging year for the Travel industry, sales in our Travel business fell by 5.9% from £262m to £246m, leading to an operating loss before significant items of £2.3m, down £7.6m on last year. To mitigate the impact of lower volumes, action was taken during the year to both reduce the cost base and improve business efficiency, including consolidation of our profitable call centre businesses and changes to the business model within our Homeworking Division. This work has helped to ensure we are better placed to benefit from the future recovery in the economy.

2009 saw the launch of our own tour operation 'Co-operative Holidays', in partnership with Cosmos, and the continued growth of our dynamically packaged beach holidays. Sales through our new website, www.co-operativetravel.co.uk, grew rapidly in 2009 as we further developed the site, and our Travel business was voted National Retail Travel Agent of the Year at the British Travel Awards.

Legal Services

Our Legal Services business had an excellent year with sales up 45% from £14m to £20m and with operating profits before significant items up £2.1m from £1.7m to £3.8m. In a short period of time we have established the business as a significant provider of personal injury claims management services to internal and external business partners. In addition, we have become one of the leading providers of wills, probate and estate administration services in the UK, supporting not only customers of Co-operative Funeralcare but also those of other societies within the Co-operative Movement and of external partners.

Life Planning

With sales up 73% from £18m to £31m and an operating profit before significant items up £2.6m from £1.9m to £4.5m, our Life Planning business enjoyed another record year. Success continued to be driven by broader distribution, continued product innovation and greater customer awareness. 2009 has seen the investment and planning carried out in 2008 really start to reap dividends. For instance, our legal charge product which was launched the previous year, in partnership with Axa, went on to surpass all expectations.

Travel colleague Shelby Bunn was our top seller of Co-operative holidays in 2009.

We launched our own tour operation with Cosmos last summer and for the first time we're with our customers all the way to the resort and back.

We provided personal injury claims support for more than 10,000 people during 2009.

Sunwin Services Group
2009 has seen Sunwin Services Group continue the growth begun the previous year. Sunwin Security and eSolutions have both worked hard to expand their business and Aegis has worked tirelessly to reduce costs and provide an industry-leading service which is now being extended to Somerfield stores. Overall, sales were up by 28.9%, from £22m to £28m and operating profit before significant items was up £3.8m, from £0.7m to £4.5m.

Motors
The current economic climate has undoubtedly impacted upon the Motor business with turnover decreasing by 5.5% from £209m in the previous year to £198m, and profit decreasing to a loss of £1m. Whilst the Government's scrappage scheme has stimulated sales of new cars, this has adversely affected margins with reduced interest in higher margin used cars. The business also began rebranding in 2009, from Sunwin Motors to The Co-operative Motor Group, and this will continue in 2010, thereby taking advantage of a wide range of synergies with the other businesses in the Group as well as renewed consumer awareness of The Co-operative as a trusted brand.

E-Store
Despite continuing challenges presented by a fiercely competitive market, our Electrical business has had an excellent year in 2009, with Internet sales up 36% compared to last year. The electrical industry in the UK was approximately 10% down in 2009, and the on-line electrical sector finished the year level, measured against 2008. Considering these industry figures, it is apparent E-Store has again increased its market share during the last 12 months. Total sales including our buying group increased by a significant 54% compared to the previous year, with Co-operative Societies also performing well measured against the sector. Anglia and Channel islands also joined the buying group during 2009, which has assisted the buying group in achieving its volume growth.

Corporate Clothing
If 2008 was the year in which our corporate Clothing business was brought into the 21st century – relocating to a state-of-the-art new facility in Washington in Tyne and Wear, and expanding to incorporate a whole host of new contracts – then 2009 has been the year in which all of that hard work has started to yield real dividends. In another hugely competitive market, Clothing has done a commendable job minimising the impact of a reduction in the volume of catalogue sales to deliver sales up 7% to £4.4m, with profits of £0.3m, up £0.5m. Following a period of such rapid expansion, 2010 will see the business look to consolidate and drive improvements, specifically in the areas of customer service and delivery.

In contrast to most online businesses in the UK, E-Store recorded a 36% increase in sales in 2009.

Sunwin has improved our customers ATM availability by reducing the average down time for service from 12 hours to 5 hours.

We started to rebrand Sunwin Motors as The Co-operative Motor Group during the course of 2009.

Estates

Our Estates business performed well despite the impact of the credit crunch. Turnover was slightly down from £34m to £33m due to surplus asset disposals and tenant bad debts, and trading profit down £1.6m from £20m to £18.4m. Despite a difficult market the valuation of our underlying investment portfolio increased by £3.5m to end the year at £321.6m. This is expected to improve further as the property market emerges from the recession. Through an ongoing initiative to reduce energy costs the division is saving our businesses £14m per annum, a 20% saving on a 2006 like-for-like basis. Estates is also driving forward the Group's new Head Office and Masterplan and, having completed the detailed design, work has now begun on site. Our Corporate Procurement department made an important contribution to the Group helping guarantee significant savings.

Farms

2009 has been another year of steady performance for our farming business, with an overall profit of £4.2m, a decline on the previous year driven by cereal prices, but a growth in potato packhouse profits. We have seen further expansion of our unique 'Grown by Us' range, with new products including carrots, sweetcorn and turkeys, but the key aspect of growth for the business has been the increased depth of distribution as products have been rolled out throughout both the Co-operative and Somerfield estates. The business was also included in both the high profile brand advertising campaign and Food's Christmas advertising campaign, which helped to raise its profile. The Co-operative Farms won Farm Business of the Year at The Farm Business Magazine Food & Farming Industry Awards, as well as Farmers Weekly Farmer of the Year and Green Farmer of the Year.

National Business Crime Partnership Manager, Andrew Pope, received an OBE for his work to create a truly national picture of retail crime in the UK.

Nick Padwick was judged Farm Manager and Farmer of the Year at the Farmers Weekly Awards 2009.

Our new head office, due to be completed in 2012, will be outstanding in its environmental credentials, will significantly reduce our long-term overhead costs and provide a modern working environment.

Our 'Grown by Us' Truly Irresistible Tillington 1,000 pressed apple juice is produced from 1,000 varieties of rare and endangered British apples.

Our values & principles and, in turn, the reputation they have earned us with our customers and members, have provided us with considerable strength at a time of reduced confidence in business. A 'flight to trust' saw current account openings at The Co-operative Bank increase by some 38% in 2009, while sustained growth was seen in like-for-like Food sales.

We continue to lead the way in many of the areas of sustainability that matter to our customers and members. This leadership has been recognised, during 2009, through a host of accolades: not least, our number one 'green' ranking amongst supermarkets, and our ranking as the bank that customers were most likely to recommend, in the Concerned Consumer Index; Retail Week's Responsible Retailer of the Year; the RSPCA's People's Choice Supermarket Award; Business in the Community's (BitC) Environmental Leadership Award; and leading rankings for CFS and the Group in BitC's Corporate Responsibility Index.

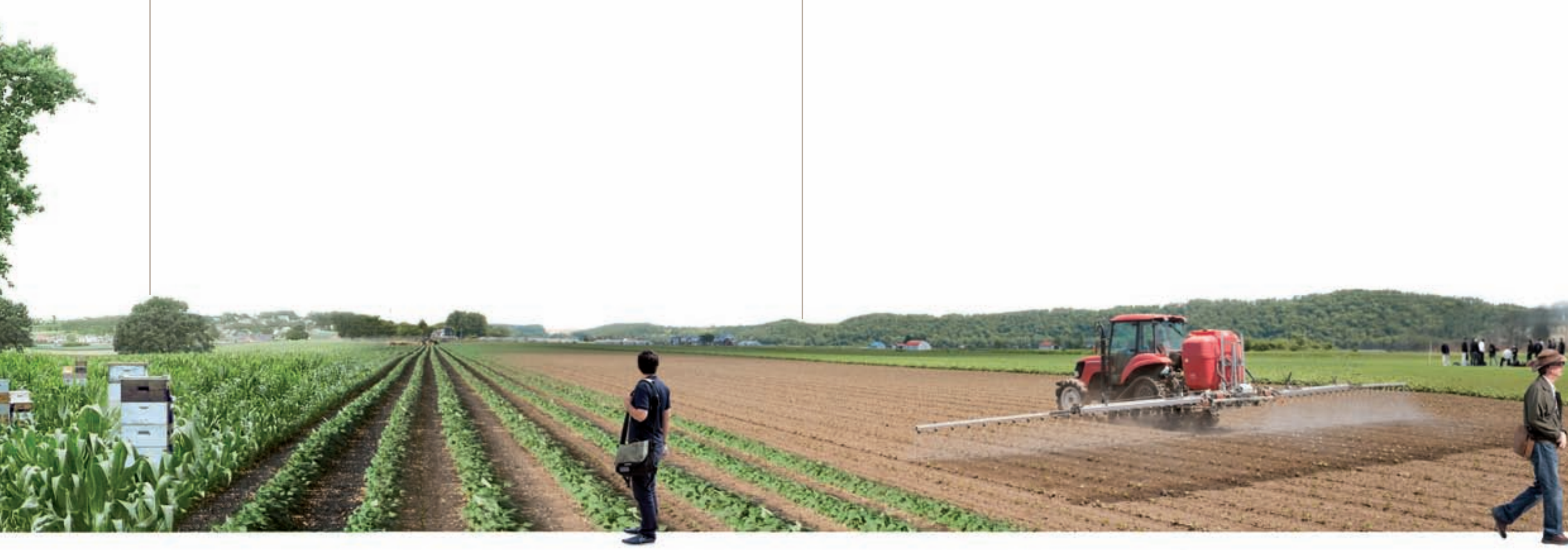
As a co-operative business, we have long recognised the benefits of consulting our stakeholders on the issues that matter most to them and developing our approach accordingly. 2009 saw the launch of a new customer-mandated Ethical Policy for The Co-operative Bank, the introduction of new initiatives that support the member-directed Ethical Policy of the Food business, and considerable progress being made to address the three themes of our member-endorsed Community Plan: inspiring young people, combating climate change and tackling global poverty.

We estimate that at least 250,000 young people in the UK are benefiting from investments being made by The Co-operative. Operating in some of the most deprived wards in England and Wales, The Co-operative StreetGames Young Volunteers programme provides young people with the opportunity to develop their sports coaching and community leadership skills. For some, this can even provide a valuable route into paid employment or other youth work. Since it was launched in October 2007, the project has seen 1,150 young volunteers give 27,000 volunteering hours to help develop sport in their local communities. StreetGames is now a National Partner of Sport England and is regarded as a national centre of expertise for developing doorstep sport in disadvantaged communities.

A major new grants programme launched in 2009, the Truth About Youth, will provide significant financial support for other young people's initiatives – some £280,000 being made available in each of the Group's seven democratic regions. Grants were awarded in 2009 to YWCA – a charity working with young disadvantaged women in Cardiff – and to Envision in Birmingham. Grants in each of the remaining regions will be made throughout 2010.

English set honey is a rarity but at The Co-operative Farms we are supporting British bees, with over 500 hives across our farms in 2009.

In 2009 17,500 primary school children visited The Co-operative Farms to learn about healthy eating, where food comes from and how it reaches our stores.



Following its endorsement by members as a key Community Plan theme, we stepped up our commitment to international development in 2009, pledging an additional £1m to tackle global poverty (over and above existing revenue commitments, such as Fairtrade premiums). This funding is being deployed in a number of ways. It will support development uplift projects in communities where we already have a relationship, with a focus on water, sanitation and renewable energy solutions. For example, we recently initiated a project with communities in Malawi that supply our own-brand sugar; providing over 30 boreholes, 1,000 latrines and fuel-efficient stoves to benefit some 10,000 people. Secondly, we are supporting overseas co-operatives, to help people lift themselves out of poverty, with initiatives agreed in 2009 with the Co-operative Travel, Funeralcare and Food businesses. A Co-operative Food project in Kenya, match-funded by the Department for International Development, will help 8,000 smallholder tea farmers to organise together as co-operatives. The project will yield improved marketing opportunities and provide assistance with achieving Fairtrade certification, making farmers eligible to supply tea for The Co-operative's flagship 99 Fairtrade tea blend. We estimate that over 500,000 people in the developing world already benefit from the activity of The Co-operative Group each year, with new initiatives increasing this impact still further.

We have taken an holistic approach to combating climate change – addressing our direct impacts as a business, investing in renewable energy and energy efficient technologies, funding carbon offset projects and campaigning for change. In 2009, 2,500 Co-operative members and their families joined The Wave, a march in London calling for a safe and fair deal ahead of the United Nations Climate Change summit in Copenhagen. This was the biggest mobilisation of our membership base in recent times and helped make The Wave the largest climate change protest ever held in the UK. We also ensured that the issue of the exploitation of unconventional fossil fuels, such as Canadian tar sands, was never far from the public eye. Closer to home, our walking buses and Green Energy for Schools programmes continued to be rolled out, with schemes operational at 224 and 185 schools respectively by the end of the year.

Nearly 1,000 Santas joined the inaugural 5K Co-operative Santa Dash in December, raising money for the Group's Charity of the Year, RNID. Adam Young from Group Pensions was the first to cross the finish line.

Almost 20,000 hours were given by Co-operative StreetGames volunteers in 2009 to support local sports programmes for young people in deprived areas.

During 2009, over 300,000 packets of wildflower seeds were given away to our members and customers as part of Plan Bee.

Our campaigning activity continues to take our sustainable development approach to a fundamentally different level to that of other businesses. Throughout 2009, we put pressure on Government to support the creation of marine reserves around the UK coast to protect threatened fish stocks. This campaign reached a successful conclusion in November when Parliament legislated to establish a network of marine reserves by 2012. Our commitment to maintaining biodiversity also led us to launch Plan Bee – a 10-point plan to save the honey bee. Through the Group's support, new research has been made possible. Members have also been mobilised to make their gardens more 'bee-friendly', through free wildflower seed giveaways, and a film 'Vanishing of the bees' has been distributed in cinemas throughout the UK to highlight the plight of the declining bee population.

Our support for films with powerful social responsibility messages saw us also help to bring the Oscar-nominated film 'Burma VJ' to a much wider UK audience. The film tracks the brave new breed of young video journalists who put their lives on the line to tell the real story of the 2007 Burmese uprisings and the subsequent repression by the ruling military regime. The Co-operative is adding its voice to the campaign to free the people in the film, who have been incarcerated for filming the uprisings.

Our colleagues and members make a massive contribution to the success of our sustainability and community investment programmes. Their passion for such activity is no better evidenced than by the staggering £3.7m that was raised for 2009's Charity of the Year, the Royal National Institute for the Deaf and £3m raised for Somerfield's charity, Macmillan. This fundraising effort is in addition to the £11.3m of community investment made by The Co-operative Group in 2009 – some 3.8% of our pre-tax profits – which will support thousands of community initiatives in the UK and overseas.

Pride of The Co-operative winner and Travel colleague Libby Gray is one of our most committed fundraisers, and campaigned on behalf of a local meningitis charity in Stockton-on-Tees.

The merger of The Co-operative Financial Services and Britannia has created a stronger, more diverse, co-operative offering in the financial services industry. The Co-operative Bank's Ethical Policy was relaunched in early 2009 with a series of new agenda-shaping banking propositions that further cement the bank's commitment to international development, animal welfare and the environment.

At the end of 2009, 185 schools were benefiting from our Green Energy for Schools programme, including St Peter's RC High School, Manchester, which received solar panels.

We work with schools across the UK to support co-operative ways of working. Our involvement includes the sponsorship of two academies, the development of a network of Co-operative Trust Schools and support for 10 Business & Enterprise colleges including St Peter's Roman Catholic High School (below).

Existing and potential corporate and business banking customers are screened to identify any business practices that pose conflicts with the Policy which, from August 2009, has extended across the enlarged business. In 2009, 43 finance opportunities were found to be in conflict with the Policy and were, therefore, turned away by the bank, whilst commercial lending continued to grow. The launch of two new funds by Co-operative Investments responded to market demand for lower-risk investments in sustainable businesses, and greatly expands our offering to the responsible investor.

Our commitment to ecological sustainability did not wane as we brought several businesses into The Co-operative Group family. Alongside the enormous amount of behind-the-scenes work that took place to ensure we remain at the vanguard of ecologically responsible businesses, we progressed significant new packaging reduction initiatives, such that we met our 15% packaging reduction target by the end of 2009 – a year ahead of schedule. We also made a concerted effort to reduce the number of plastic bags given away to customers – recording a 60% reduction on 2006 levels at the end of the year. Our range of sustainably sourced fish was expanded, with the addition of four new products taking the total number of Marine Stewardship Council-certified products from 14 to 18. Our approach to marine stewardship also saw The Co-operative Food emerging first amongst eight retailers in the Marine Conservation Society's 2009 Supermarket survey. Alongside our efforts to stock responsibly sourced fish, we were praised for our campaigning work for marine reserves and the financial support provided to enable UK fisheries to become more sustainable.

Animal welfare remained a Food Ethical Policy priority in 2009. We extended the range of products accredited to the higher welfare Co-operative Elmwood chicken standard and introduced Elmwood turkey products, adapting some 151 supplier farms to meet the standards. All premium range own-brand Christmas turkey products were 'Reared by Us' sourced from free-range traditional bronze turkeys reared by our farms. We converted our entire range of own-brand pre-packed bacon and gammon to British, in an initiative that raises animal welfare standards, whilst supporting 300 British pig farmers. We also sought to ensure that all our premium own-brand Truly Irresistible fresh pork, bacon and sausages would be made using RSPCA Freedom Food-accredited, outdoor-reared Hampshire breed pork, and have developed Elmwood pig meat standards for introduction into our own-brand pork and sausage range in 2010.

Through this, and hundreds of other initiatives, we will continue to ensure that responsible business practice remains a key business priority in 2010 and beyond.

We estimate that at least 250,000 young people in the UK are benefiting from investments being made by The Co-operative Group.

The Co-operative Food was ranked first out of eight retailers in the Marine Conservation Society's 2009 Supermarket Survey.

At the end of 2009, 99% of our electricity came from renewable sources.

Looking forward

Clearly, 2009 was an excellent year for The Co-operative Group, propelling us back into the Premiership of UK retailing and putting us in great shape to capitalise on the range of opportunities open to us.

Looking ahead, we have to make sure that we navigate the ongoing choppy waters of the recession shrewdly and with prudence. It may be that the UK does not start to see real economic growth until the end of 2010 or as late as the beginning of 2011 – but that must not hinder us from celebrating what we have achieved so far and what we plan to achieve in the coming months. We will be looking to see our Food and Financial Services businesses enjoy the benefits of greater scale, passing on greater savings and improved products and services to our members and customers. We will also be looking to see our other businesses prosper as the economic climate begins to improve. The Co-operative Group is a unique business with an unrivalled diversity of interests. We have to make sure that our recent successes lead to even greater achievements in the year ahead, as we consolidate last year's progress and use it as the springboard which takes us forward in the second decade of the 21st century. Sustaining the success we have enjoyed in recent years will not be easy, but I know we have the talent and the ability to seize the opportunities we have provided for ourselves through our own efforts so far. While success in business, as elsewhere in life, is never guaranteed, I believe we have never been better placed to drive The Co-operative Group forward in the years to come. With the continuing support of our elected members, as well as our staff and management, I know we can achieve even greater things in the next few years.

Peter Marks
Group Chief Executive

Peter Marks
Group Chief Executive

Patrick Allen
Director of Marketing

Mike Austin
Managing Director
Specialist Commercial Businesses

Richard Bide
Director of HR

Neil Braithwaite
Managing Director
Specialist Retail Businesses

David Hendry
Managing Director
Funeralcare

Tim Hurrell
Managing Director
Food

Moira Lees
Group Secretary

John Nuttall
Managing Director
Healthcare

Lynda Shillaw
Managing Director
Estates

Martyn Wates
Chief Financial Officer

The financial statements for 2009 reflect an excellent year for the Group. The acquisition of Somerfield and the merger with Britannia and Plymouth & South West Co-operative have provided significant challenges around integration of structure, systems and the brand going forward. These challenges have been addressed and considerable progress has been made to date, with full integration planned during 2010.

Revenue
Group revenue before reinsurance premiums was £12.5bn in 2009, an increase of £3.1bn (33%) on 2008. Revenue in the Trading Group was up by £3bn with most of this due to the Somerfield acquisition in February. However, it must be noted that this year only includes a 51-week trading period compared to 52 last year. Strong performances have been achieved in several Trading areas. Food business like-for-like sales were up 5.5%, 1.8% ahead of the market and Funerals sales despite the declining death rate were 5% higher than prior year. A number of smaller businesses, Sunwin Services, Co-operative Legal Services, Co-operative Life Planning and E-Store all achieved significant increases in sales revenue, which compensated for Travel, Motors, Farms and Property which suffered due to the economic climate and market conditions.

Our Financial Services business emerged in good shape from the global crisis prompted by the credit crunch and the subsequent worldwide recession. This was due principally to the business being underpinned by strong capital reserves. Overall Financial Services Revenue (including Britannia from 1 August 2009) but before reinsurance premiums and long-term business was above last year by 8.4% at £1.6bn.

Operating profit
Group operating profit before significant items was £612m, £219m (56%) higher than 2008. This includes a fair value amortisation of £99.1m in respect of the Britannia merger. Trading Group profits of £378m were £103m (38%) up on the previous year. This figure is boosted by a significant improvement in the valuation of investment property (2009: £3.5m gain, 2008: £62m loss) offset by the reduction in one-off underlying trading profits from the disposal of fixed assets (2009: £36m, 2008: £58m). Excluding these, underlying trading profits were 21.6% higher than last year's £278m at £338m, albeit that 2009 was a 51-week trading year versus 2008's 52 weeks.

The Co-operative Financial Services (CFS) shareholder profit before tax, FSCS levy, significant items, short-term investment fluctuations and fair value amortisation for 2009 was £177m compared with £147m in 2008. These results reflect the business' success in maintaining profitability despite the continuing weaknesses of the financial services market, while underlying capital and liquidity positions continue to provide the foundations for stable growth.

The CFS retail business remained profitable despite the low interest rate environment and the economic recession. The long-term business which is run in the interests of policy holders achieved target levels across the board, with new business premiums for 2009 13% ahead of 2008. Commercial and Markets (CAM) profits increased on a like-for-like basis from a £4.4m loss to £113.2m profit, an increase of £117.6m, being driven by improved margins and rigorous cost control but also by the recovery from the investment provision made in 2008.

Significant items totalled a net figure of £109m in 2009 compared with £117m in 2008; £54m related to integration and restructure costs in CFS. The Trading Group costs of £55m were principally the integration costs relating to Somerfield offset by the disposal of Food stores both compulsory and tactical due to this acquisition. Group operating profit after significant items was £503m, an increase of £228m (83% on the 2008 figure of £275m).

Financial income and expense
Net interest payable was £108m compared with £36m in 2008. This principally reflects the increased levels of borrowings to finance the Somerfield acquisition that took place in February 2009 and the level of refits and rebranding that took place subsequent to this transaction. The structure of this refinancing involved a bridging loan, which was paid back within the timescales required due to planned tactical and OFT disposals. The mark to market movement in 2009 was a charge of £35m compared with a charge of £83m in 2008. This predominantly reflected movements in quoted debt and fixed interest hedging arrangements due to reductions in long-term interest rates, partially offset by gains on foreign currency movements.

Payments to and on behalf of members
The Group paid out over £100m to and on behalf of its members during the year. A dividend of £96m was approved at the June 2009 AGM and a further interim dividend of £11m was approved at the November 2009 half year meeting, a total of £107m.

Dividend strategy
The Group's policy is to distribute a maximum of 40% of profits available for distribution to and on behalf of our members. Profits available for distribution are broadly underlying trading profits less underlying interest and tax.

The policy determines that distributions are allocated across our stakeholder groups as follows:

	Allocation	Notes
Individual and Corporate members	70%	The split between Corporate and individuals is determined by their relative economic participation in the Group
Employee members	20%	
Community	10%	The Board can cap this at £10m at their discretion

The relative economic participation of Corporate and individual members is determined by the proportion of federal trade that Corporate members conduct with various Co-operative buying groups across our businesses (principally Food, Travel and Healthcare) relative to our total retail trade with the public. Based on this formula, individual members receive broadly three quarters of the 70% of total dividend available with a quarter going to Corporate members.

The amount available to individual members is used to fund member activity (historically around £6m to £8m) with the balance being distributed across our individual members, based on their trade with the Group. During 2009 our customer members will receive 2p for every point earned from trade with the Group. Points are earned across our businesses from bank accounts, mortgages and insurance policies in CFS to holidays in the Travel business, the vast majority of purchases in our food stores and in many other areas. The rate at which points (worth 2p this year) are awarded varies depending on product type – for example whilst every £1 spent on qualifying purchases in a food store is worth one point, amounts borrowed or invested in a mortgage or current account will accrue points at a different rate.

The allocation of Corporate dividend to each Corporate member is based on the proportion of federal trade that they undertake with the Group.

All employees who are members receive the same dividend, regardless of their salary, albeit pro-rated for part-time workers and starters and leavers in the year.

Community dividend is made available to members to decide how it is distributed. The awards paid out to communities from this dividend are determined by members principally through the Values & Principles Committee and examples of the key beneficiaries this year are included below and in more detail in the Group's

Sustainability Report. This fund is also used to support the Co-operative Movement and its charities and a small charge is made to cover the costs of administering the funds.

The policy determines that distributions are allocated across our stakeholder groups as follows:

	£m
Payments to and on behalf of individual members	54.5
Payments to and on behalf of employee members	23.0
Payments to and on behalf of corporate members	19.6
Payments to and on behalf of the community and fellow Co-operatives	10.0
	107.1

Payments to and on behalf of individual members
This comprised payments of £48m to customer members based on their trade across all of our businesses including Food, Banking, Insurance, Travel and many others. The payment represented a reward of 2p for every £1 spent with us by our customer members. A further £6.5m was spent supporting and promoting activity and initiatives on behalf of, and determined by, our individual members.

Payments to and on behalf of employee members
Our employees who are also members of the Group are a very important stakeholder in our business and received total distributions of £23m calculated based on hours worked and length of employment during the year with leavers and starters receiving a pro-rata payment. The payment represented a full-time equivalent of £500 per employee and is seen as a key element of our stakeholder strategy.

Payments to and on behalf of corporate members
The payment to our Corporate members of £19.6m is also based on federal trade conducted with the Group including participation in joint buying groups across principally, although not exclusively, our Food, Travel, Petrol and Pharmacy businesses. The distribution represented a £1.24 dividend for every £100 of qualifying purchases.

Payments to and on behalf of the community and other Co-operatives
Finally a further £10m was allocated for distribution to and on behalf of communities and to support the wider Co-operative Movement. The beneficiaries of these funds in 2009 and in future years are decided by our members and full details of all key initiatives are presented in our Annual Sustainability Report which will be published shortly. During 2009 we paid £1.9m to support the Co-operative Movement and £7.0m to communities including support for our two main charities (Co-op Action Ltd £1.2m and the Charitable Foundation £840k), as well as for the Green Energy for Schools project (£650k) and Business in the Community (£239k).

Payments in respect of profits earned during 2009 are anticipated to be £98.9m including the £11.3m interim dividend already paid. This represents £19.4m proposed to corporate members, an individual dividend of £49.8m, community distributions of £9.9m and an employee dividend of £19.8m. This is subject to the approval of members at our AGM on 22 May 2010.

Discontinued Operations
The Discontinued Operations relate to the Somerfield stores that have been disposed of during the year. The net post tax loss of £20.1m includes the effect of the disposal of the Somerfield stores and the interest on the bridging loan which was directly attributable to the stores acquired with a view to resale.

Taxation
The tax charge on continuing business is £114m (2008: £2.9m credit) excluding £6.4m (2008: £52m credit) relating to tax attributable to Co-operative Insurance policy holders' returns. The charge excluding tax relating to policy holders is £121m (2008: £55m credit). The effective tax rate is 38.8% compared with a standard rate of 28%. A reconciliation of the standard rate of tax is shown in Note 13.

Balance Sheet Capital and Reserves
The Group Balance Sheet has increased in both size and strength from £3.9bn to £4.5bn. This is principally due to the CFS merger with Britannia as well as the retained profit for this period. These have been offset by significant actuarial losses on the Pension fund of £546m.

Group fixed assets as mentioned have grown principally due to the acquisition of Somerfield, the merger with Plymouth & South West Society and the increased refit and brand activity on the newly acquired stores. Working capital levels have increased year-on-year to deal with requirements of the larger business. The key banking covenants that were introduced on the restructuring of the Trading Groups' finance for the Somerfield acquisition were all comfortably satisfied with significant headroom.

Co-operative Financial Services has maintained a strong Balance Sheet continuing to pursue a policy of financial prudence, maintaining high levels of capital and excellent liquidity and funding levels. The Bank has a capital ratio of 13.6% after the deduction of fair value merger adjustments. The tier 1 ratio is 9.0% with a core tier 1 of 8.6%. These ratios have all increased since 2008, again demonstrating the strength of the merged business. Meanwhile, the Bank has maintained its high level of customer funding ratio of 104%.

At 31 December 2009, the realistic working capital within the Co-operative Long-Term Business Fund, being the excess of the realistic values of assets over the realistic value of liabilities, stood at £1,008m compared to £573m at the start of the financial year. Excluding the effect of gilt repos and reassurance collateral arrangements, this represents a working capital ratio of 7.2% compared to 3.7% at 10 January 2009. The Balance Sheet performance for the Corporate banking operation indicates that we have continued to develop the lending side of the business. The business is focused on a tight lending policy, a prudent lending approach and supporting existing and long-standing customers. Meanwhile deposit growth is strong, indicating that customers remain confident in CFS.

Pension costs
In 2009 there is a £5m charge to the Income Statement (2008: £28.7m credit) comprising a £53m current service cost (2008: £52m), interest on liabilities charge of £332m (2008: £313m) and expected return on plan assets credit of £380m (2008: £374m). There has been no curtailment benefit recognised in the Income Statement (2008: £19m credit).

During the year, the Group has acquired a number of pension schemes – including Somerfield, Plymouth & South West and Britannia with an impact on the Income Statement of £5m current service cost, interest on liabilities of £38m and expected return on plan assets of £32m.

Actuarial losses on liabilities of £771m (all schemes) have arisen from an increase in inflation of 0.55% during the year and a decrease in the discount rate of 0.1%. These losses have been offset by actuarial gains on assets of £227m that relate to higher than expected asset returns broadly reflecting the stabilisation of the Stock Market value during the year. The above factors in the Income Statement, Statement of Comprehensive Income along with the acquisition of the aforementioned schemes have combined to move the opening surplus in the Group Balance Sheet of £257m to a closing deficit of £284m.

Key performance indicators

The Trading Group and Co-operative Financial Services (CFS) have a common set of strategic priorities focusing on profitability, customer and employee satisfaction, and social and corporate responsibility.

The different nature of the markets in which the Trading Group and CFS operate means that the measures developed to track their strategic objectives are slightly different and therefore are considered separately. The one exception to this is in the area of growing and engaging membership.

Growing and engaging membership
Increase in active members
The Co-operative Group is jointly owned and democratically controlled by its members. Members of The Co-operative enjoy a share in our profits and can exercise their democratic control, with equal rights and benefits. Growing a strong and committed membership base is integral to our vision and beliefs and is an integral part of our brand. Growing engagement with our customers via membership is a key element in delivering competitive advantage and social goals.

Whilst we are committed to growing our membership base, we recognise the importance of ensuring that our members are engaged with The Co-operative. True engagement will be reflected in both transactional and democratic participation. The focus in 2010 will continue to be to drive active engagement from our members. This will be demonstrated by increasing participation rates across the diverse range of businesses offered by The Co-operative Group, so that individual members transact with multiple businesses. In 2009, 783,511 members traded with more than one business; this is an increase of 43% on the previous year. Inevitably, this type of activity will also attract new members. In 2009 we recruited 738,000 members, which was above the target of 720,000.

Growth in total points earned
A key element of the brand and membership programmes has been the introduction of a true dividend where members receive a share of our profits by way of a dividend, the scale of which is directly determined by the value of trade that they have carried out across our various businesses.

As part of our aim to grow and engage membership, therefore, we track the total value of points earned by members through their trade across our businesses. Members earn points based on their trade with the Group's businesses including Food, Travel, Banking, Insurance and many others. The total points earned by members are captured within our dividend system and determine, for each individual member, the size of their share of our profits. In 2009 members earned 2,456 million points (2008: 1,912 million points) an increase of 29% on the previous year.

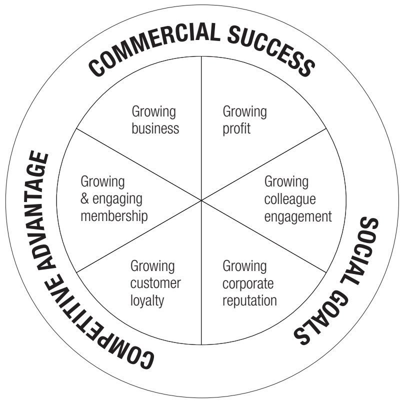
Growing corporate reputation
In 2009, The Co-operative Group began using Business in the Community's (BitC) Corporate Responsibility (CR) Index to measure progress towards its strategic objective of growing corporate reputation.

The CR Index provides a benchmark for businesses to evaluate their management practices in four key areas of corporate responsibility (community, environment, marketplace and workplace) and performance in a range of environmental and social impact areas. It is a survey that is checked and scored by BitC, and is widely considered to be the foremost UK-based CR benchmark. In 2009, 126 organisations publicly participated in the Index.

In 2009, The Co-operative Group attained a score of 96.5%, achieving a 'Platinum' ranking. The Group scored 100% in five of the seven areas covering strategy, integration and management practices (corporate strategy, integration, community management, marketplace management and assurance processes). 100% scores were also attained in three of the six impact areas (climate change, community investment and responsible products and services).

Going forward, the Group will be seeking to maintain or improve on its Platinum rating and address performance in those areas that scored below the sector norm.

Trading Group
The key performance indicators (KPIs) of the Trading Group are constructed around the key elements of its strategic direction, focusing on competitive advantage, commercial success and social goals, and specifically target the six key aims of:



Growing profit
Underlying trading profit is a key measure because it tracks the underlying profitability of the Group from ongoing trading before any one-off or non-trading items such as property disposals, changes in the investment property portfolio or significant one-off integration costs or business disposal profits. As reported elsewhere in this report, the result for 2009 was £338m, an increase of 22% on last year and in excess of budget.

Growing business
Achieving sales growth is clearly a key element of growing business. The Trading Group aims to increase its share of its customers' spend year-on-year, such that the Co-operative Group takes an increasing share of the markets across which it operates. Within each of the business areas, like-for-like sales and market share are tracked and these are referred to in the business review on pages 6 to 21.

Growing employee engagement

The 2009 employee attitude survey was the most successful ever, with over 64,000 (85%) people choosing to respond. The independently conducted survey (now in its sixth year) measures the level of employee engagement, as well as capturing a colourful snapshot of the overall employee experience.

Using the Group's own extensive database of responses, high levels of employee engagement continue to be reliably linked to positive outcomes for business performance and employee experience.

The 2009 results reflected a general improvement in most aspects of the employee experience. Perceptions of some aspects of The Co-operative brand had improved significantly since 2008, as had general perceptions of the local working environment.

This year, around 5,000 results and action planning packs were distributed to managers, to enable a plan to be discussed and implemented within teams that will continue to change people's working lives for the better.

The engagement measure is expressed as a score between 0 and 100 and the 2009 score is 79, which is a two-point improvement over the score of 77 achieved in 2008.

CFS

Key performance indicators

Performance against our vision – to be the UK's most admired financial services business – is a balance between customers, people, processes and financial strength.

Customers

The Co-operative Financial Services offers a clear, simple customer promise – one that is fair, easy, responsible and personal. This proposition is proving particularly attractive, both to existing customers and those seeking a different relationship with their financial services provider.

Among existing banking customers, satisfaction with front line delivery remains consistently high, with branch service attracting 'satisfied/very satisfied' scores of 90%, telephone service scores up to 88%, financial adviser and online ratings of 88%, and direct sales (telephone) 88%. These ratings demonstrate our singular focus on putting our customers first.

Within our insurance business, customer satisfaction continues to compare favourably with industry norms, with General Insurance customer satisfaction nearly nine percentage points higher than the Top 5 market share score.

Meanwhile among our corporate customers, 90% are satisfied with their relationship manager, while 84% would recommend us to an associate.

During 2009, we have also been recognised by both customers and market commentators as a champion of co-operative principles. At the start of 2009 The Co-operative Bank was named Best Financial Provider by Which? Magazine; and as the year drew to a close we received the UK Customer Experience Award as 'best large company'. In the intervening months we received a number of other accolades:

- The Co-operative Bank and smile took two of the top three spots at Which's inaugural People's Choice awards, while smile and Co-operative Bank current accounts topped the Which? customer satisfaction charts with 91% and 84% satisfaction ratings respectively
- Co-operative Insurance won a platinum award for Motor Claims customer satisfaction from Consumer Intelligence
- Platform was named Best Intermediate Lender by Your Mortgage Magazine
- Our Corporate Banking operation was named small/mid-sized debt provider of the year.

Crucially, as a business that seeks to take both personal and social responsibility, The Co-operative Financial Services also became one of only seven businesses to be awarded the new 'platinum plus' rating from Business in the Community.

These awards have helped bring us to the attention of the wider consumer population. Current account sales have seen a 38% uplift at a time when many of our competitors are struggling to keep their existing customers. Meanwhile, life & savings new business premiums have increased by 13% and general insurance gross written premium by 8%.

People

In order to deliver our customer promise, it is vital that we create a great place for our people to work, grow and develop. The business has moved fast in the period following the Britannia merger, to establish a new strategy and leadership structure, minimising the inevitable uncertainty that comes with any major change, while seeking to deliver 'business as usual' to our customers.

A commitment to excellent communication has been essential; the Executive spent much of November on the road, taking the business' purpose, givens, vision and values to every colleague, helping them to understand our strategy and most importantly listening to their feedback on what it means to them. It is gratifying to note that colleague engagement levels remain extremely high across the business, with some 94% of colleagues stating that they are proud to work for The Co-operative Financial Services and over 91% stating that they are satisfied or very satisfied with CFS as an employer.

Processes

To support our people in delivering our customer promise, and to lay the foundations for sustainable long-term growth, we are investing significantly in the transformation of our systems and process infrastructure. 2010 will see the first phase implementation of a major programme to transform our banking systems infrastructure with the launch of a new, more customer-centred business banking service.

Financial strength

Our strategy is to generate underlying growth whilst maintaining both core financial strength and award winning levels of customer service. Our liquidity position remains excellent, with a customer funding ratio of 104% (excluding securitised assets); while our capital ratio stands at a healthy 13.5%. We have also maintained our focus on control of expenditure continuing the excellent cost control of both pre-merged businesses, with pro-forma 12-month operational costs maintained at prior year levels. Our business is determined to achieve commercial success within a framework of financial prudence and strength.

During a year in which much of our focus was on delivering a ground-breaking merger while maintaining 'business as usual' it is to the credit of colleagues across the business that profits have not only been maintained, but improved. Our underlying like-for-like profitability has increased by 3.4% to £174.3m.

Operational risk

Health & Safety

The Co-operative Group Health & Safety Policy Statement sets out clear and consistent responsibilities across all Group business areas and will ensure statutory compliance. The Statement has been endorsed by both the Executive and Business Heads.

Changes to legislation now identify those persons within the Society who have the direct responsibility to undertake management and control to ensure that they provide safe premises, safeguard the health & safety of all employees at work, and all persons who enter and who carry out work in or reside in Society premises.

The Group Board is regularly updated on their responsibilities with regard to health & safety and a bi-annual update and presentation will be provided showing achieved levels of compliance against agreed targets to reduce the exposure to risk for both individuals and the Group.

The Corporate Manslaughter and Corporate Homicide Act 2007 and the Health & Safety Offences Act 2008 legislation have imposed tighter controls on the implementation of previous legislation with clear ownership at senior levels within every business. This legislation will identify those persons responsible for failure, increase penalties and provide courts with greater sentencing powers for those who negligently fail to fulfil the requirements of health & safety legislation.

The following were identified by the Health & Safety Department as necessary provisions for all those persons within the Society who have responsibility for health & safety, to ensure compliance:

- A revised quarterly health & safety/fire audit process that will provide identification of compliance failure and remedial action
- Criteria for accident/incident analysis that will identify trends and causes, thereby targeting response and reduction
- A revised intranet 'safe working procedures' document, a health & safety manual and other policies that can be easily accessed and updated, which will provide guidance and information
- Revised training programmes from induction to refresher courses to establish improved health & safety awareness
- Improved policy and documentation controls for contractors, establishing levels of competence and management
- Standardised procedures and safe working systems for areas managed by facilities in response to significant findings
- Standard statutory compliance checks for high-risk areas
- Targeted health & safety standardisation across the Society
- A standard fire risk assessment process that will support the Society's fire safety compliance
- Partnership development with enforcement bodies that will provide support to the Society to establish safe working practices and procedures.

Business continuity

Business continuity is designed to enable the recovery or continuation of critical business activities in the event of a sudden, unplanned incident that could seriously harm employees or compromise our ability to trade.

Business continuity is managed centrally from within operational risk to support business operations within the Group. The three main objectives are to protect:

- Life
- The brand
- The business.

During the year, the Trading and Corporate business areas made some significant enhancements to improve their resilience to operational threats of disruption to our people and ability to trade. These improvements built upon the work achieved previously and were focused on extending our third-party recovery arrangements together with working towards the Group standard for business continuity.

One element of the Group standard includes recovery exercising and in 2009 more exercises were undertaken than ever achieved previously. Each business is assessed at least quarterly on its level of compliance against business continuity and this information is reported to a number of internal groups for review.

Data Protection

The Group is committed to the protection of all personal information being processed and recognises the importance of keeping all member, employee and customer information secure and confidential. The primary aim is to ensure that all parts of the Trading Group are aware of their responsibilities to enable them to comply with the Data Protection Act 1998. The data protection function is developing a consistent and co-ordinated management programme incorporating recognised industry best practice, based around the eight principles of the Act. Data Protection is managed centrally from within the Operational Risk department, by a dedicated Data Protection team.

In 2009, extensive work continued across the Group to deliver policies and procedures to raise awareness across the Group in all areas, including Data Protection, Physical Security, IS Security and the controls of Business Sensitive and Confidential Information.

Environmental compliance

In December 2009, environmental compliance became part of operational risk, with the following objectives identified as priority for 2010:

- Provision of business-specific legal registers for the Trading Group
- Delivery of comprehensive activities matrix and audit plan for each business
- Creation of environmental compliance intranet page and e-manuals, induction and computer-based training packages
- Establishment of a central 'Help Desk' for all incidents of environmental compliance enforcement
- Creation of a steering committee with representation from all key areas of the Group
- Provision of a 'live' environmental compliance risk map to the risk committee.

Principal risks and uncertainties

Managing our risks

Taking and managing risk is an inevitable part of doing business and, like all businesses, the Group faces potential threats and opportunities that could affect long-term performance. The key challenge is to identify the principal risks and to develop and monitor appropriate and proportionate responses.

A successful risk management process enables informed decision making based on assessment of the impact and likelihood of events, and balances risk and reward rather than seeking to eliminate risk entirely.

Our approach to risk management

The Group is a complex mixture of financial services and retail trading businesses. Each business faces a variety of risks that could compromise its performance and ability to meet strategic objectives.

The risk management process incorporates all divisions of the Group in order to maintain full and comprehensive reporting on the risks faced by the business.

The Group Board has overall responsibility for risk management, and for ensuring that the process is aligned to business strategy and objectives. Our risk management committees play a key role in monitoring our overall risk profile and regularly report to the Management Executive teams and Group Board through the Audit & Risk Committee. The risk committees establish the risk management framework and oversee the process, review principal risks and drive a culture of risk ownership. The committees report at least four times a year to the Group Audit & Risk Committee.

Group risks

The most significant risks faced by the Group and related mitigation actions are set out below.

Pension risks

The Group's pension arrangements are regarded as an important part of our rewards package for employees and a key element in the attraction and retention of our people.

As a result of recent mergers and acquisitions the Group operates a number of pension schemes, including final salary, defined benefit, and defined contribution schemes; the majority of which are closed to new members. The majority of pension scheme members belong to a Group-wide defined benefit scheme based on career average earnings (PACE). The PACE scheme is open to new members.

The Bank and Co-operative Financial Services Management Services (CFSMS) currently participate in PACE in respect of pre 1 August 2009 employees. Following its merger with CFS, Britannia's Pension Scheme (containing both defined benefit and defined contribution sections) passed initially to the Bank and then immediately afterwards on to CFSMS. CFSMS is the current principal employer and will account for the scheme with the Bank required to meet contributions. As an interim measure from the date of merger, new employees to CFS business are eligible to join the defined contribution section of the Britannia Pension Scheme.

These schemes are subject to risks regarding the amount of the liabilities as a result of changes in life expectancy, inflation, future salary increases, together with the risks regarding the value of pension scheme investments and the returns derived from such investments.

The Group and the schemes' trustees continue to carefully monitor the pension risks, taking action when necessary to adjust contributions to the schemes and revising the schemes' investment strategy to mitigate risks.

Business integration

In 2009 the merger between CFS and Britannia took place, and the Group acquired the Somerfield food business. In addition, the Plymouth & South West Co-operative Society members agreed a transfer of engagements to the Group. The successful integration of these entities is critical to our success, and failure to manage the integration change programme adequately could put at risk the objectives and financial targets of the Group.

The Group aims to minimise risks from these changes by adoption of disciplined project and programme management processes, use of experienced resources and close monitoring by Executive Management. Effective governance structures have been established to evaluate the capacity and prioritisation of the change portfolio. Reviews of each programme are undertaken on a regular basis, considering resource requirements, progress, dependencies between projects, and risks.

In addition to managing change to processes and systems, changes wrought by bringing together different working cultures also need to be managed in order to maintain engagement and retention of employees. Clear, relevant and timely communication of change is essential as well as investment in the training and development of colleagues.

Economic impact on consumer spending

The economic slowdown has resulted in additional risk in remaining competitive in the markets in which we operate, and adapting to changes in consumer spending patterns.

As customers have faced pressures on disposable income, reduced job security and limited availability of credit, the challenge of maintaining a competitive offering has increased.

Close monitoring of performance and regular reviews of business strategy are key to responding to the needs of our customers. We seek to continually improve our understanding of our customers to ensure we deliver a competitive offering of products and services that appeal across our different markets.

Financial and Treasury Risks

The key financial risk of the Group relates to the generation and availability of sufficient funds to meet business needs, and to deliver our member payment responsibilities. The Group is exposed to changes in commodity prices and fluctuations in interest and foreign exchange rates, which can impact on financial performance.

Energy procurement is managed centrally by the Group within a hedging policy mandated by the Board. The Treasury function is responsible for managing various financial risks, including funding requirements and financial exposures as set out in Note 54.

Damage to our reputation or brand

The successful rebranding programme has brought our businesses together under a single brand identity. As such, our various trading divisions are easily recognisable as being part of The Co-operative. The branding has also been adopted by a number of independent Co-operative societies.

Our brand has strengthened, and along with our ethical stance and membership offer, it is one of the cornerstones of our reputation which drives our continued success. Anything that could damage that reputation in any of our business areas – for example, a failure in maintaining our ethical policies or an issue in product quality and safety – could impact the size of our customer base across the Group.

We regularly monitor our corporate reputation and police our brand standards within stores through mystery shopper exercises. The Management Executive take steps to address any areas that are seen to be potential weaknesses.

Competition

The Group operates across a number of highly competitive markets. Many of these markets are mature, with relatively low underlying growth, and competition from large and well-established organisations. Failure to compete effectively against existing players would have a detrimental impact on our sales and profitability, so too would failure to anticipate or react to new entrants in any of our markets.

We actively and continually monitor the competitive landscape and follow trends and developments in our respective markets. We track our performance through the use of KPIs such as market share, price position, promotions and measures of quality and service. We also monitor customer perceptions to make sure that we continue to attract and retain customers by delivering on price, product range, quality and service.

Regulation

The Group operates in markets which are subject to various laws and regulations.

As a retailer, especially one in the field of food retailing, pharmacy and funerals, the Group is subject to competition reviews, health and safety and a variety of retailing legislation. This relates not only to the products we buy and sell, but also to virtually every area of our business, from packaging and labelling, to pharmacy dispensing and food hygiene. Failure to comply with relevant laws could have damaging consequences for our business, including punitive fines and harm to our reputation. Additionally, changes to existing regulation or regulators bringing new areas or products under control may have cost implications for the Group or may otherwise adversely affect our business.

Co-operative Financial Services (CFS) operates in regulated markets and is subject to significant Government regulation with the main regulator of CFS being the FSA. Regulatory intervention is an ongoing feature of UK financial services and changes could affect the profitability of our business. Within CFS the most significant regulatory issue that has uncertain consequences relates to past sales of payment protection insurance (PPI). This is an industry-wide issue on which the FSA is currently considering its requirements following a consultation process undertaken at the end of last year. Within CFS relevant PPI sales have been made by the Bank, although it may be noted that such sales have ceased with effect from 4 January 2009. It may also be noted that the total complaints received from customers remain very low as a proportion of total PPI sales.

As a business, the Group is also subject to increasingly stringent laws relating to pollution, health and safety, data protection, product safety and protection of the public and the environment. We work with the Government and various trade bodies to help develop public policy and represent the views of our customers and members to improve the environment in which we operate.

Business disruption

The risk of an unplanned disruption to business in an organisation the size of The Co-operative Group is significant and a number of risk management tools are used to highlight and minimise the impact where possible.

If a major disruption occurred, such as the loss of a key facility or critical IT system failure, not only would this have a detrimental impact on the business's ability to operate effectively and an adverse effect on financial results, but it could also cause longer-term damage to the reputation of the Group.

Business Continuity sets out to manage the recovery or continuation of business activities in the event of a sudden, unplanned incident.

In 2009 the Group faced a number of incidents including power outages within Manchester, postal strikes, and the initial outbreak of H1N1 (swine flu) and the subsequent second wave later on in the year.

The incidents were managed with a coordinated response and did not affect the ability of the businesses to trade. In a number of these incidents, specific preparations were completed within the business teams to ensure the response was effective and appropriate.

Value of the Group's property investment portfolio

The investment property portfolio has seen a significant fall in value since the economic downturn. In the second half of 2009 values recovered to end the year with an overall in-year uplift. It is likely that the bottom of the cycle has been seen. However, further shocks to the economy, which could see a double dip in property values, cannot be ruled out.

The investment portfolio is made up of relatively small, marketable properties with a geographical and sector spread and remains under continuing review.

Financial Services risks

The Bank, CIS and Co-operative Insurance Society General Insurance (CISGIL) Boards are responsible for approving entity strategy, their principal markets and the level of acceptable risks articulated through their respective statements of risk appetite.

The Boards are also responsible for overall corporate governance, which includes ensuring that there are adequate systems of risk management and that the level of capital held in each entity is consistent with the risk profile of the respective business.

Board Committees and Senior Management Committees oversee and challenge the risk management process, identifying the key risks facing each business and assessing the effectiveness of planned management actions.

The following risks are specific to the CFS business.

Market risk

Market risk is managed separately in respect of CIS, CISGIL and Bank entities. CIS and CISGIL market risk arises from the mis-matching of assets and liabilities.

CIS with-profits policyholders have an expectation that a proportion of their savings will be invested in equities and property to maximise returns and provide some protection of their savings against future inflation. However, with-profits policies have traditionally also included a minimum guaranteed benefit to provide a minimum return to the policyholder, which requires investment in a substantial proportion of fixed-interest securities. These conflicting investment objectives inevitably lead to a degree of mis-matching of assets and liabilities, and, as a result, market risk is a major potential risk to the solvency of the Long-Term Business Fund.

For CISGIL, market risk arises from unexpected increases in interest rates and credit spreads resulting in an adverse impact on the market value of assets available to meet General Insurance liabilities.

Bank market risk arises from the effect of changes in market prices of financial instruments, on income derived from the structure of the balance sheet, execution of customer and inter-bank business and proprietary trading. The majority of the risk arises from changes in interest rates as the Bank does not trade in complex financial derivatives or commodities and has minimal exposure to foreign exchange movements. The CISGIL fund comprises mainly short-dated bonds and gilt which reduces the extent of market risk faced by the general insurance business. However, there remains the risk that interest rates or credit spreads change unexpectedly with an adverse impact on the market value of assets available to meet general insurance business.

Credit risk

Credit risk arises from exposure to the risk of loss if a counterparty fails to perform its financial obligations to CFS. For CIS and CISGIL, this includes issuers of corporate bonds, counterparties to financial transactions and reinsurers.

For the Bank, this could arise out of exposure to individuals, corporates, financial institutions and sovereigns. Reasons for Bank counterparty default include general economic or sector specific downturns and structural changes such as increased personal indebtedness.

Insurance & business risk
Insurance risk refers to fluctuations in the timing, frequency and severity of insured events relative to the expectations of the firm at the time of underwriting.

The principal risk that CIS and CISGIL face under their insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities.

In CIS, a significant potential risk is of increases in the cost of annuities in payment, the guaranteed benefits under deferred annuity contracts and Guaranteed Annuity Options (GAOs) costs on personal pensions arising from further improvements to pensioner longevity above those assumed in provisioning.

In CIS there is a persistency risk, should more policies than expected reach their investment guarantee dates resulting in an increase in the expected costs of guarantees. In particular, there is a risk that more personal pension policyholders reach their normal retirement date at which point GAOs become available. There is also the risk that profits from non-profit business fail to materialise as a result of more policies lapsing than expected.

Expense risk also exists in CIS. Although most of the long-term business expenses can be charged directly to policyholders, there is a financial effect from higher expense charges to asset shares leading to a reduction in asset shares and so an increase in the cost of providing guaranteed benefits. In addition, for products written on fixed terms or on a fixed charge basis, such as non-profit business and stakeholder pensions, higher expenses will result in reduced profitability.

In CISGIL, insurance risk comprises of risks that arise in respect of claims that have already occurred and for which reserves are already held (reserving risk) and of claims that are yet to occur (underwriting risk).

The key insurance risks to CISGIL are the risk that there is a natural catastrophe which is above the limit of the reinsurance programme on the property account, and the risk that motor bodily injury claims are worse than expected.

Business risk arises from changes to the Bank business, specifically the risk of not being able to carry out the Bank's business plan and desired strategy, including the ability to provide suitable products and services to customers. In a narrow sense business risk is the risk that the Bank suffers losses because income falls or is volatile relative to the fixed cost base. However, in a broader sense it is the Bank's exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks.

CFS operational risk
Operational risks are identified, managed and mitigated through ongoing risk management practices including risk assessments; formal control procedures; training; segregation of duties; delegated authorities; and business continuity planning. Operational risks are formally reviewed on a regular basis. Significant operational risks are regularly reported to Executive Directors, a management Operational Risk Committee, and the Audit & Regulatory Compliance Committee (a formal Board Sub-Committee). These meet regularly to monitor the suitability of the risk management framework and management of significant risks within CFS. Capital requirements in relation to operational risk are monitored by the Risk Management Committee.

CFS also has a corporate insurance programme to transfer specific risks to insurers as part of its risk management approach.

2009 has seen the merger of Co-operative Bank with the Britannia Building Society. Work is underway to ensure that CFS' operational risk framework is consistently applied across the merged organisation, in compliance with the Basel II Standardised Approach to operational risk.

Liquidity risk
Liquidity risk arises from the timing of cash flows generated from the Group's assets, liabilities and off-balance sheet instruments. The Group's liquidity management policies are reviewed and approved annually by the Risk Management Committee and compliance reviewed monthly by the Asset and Liability Committee (ALCO).

The Bank has a high proportion of retail assets funded by retail deposits, ensuring there is no over-reliance on wholesale funding. There is a target funding ratio set in line with the Board approved strategic plan, which is being met. The Group's structural liquidity risk management is therefore retail-based and is dependent on behavioural analysis of both customer demand and deposit and loan drawdown profiles by product category based on experience. The behaviour of retail products is reviewed by ALCO on a quarterly basis. In addition, the Group has maturity mismatch limits to control the exposure to longer-term mismatches.

The Bank's liquidity position is monitored on a daily basis and reported to ALCO each month. Treasury holds a pool of liquid assets on behalf of the Bank, and actionable management actions are in place to provide additional liquidity. These sources of liquidity are held in order to be available to meet unexpected liquidity requirements.

Marketable assets are maintained as a liquidity pool against potential retail outflows; the asset quality of these is controlled via credit limits. Concentration limits are set by issuer name and holding per bond to ensure diversity of assets.

The Bank has two Covered Bond Programmes, a heritage Co-operative and heritage Britannia programme. Both these programmes issued bonds which were brought back onto the Bank's balance sheet to enable the bonds to be used as collateral for the Bank of England Special Liquidity Scheme.

Finally, both CIS and CISGIL regularly review liquidity requirements and ensure sufficient liquid assets are held and meet potential cash requirements.

Securitisation risk
Securitisation risk is the residual credit risk arising from retaining an interest in the Bank's securitisation companies through the provision of subordinated debt and/or start up expense loans where applicable. The Bank has historically entered into securitisation transactions in which it sells mortgages to special purpose vehicles (SPVs). These SPVs are included as subsidiaries in the consolidated financial statements. The Bank continues to recognise these securitised assets as loans and advances to customers on the balance sheet and income from the securitised assets continues to be recognised as income. Securitisations provide a committed and linked source of funding for higher-risk mortgage lending.

The Bank has 13 years' experience issuing securitisations under the 'Leek' programme, and has built up a depth of knowledge, processes and management information to deal effectively with these funding vehicles. Securitisation has historically been used as part of a balanced portfolio management approach whilst helping to increase the diversification of funding sources available whilst managing maturity mismatch risk and also assisting overall credit risk management.

The appetite for securitisation risk is low, and the Bank has only acted as mortgage originator and servicing agent. The Bank does not provide liquidity facilities, bridging loans or repackaging nor does it act as underwriter or dealer in the securitisations. All transactions have relevant accounting and legal advice to ensure compliance with applicable regulatory/statutory rules and are also approved at Board level.

Corporate Governance

The Co-operative Group is an Industrial and Provident Society that is jointly owned and democratically controlled by its members. It is unusual amongst other UK consumer co-operatives in that it has both Independent Co-operative Society Members and individual members. As a co-operative society, it is not mandatory for The Co-operative Group to comply with the Combined Code; however, we are committed to the highest standards of corporate governance and recognise that good governance helps the business to deliver its strategy, strengthen member confidence and safeguard the long-term interests of the Society.

This Governance report describes the key governance mechanisms operating within the Society, through which the Group aims to conform to the spirit of the Combined Code, in a manner which recognises its unique member owned and democratically controlled structure.

The Society also adheres to a Corporate Governance Code of Best Practice, published by Co-operatives UK, which applies to consumer co-operatives within the UK. The Society will report on its compliance with this Code directly to Co-operatives UK, as appropriate, and full copies of this report will be made available on request from the Group Secretary.

Constitutional review

In October 2008, members approved a new Rule-book based on the recommendations of the Constitutional Review, (the 'Review'), which was instigated following the merger of The Co-operative Group with United Co-operatives in July 2007. These recommendations, on the governance of the Society, have been implemented during the course of 2009.

Up to the end of February 2009, the individual membership structure comprised nine regions each represented by a regional board, elected from members within the region. The number of regions was reduced from nine to seven in spring 2009.

Group Board composition and independence

From January 2009 to 6 June 2009, the Board comprised 32 Directors, 25 elected by and from the Group's nine regions and seven elected by and from Independent Society Members. Following the recommendations of the Review, the Board reduced in number to 20 with effect from 7 June 2009 and currently comprises 20 non-executive Directors; 15 representing the individual members, elected by and from the Group's seven regions and five representing the Independent Societies, elected by and from Independent Society Members. The number of votes of each Independent Society Member is based on their level of trade with the Society.

Each Director is elected for a three-year term; however, the terms of office in respect of the elections held during 2009 were three-year terms for seven Directors, two-year terms for six Directors and one-year terms for seven Directors. As a consequence, elections will be held during 2010 in respect of seven seats.

Directors are expected to exercise their judgement when making decisions in the best interests of the Society as a whole, mindful of their responsibilities to members and other stakeholders. Independent Society Members enter into material transactions with the Society. In addition, Independent Society Members may carry out similar trading activities to the Society; whilst this is inherent in the federal role and constitution of the Society, conflicts of interest are declared where appropriate during Board business and necessary safeguards are put in place.

The Board believes that all of its Directors make valuable contributions to the operation of the Society. There is no senior independent director as the Group Board is wholly made up of non-executive Directors. It is the Board's view that this role is not appropriate in the Group Board.

Role and responsibilities of the Group Board and Subsidiary Boards

As a result of the Constitutional Review, the role of the Group Board has changed and it is now more strategically focused. In addition to the existing CFS Board, details of which can be found in the separate CFS Report and Accounts, two new subsidiary boards, both Industrial and Provident Societies, were established in 2009. The two new subsidiaries have responsibilities set by the Group Board for specific areas – one for the Food business and one for the other customer-facing businesses (the Specialist Businesses) and have been designed to improve the Group's governance and to provide greater scrutiny of its large and diverse businesses. The composition of each of the new Subsidiary Boards is shown on page 5. In addition, the Rules of the subsidiaries allow for the appointment of up to two Independent Professional Non-Executive Directors (IPNEDs) in order to expand the experience and skills of the Boards. The process for the appointment of the IPNEDs commenced at the end of 2009, with the intention that they be appointed in spring 2010.

The Group Board meets on a bi-monthly basis, at least six times a year and annually devotes two days, alongside senior executives, to performance and longer-term planning, giving consideration both to the opportunities and risks of future strategy. The Subsidiary Boards meet once a month, at least 11 times a year and have responsibility for the detailed scrutiny of their respective businesses. These Boards also contribute towards the formulation of the strategy of the business.

The attendance of Directors at scheduled Board, Subsidiary Board and Committee meetings is shown on the table on page 34.

The responsibility of the Group Board is to direct the business of the Society, in particular:

- Ensuring that the Society's affairs are conducted and managed in accordance with its purpose and objects as set out in its rules, and in accordance with the best interests of the Society and its individual and Independent Society Members
- Determining the vision and strategy of the Group in consultation with the Chief Executive and the Executive
- Overseeing the Group Chief Executive and the Executive in the day-to-day management of the business of the Society.

In addition, the Group Board is responsible for monitoring performance against key financial and non-financial indicators, overseeing the system of risk management, and setting standards in governance matters. The Board also receives regular reports from the Subsidiary Boards, including those of its financial services businesses.

Board procedures

Board and Committee papers are distributed at least one week in advance of meetings. This provides the opportunity for Directors to prepare fully for meetings. The minutes of all meetings are circulated to all Directors. As well as circulating papers as hard copies, the Board has access to its own secure website where papers are available together with additional supporting material.

There is regular communication between the Directors, the Group Chair, the Group Chief Executive and the Group Secretary between meetings.

When a Director is unable to attend Board or Committee meetings, issues can be raised with the relevant Chair. Written questions for management on papers are encouraged from Directors between meetings. A rolling schedule of matters arising from Board and Committee meetings are followed through.

The roles of the Group Chair and Chief Executives

The Group Chair, Len Wardle, is elected by and from the Group Board and is a non-executive. He has primary responsibility for leading the Group Board. The Group Chief Executive, Peter Marks has executive responsibility for the operations of the (Trading) Group and Group-wide issues. The CFS Chief Executive is appointed by the Group Board and has executive responsibility for the operation of CFS which has a separate Board.

Group Board Committees
The Group Board governs through clearly identified Board Committees. These are the Audit & Risk Committee, Remuneration & Appointments Committee, the Chairs Committee and the Governance Working Party. In addition, there is a Values & Principles Committee, which although it is not a formal Board Committee, has Group Board and Regional Board representation and is accountable to the Group Board.

Until May 2009, there was a Constitutional Review Committee whose remit was to implement the recommendations of the Review. This Committee was disbanded following the implementation of all the recommendations of the Review.

Each Committee is properly authorised under the constitution of the Society to take decisions and act on behalf of the Group Board within the guidelines and delegations laid down by the Group Board. The Group Board is kept fully informed of the work of these Committees. Any issues requiring resolution will be referred to the Group Board. A summary of the operations of the principal committees is set out below.

The terms of reference and the size of all Board Committees were reviewed during 2009 as a result of the reduction in the size of the Group Board and the creation of the Subsidiary Boards.

Group Audit & Risk Committee
The Committee comprises five members, all of whom have the necessary ability and experience to understand financial statements – Ben Reid (Chair of the Committee), Duncan Bowdler, Patrick Grange, Nigel Keane and Ursula Lidbetter. In addition, the Chair of the CFS Audit & Regulatory Compliance Committee together with the Chair of the CFS Risk Management Committee, attend meetings. Ben Reid fulfils the requirements of the Combined Code in relation to having recent and relevant experience.

Under its terms of reference, the Audit & Risk Committee:

- Monitors the integrity of the Society's financial statements and any formal announcements relating to the Society's performance, together with any significant financial reporting judgements contained in the financial statements
- Monitors the effectiveness of the external audit process and makes recommendations to the Board, for it to put to the members in general meeting, in relation to the appointment, reappointment and remuneration of the external auditor and to approve the remuneration and terms of engagement of the external auditor
- Reviews and monitors the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements
- Ensures that an appropriate relationship between the Society and the external auditor is maintained, including reviewing non-audit services and fees, taking into account relevant ethical guidance on the provision of non-audit services by the external audit firm and reports to the Board, identifying any matters in respect of which it considers that action or improvement is needed
- Reviews annually the Society's systems of internal controls and the processes for monitoring and evaluating the risks facing the Society
- Reviews the effectiveness of the Internal Audit function and is responsible for approving, upon the recommendation of the Group Chief Executive, the appointment and termination of the head of that function
- Reviews the Society's whistleblowing procedures to ensure the arrangements are in place to support employees and suppliers to raise concerns on a confidential basis including support from an external independent service
- Reviews the minutes and receives reports of the Co-operative Financial Services Audit and Regulatory Compliance Committee and its Risk Management Committee
- Annually reviews its terms of reference and recommends to the Board any changes required as a result of the review.

The Committee meets with Executive management, as well as privately with the external auditor and Head of Internal Audit. Due to the changes brought about by the Constitutional Review, the Committee did not conduct an effectiveness evaluation during the year; however, this will take place during the course of 2010.

Group Remuneration & Appointments Committee
The Committee currently comprises six members: Paul Flowers (Chair), Chris Herries, Len Wardle (Group Chair), Bob Burlton (CFS Chair), Allan Smith and Steve Watts.

The Committee's role in respect of Executive management is to determine remuneration and employment policy, oversee contractual arrangements, review salaries, approve incentive schemes and any payments made under such schemes and recommend appointments to the Board.

In respect of Directors, the Committee makes recommendations to the Board on Director remuneration, which in turn makes recommendations to members in a general meeting for a decision. The Committee also makes recommendations on the appointment of independent professional non-executive Directors and appointments to the Subsidiary Boards and Board Committees. The Committee is supported by the CFS Remuneration and Appointments Committee in ensuring consistency, where appropriate, across the wider Group.

The Committee met nine times during the year and its report can be found on page 37.

Group Chairs Committee
The Group Chairs Committee comprises four members, Len Wardle, Peter Marks, Allan Smith and Steve Watts, together with any other persons the Board decides from time to time. It has authority to act between Board meetings if required. The remit of the Group Chairs Committee covers all areas reserved to the Board.

Governance Working Party
The Governance Working Party was established in June 2009. It meets as required to consider any matter that relates to the good governance of the Group that the Group Board requests. There are five Directors on this body: Len Wardle, (Group Chair), Duncan Bowdler, Marilynne Burbage, Chris Herries and Stuart Ramsay.

Values & Principles Committee
Following the Constitutional Review, the role of this Committee has changed and although it is no longer a formal Committee of the Board, it is monitored by and accountable to the Group Board and the Group Board receives regular reports as to its activities. Its membership comprises four Directors and seven regional representatives, from each of the Group's seven regions: one person appointed by the Diversity Working Group and one representative appointed by Independent Society Members. The four Group Directors are: Marilynne Burbage (Chair), Jenny Barnes, Herbert Daybell and Stuart Ramsay.

The Committee is responsible for monitoring the Group's Membership engagement and community strategies. It also scrutinises the Group's Sustainability Report on behalf of the Group Board and is responsible for maintaining relationships with the wider Co-operative Movement.

Provision of advice to Directors
A number of external consultants provide professional advice to the Boards of the constituent parts of the wider Co-operative Group. There is an agreed procedure by which Directors may take independent professional advice at the Society's expense in furtherance of their duties.

Board training and development
A new role of Member and Director Learning Manager was created to develop a new training framework and to support Directors' learning and development.

In 2009, nine new Directors undertook a structured induction programme. This was designed to include key corporate governance and business information, including briefing sessions with members of the Executive team on the strategy and performance of key business areas.

In addition, new Directors received information on the operation of Board Sub-Committees, including the powers delegated to the Committees, corporate governance practices and procedures and the powers reserved to the Executive, together with the latest financial information.

A separate, tailored induction and other training has also been organised for members of Board Sub-Committees including the Group Remuneration & Appointments Committee and the Group Audit & Risk Committee. The Specialist Businesses Board Directors commenced a series of roundtable seminars with senior business managers which will continue into 2010. Five Directors completed four half-day orientation training sessions and two computer-based modules on Co-operative Financial Services and three Group Directors newly elected to the CFS Board embarked upon a comprehensive and technical induction programme. In addition, one-to-one support has been provided to a number of Directors.

Performance evaluation
The Combined Code requires the Board to undertake a formal and rigorous annual evaluation of its own performance and that of its Committees and individual Directors. As the Group Board reduced in number from 32 to 20 in 2009 and there were changes to its composition, an evaluation was not conducted during the year. An interim evaluation of the Group Board and the Food and Specialist Businesses Boards has recently taken place to assess their operation given the changes to the governance structure in 2009.

The Secretary to the Board
The Group Secretary is professionally qualified and is responsible for advising the Group Board through the Group Chair on all governance matters. The Directors have access to the advice and services of the Group Secretary. The Society's Rules provide that the appointment and removal of the Group Secretary is a matter for the full Board.

The Executive
It is the responsibility of the Executive to implement the strategic objectives as agreed by the Board. The Executive, under the leadership of the Group Chief Executive, is responsible for the day-to-day management of the Society.

Membership involvement
As a Co-operative, the Society is jointly owned by its members. Members of the Society exercise democratic control by serving on the governance bodies as elected members, or by voting in elections or participating in consultation initiatives.

The Society regularly communicates with active members using magazines, mailings and the internet. Additionally the Society encourages members to share their views and influence policies and standards through local area meetings, web chats and surveys.

Group Audit & Risk Committee

Internal control
The Group Board has overall responsibility for the Society's system of internal controls, which aims to safeguard the Society's assets and to ensure that proper accounting records are maintained and that the financial information used within the business and for publication is accurate, reliable and fairly presents the financial position of the Society and the results of its business operations.

The Group Board is also responsible for reviewing the effectiveness of the system of internal controls. This has been in place for the year under review and is regularly reviewed by the Group Board. The system is designed to provide reasonable assurance of effective operations and compliance with laws and regulations, although any system of internal controls can only provide reasonable, not absolute, assurance against material mis-statement or loss, and can only mitigate rather than eliminate the risk of failure to achieve business objectives.

Since the publication of the Turnbull Report in September 1999, 'Internal Control: Guidance for Directors on the Combined Code by the Institute of Chartered Accountants in England and Wales', the Directors have continued to review the effectiveness of the Society of non-financial as well as financial controls, including operational controls, risk management and the Society's high-level internal control arrangements. The Society has adopted an internal control framework that contains the following key elements:

Control environment
The Society's control environment is designed to create an attitude of taking acceptable business risk within clearly defined limits. The control environment includes:

- An organisational structure with clear lines for responsibility, delegation of authority and reporting requirements
- Co-ordinated activity across the whole Group through Executive meetings that include executives from Trading and Corporate
- Clearly defined policies for capital and revenue expenditure. Larger capital and revenue expenditure requires Board authorisation
- Comprehensive systems of financial reporting. The annual budget and long-term plans of the Society and of each Division are reviewed and approved by the Board. Results are reported against budget and previous year. The relevant Executives consider any significant changes and variances, and remedial action is taken where appropriate. Group tax, treasury and insurance activities are co-ordinated centrally
- A Code of Business Conduct covering relations with customers, members, employees, suppliers, community and competitors. The Code provides procedures to allow any employee to report, in confidence, suspected serious malpractice. An anti-fraud policy was introduced in 2009 to further support the Code
- Internal audit, compliance and operational functions that review the system of internal control, including a financial control self-assessment process.

Risk management
The Group Board and Management Executive teams have the primary responsibility for identifying the key business risks facing the Society.

The Group operates a risk management process that identifies the key risks facing each business. Each business has a risk register that identifies the likelihood and impact of those risks occurring and the actions being taken to manage them. Risk assessments are updated on a quarterly basis and reported to the appropriate Risk Management Committee and Audit & Risk Committee. The information is consolidated for the Group Risk Management Committee, which provides reports, four times a year, to the Group

Audit & Risk Committee on how the key risks are being managed. The Group's Risk Management Committee has responsibility for establishing a coherent framework for the Group to manage risks. The objective of the Committee is to assist the Board in carrying out its responsibility to ensure effective risk management and a system of control.

The specific responsibilities of the Committee are currently as follows:

- Defining and maintaining the policy, methodology and standards for risk management
- Identification of significant risks affecting the Group as a whole, communicating these to the businesses and corporate departments to ensure progress and action plans to address the identified risk
- Oversight of the business risk management committees, including ensuring that progress is made on action plans reported
- Ensuring the systems of risk management are operating throughout the year
- Providing regular reports to the Board and Audit & Risk Management Committee that explain the significance and likelihood of the risks and the necessary actions being taken by management to manage those risks.

Attendees at the Group Risk Management Committee meetings include the Group Chief Executive (Chair), the Group's Chief Financial Officer, the Group Secretary, the CFS Chief Financial Officer, the CFS Director of Capital Pricing & Risk, the Director of Strategic Planning and Change (Secretary to Committee), the Pensions Finance and Risk Controller, the Head of Ethics, Social Goals and Sustainability and the Head of Internal Audit. The Committee met four times during 2009.

Control procedures
The Society's control procedures are designed to ensure complete and accurate accounting for financial transactions and to limit the potential exposure to loss of assets or fraud. Procedures and reference information are maintained in relation to the Society's Rules, accounting policies and procedures, insurance, employees and Code of Business Conduct. These are issued to appropriate management who are trained in the procedures.

Information and communication
Communication takes place with all key stakeholders through a variety of media including the Group's Sustainability Report. Employees receive and provide information on strategy and objectives through their reporting lines and a formal performance measurement process. Newsletters, magazines, bulletins, events and electronic media communicate other information.

Monitoring
The operation of the system of internal control is the responsibility of line management. It is subject to independent internal audit review and, where appropriate, by the Society's external auditors and external regulators.

The Group Audit & Risk Committee, on behalf of the Group Board, reviews the reports of the Society on internal control. Full details of the operation of the Committee can be found on pages 31 and 32.

A key part of the process in assessing internal control by the Group Audit & Risk Committee is an annual 'letter of assurance' process by which the Executive confirm they have assessed the effectiveness of their systems of internal financial and non-financial controls, their compliance with Society policies (including those relating to safety, health and the environment), local laws and regulations (including the industry's regulatory requirements) and reporting any key control improvements required. The outcome of these letters is reported to the Group Audit & Risk Committee. The Directors are then able to review the system of internal controls and believe it complies with the Turnbull Report guidance. The Committee considers that there have been no weaknesses that have resulted in any material losses or contingencies that have not been disclosed.

External Audit
One of the duties of the Audit & Risk Committee is to make recommendations to the Board in relation to the appointment of the external auditors. A tender for the external audit of the Society was undertaken in 2003 at which KPMG Audit plc was successful. The Group Audit & Risk Committee delayed a further tender in order to ensure the smooth integration of United Co-operatives in 2007 and, currently, Britannia and Somerfield. Details of the amounts paid to the external auditors during the year for audit and other services are set out in the notes to the financial statements in Note 3.

The Committee has put in place safeguards to ensure that the independence of the audit is not compromised, including a policy on the conduct of non-audit services from the external auditor. The external auditors are permitted to provide some non-audit services that are not, and are not perceived to be, in conflict with their independence. At each meeting the Committee receives a report providing details of assignments and related fees carried out by the external auditors, in addition to their statutory audit work. The pre-approval of the Committee is required for services above certain thresholds determined by the Committee. In addition, the following assignments are prohibited from being performed by the external auditors:

- Book-keeping or other services related to the accounting records or financial statements
- Financial information systems design and implementation
- Actuarial services
- Internal audit outsourcing services
- Management functions or human resources
- Any other services that the Audit & Risk Committee may determine.

The performance of the external auditors is formally monitored annually to ensure it meets the needs of the Society and the results are reported to the Committee.

Internal Audit
Internal Audit is an independent appraisal function that derives its authority from the Board through the Group Audit & Risk Committee. Its primary role is to provide reasonable and objective assurance about the adequacy and effectiveness of the Society's financial control framework and risk management.

Internal Audit seeks to discharge the responsibilities set down in its charter by reviewing the processes that ensure business risks are effectively managed; reviewing the financial and operational controls that help to ensure compliance with corporate objectives, policies and procedures and external legislation (other than those relating to safety, health and the environment and product regulatory compliance, which are the responsibility of other assurance functions) and, on an ad hoc basis, reviewing that value for money is obtained. Internal Audit also acts as a source of constructive advice and best practice, assisting senior management with its responsibility to improve the process by which business risks are identified and managed and to report and advise on the proper and effective use of resources.

Statement on Going Concern
After making all appropriate enquiries, the Directors have reasonable expectation that the Society has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the Society's financial statements. More detail of the rationale for adopting the going concern basis is set out in the Accounting basis section of Note 1: Accounting Policies.

Attendance

The following table shows the attendance of current and former Directors at scheduled Group Board, Subsidiary Board and Committee meetings.

Number of meetings	Group Board	Audit & Risk Committee	Remuneration & Appointments Committee	Specialist Businesses Board	Co-operative Food Board	Constitutional Review Board	Governance Working Party
Jenny Barnes [2]	4(4)				5(5)		
Joyce Baruch [1,3]	4(5)						
Steven Bayes [2]	4(4)			5(5)			
Graham Bennett [1] *	5(5)	1(2)	3(3)			5(5)	
Duncan Bowdler *	8(9)	5(5)				5(5)	0(1)
Allen Brett [1]	5(5)	1(2)	3(3)			1 (1)	
Marilynne Burbage [2]	4(4)			5(5)			1(1)
Bob Burlton [1] *	5(5)	1(1)#	7(9)			1(1)	
Simon Butler [1,3] *	5(5)	0(2)	3(3)				
Eric Calderwood	7(9)				4(5)		
Herbert Daybell [2]	3(4)				4(5)		
David Doyle [1,3]	5(5)						
John Fitzgerald [3]	8(9)				4(5)		
Douglas Fletcher [1,3]	5(5)	1(2)					
Paul Flowers *	9(9)		8(9)				
John George [1]	4(5)	2(2)				5(5)	
Patrick Grange	9(9)	3(3)	3(3)		5(5)	1(1)	
Mike Harling [1,3]	4(5)						
Ray Henderson [2]	4(4)				5(5)		
Chris Herries [2]	4(4)		6(6)	5(5)			1(1)
Frank Jones [1]	5(5)		3(3)				
Nigel Keane [2]	4(4)	3(3)		5(5)			
Ursula Lidbetter [2]	4(4)	2(3)		5(5)			
John Macbeth [1,3]	5(5)	2(2)				2(3)	
Ian Mason [1]	4(5)					5(5)	
Terry Morton [1] *	4(5)	2(2)					
Bertie Murray [1]	5(5)						
Russell Porteous [1]	5(5)					5(5)	
David Pownall [3]	9(9)			5(5)		5(5)	
Stuart Ramsay [2]	4(4)			5(5)			1(1)
Alban Rees [1]	4(5)					4(5)	
Brian Rees [1,3]	4(5)	2(2)					
Ben Reid *	7(9)	3 (5)	2(3)			2(5)	
Richard Samson [3]	8(9)				5(5)		
Allan Smith [3]	8(9)	1(2)	6(6)		5(5)		
John Smith [1,3]	5(5)						
Kathryn Smith [1] *	5(5)	1(1)#	2(3)			1(1)a	
Robin Stewart [1]	5(5)		3(3)				
Jeanette Timmins [1]	5(5)					5(5)	
Len Wardle *	9(9)	1(1)#	9(9)	5(5)	4(5)	5(5)	1(1)
Steve Watts *	7(8)		8(9)	4(5)			

The number in brackets indicates the number of meetings a Director was entitled to attend.

* Attendance as a Director of Co-operative Financial Services and its Boards are shown in the annual report of CFS.

\# Attended as a result of the Joint CFS Audit & Regulatory Compliance Committee and the Group Audit & Risk Committee meeting.

a Attended as an Alternate.

1 Stepped down as a Director on 7 June 2009.

2 Appointed as a Director on 7 June 2009.

3 Also served on the former Food Retail Board before it was disbanded at the end of May 2009.

Report of the Group Board of Directors

The Directors submit their Report, Business Review and audited financial statements, for the 51 weeks ended 2 January 2010. The comparative information is for the 52 weeks ended 10 January 2009.

Business review
A full business review of the development and performance of the Society and its operating subsidiaries during the financial year, and any significant events since the year end, are set out on pages 6 to 24 of this report. This review also sets out the key financial and non-financial performance indicators on pages 24 to 25. In addition, the principal risks and uncertainties facing the Society are set out on pages 27 to 29. Note 54 of the financial statements provides details of the Society's principal subsidiaries and the nature of each organisation's business.

Significant events since the year end
There have been no significant events since the year end.

Principal activities
The major activities of The Co-operative Group include food retailing, funerals, pharmacies, travel agencies, legal services and farming. It is the parent organisation of Co-operative Financial Services (CFS), whose operating subsidiaries – The Co-operative Bank Plc, Co-operative Insurance Society Limited (CIS) and CIS General Insurance Limited (CISGIL) – provide an extensive range of banking and insurance products and services.

Changes to the Group Board
The names of the current members of the Board, their biographies and details of length of service are set out on pages 4 to 5.

Under the Rules of the Society, a third of the Directors are subject to re-election each year; however, as a result of the Constitutional Review, all Directors stood down on 7 June 2009 and elections were held in the preceding period to fill the 20 seats on the Board.

Directors who stepped down from the Board on the day following the Annual General Meeting were:

Joyce Baruch	Graham Bennett
Allen Brett	Simon Butler
David Doyle	John George
Mike Harling	Frank Jones
John Macbeth	Ian Mason
Terry Morton	Bertie Murray
Russell Porteous	Alban Rees
Brian Rees	John Smith
Kathryn Smith	Robin Stewart
Jeanette Timmins	

Bob Burlton also stepped down as a Director with effect from 7 June 2009, although remains as Chair of Co-operative Financial Services (CFS). In addition, following the transfer of engagements of Plymouth and South West Co-operative Society, Douglas Fletcher stepped down as a Director of The Co-operative Group with effect from 7 June 2009.

The following Directors were successfully re-elected to the Group Board:

Duncan Bowdler	Eric Calderwood
John Fitzgerald	Paul Flowers
Patrick Grange	David Pownall
Ben Reid	Richard Samson
Allan Smith	Len Wardle
Stephen Watts	

The following Directors were newly elected to the Group Board:

Jenny Barnes	Steven Bayes
Marilynne Burbage	Herbert Daybell
Ray Henderson	Chris Herries
Nigel Keane	Ursula Lidbetter
Stuart Ramsay	

Results and distributions
The profit before taxation was £294.8m (2008: £115.9m), an increase of £178.9m on 2008.

A more detailed review of the business is contained in the business review on pages 6 to 21.

The Directors recommended the following distributions in respect of 2009 profits: a payment of £19.4m to corporate members at the rate of 123p per £100 of qualifying purchases from the Society during the period ended 2 January 2010; individual payments of £38.5m; community distributions of £9.9m; and employee distributions of £19.8m based on employee membership of the Society. This is in addition to the interim dividend of £11.3m, which was approved at the Half-Year General Meeting on 7 November 2009.

Directors and their interests
Due to the nature of the Society, Directors are elected through the democratic process by both individual and Independent Society Members. Directors elected by individual members hold shares directly in the Society, whilst those Directors elected by the Independent Society Members have an interest in the Society by virtue of their respective Independent Society Members' shareholdings. It is not considered appropriate to detail the interests of each Director in this report as they are not material. As a key role of the Society is to provide a federal service to its corporate members, material transactions are conducted with these members, some of whom are represented on the Board.

Other than this, no Director had a material interest at any time during the year in any contract of significance, with the Society or any of its subsidiary undertakings.

Directors' and Officer's Liability Insurance and Indemnity
The Society maintains appropriate Directors' and Officers' liability insurance cover in respect of legal action against its Directors. The arrangements for this are currently being reviewed.

The Directors, the Secretary and any of the Society's Approved Persons under the Financial Services and Markets Act 2000 from time to time have entered into a contract of indemnity with the Society in respect of certain liabilities they may incur whilst discharging their functions.

Employees
The Society and its subsidiary undertakings employed 114,561 persons at 2 January 2010 (2008: 82,359) and their aggregate remuneration for the year was £1,701.4m (2008: £1,313.5m).

Provision of information and consultation with, and involvement of, employees
The Society has a long-established policy to inform and consult its employees and trade union representatives about business issues and matters that affect them at work. Over time, a flexible framework has been constructed, through which information is shared with, and opinions sought from, employees and trade union representatives. Internal communications are designed to ensure that employees are well informed about the business; these include a staff magazine called 'Us' and a management magazine, mag:ma.

Developing and engaging people
The Society recognises that competitive advantage comes from putting employees at the heart of the business strategy. The Society's clear commitment to employees is demonstrated through our strong focus on engagement, building organisational capability and nurturing and developing talent now and for the future. The Society continues to enhance current practices and develop innovative new solutions in support of this.

Managing and rewarding performance
The Society recognises that one of the keys to success is objective and effective performance management. Good performance is not solely about what is achieved but also about how it is achieved.

Diversity
The Society aims to employ people who reflect the diverse nature of the UK population, and seeks to provide easy access to goods, services and facilities for customers, employees and members. The Society is a member of the Employers' Forum on Age; the Employers' Forum on Disability; the Employers' Forum on Belief; Opportunity Now Gender equality; Race for Opportunity; and Stonewall for sexual orientation.

The Society is currently positioned at Gold status in the Race for Opportunity (RfO) benchmark and Silver status in the external Opportunity Now benchmark for gender equality, which is a Stonewall champion to demonstrate commitment to colleagues who are gay, lesbian and bisexual. The Society is also an Age Positive Employer Champion and has removed the retirement age as part of its commitment to removing age discrimination.

Employees with disabilities
The Society has included within its Diversity Policy provisions to consider employment applications from people with disabilities and to match vacancies with an individual's particular aptitudes and abilities.

The Co-operative Group is also a JobCentre Plus 'Two Ticks' employer, committing to interviewing any disabled candidate who meets the minimum job requirements.

Supporting customers with disabilities
The programme to ensure that the Society was compliant for the introduction of the Disability Discrimination Act Part III in providing goods and services to customers was satisfactorily completed. A review is now underway to ensure that compliance is being maintained at the right level.

Corporate responsibility and the environment
The sustainable development section can be found within the Business Review on pages 17 to 20. In addition, the Society's Sustainability Report, which will be published towards the latter half of the 2010 financial year, describes how the Society manages its social, ethical and environmental impact.

Political and charitable donations
In 2009 an annual subscription of £496,000 (2008: £476,000) was made to the Co-operative Party. In addition, just under £180,000 (2008: over £170,000) was paid in grants to Co-operative Party Councils. An in-kind donation of £5,000 (2008: £6,000) was made by the Society to the Co-operative Party, reflecting use of office space. These donations have been reported by the Co-operative Party to the Electoral Commission in accordance with its reporting obligations as a registered political party under the Political Parties, Elections and Referendums Act 2000.

Furthermore, The Co-operative Group made donations of £63,090 direct to the Labour Party during the course of 2009. In addition, expenditure of just under £7,000 was made to support various Labour Party activities at local, regional and national levels (such as Labour North West's conference in October 2009 and the Labour's Women's Dinner in December 2009).

Like many other businesses of a comparable size, the Group undertakes a programme of activity designed to showcase its corporate credentials to a wide audience of political opinion formers. This work is led by the Group-wide Public Affairs team and the most significant financial element of this activity is the Group's presence at party political conferences. In 2009, the Group was represented at the conferences of The Co-operative Party, Liberal Democrat Party, Labour Party, Conservative Party and the Scottish National Party.

Market value of land and buildings
Freehold and leasehold land and buildings held by the Society (excluding investment properties) are held on the balance sheet at historic cost and have not been revalued. These have been internally assessed at a market value of £2.386bn, which is £855m higher than historic cost.

Supplier payment policy and practice
In many cases, the Society does not impose standard payment terms on its suppliers but agrees terms separately with each of them, whilst in others the use of standardised terms is regarded as consistent with much of the market. Every effort is made to pay suppliers in accordance with the terms that have been agreed. At 2 January 2010, trade creditors expressed as number of days outstanding was 43 days (2008: 38 days) for the Society.

Statement of Directors' Responsibilities in Respect of the Directors' Report and the Financial Statements
The Directors are responsible for preparing the Directors' report and the Society financial statements in accordance with applicable law and regulations. Industrial and Provident Society law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRS as adopted by the EU.

The Society financial statements are requested by law to present fairly the financial position and the performance of the Society. In preparing these financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently
- Make judgements and estimates that are reasonable and prudent
- State whether they have been prepared in accordance with IFRS as adopted by the EU
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Society will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position and the performance of the Society and enable them to ensure that its financial statements comply with the Industrial and Provident Societies Acts. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Society and to prevent and detect fraud and other irregularities.

Under applicable law the Directors are also responsible for preparing a Directors' report that complies with those Acts. The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Society's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Financial statements
So far as the Directors are aware, there is no relevant information that has not been disclosed to the Society's auditor, and the Directors believe that all steps have been taken that ought to have been taken to make them aware of any relevant audit information and to establish that the Society's auditor has been made aware of that information. A statement by the Directors as to their responsibilities for preparing the financial statements is included in the statement of Directors' responsibilities set out above. The Directors' statement on going concern is included on page 33.

Auditor
In accordance with Section 4(5) of the Friendly and Industrial and Provident Societies Act 1968, a resolution for the reappointment of KPMG Audit Plc as auditor of the Society and a resolution to authorise the Directors to fix their remuneration are to be proposed at the next Annual General Meeting.

By Order of the Board

Moira Lees
Group Secretary
17 March 2010

Remuneration report

As a Co-operative, the Society is required to produce its accounts in accordance with the Industrial and Provident Societies Act 1965 to 2002, the Industrial and Provident Societies (Group Accounts) Regulations 1969 and applicable accounting standards. In the interests of best governance practice as a guideline for its disclosure in relation to remuneration, the Society uses the disclosure requirements applicable to listed companies, as set out in the *Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008* (incorporated into the Companies Act 2006).

The Co-operative Group Board is entirely non-executive, the Directors being elected from its membership. The day-to-day management of the Society falls to Executives. For completeness, this report provides details of both Executives' and Directors' remuneration.

This report will be put to an advisory vote of the Society's members at the AGM on 22 May 2010.

Introduction
The Remuneration Report is presented by the Board and contains the following information:

- A description of the role of the Remuneration & Appointments Committee (the 'Committee')
- A summary of the Society's remuneration policy, including statements of policy on Executives' and Directors' remuneration
- Details of the terms of the service contracts and the remuneration of each Executive for the 2009 financial year
- Details of the current terms of office and the remuneration of each Director for the 2009 financial year.

Role of the Remuneration & Appointments Committee
The Committee's principal terms of reference are to:

- Determine policy on remuneration and other main terms and conditions of employment in respect of all Group employees who are members of the Group Executive, including the Group Chief Executive and the Co-operative Financial Services Chief Executive
- Oversee contractual arrangements for Executives and approve the principal terms and conditions of their employment
- Review remuneration using comparisons against the agreed market policy for the Executive
- Make recommendations on Executive appointments and the terms and conditions relating to these
- Approve any relevant incentive schemes and ensure that they are in line with current market practice and authorise payments under any incentive schemes in line with their rules
- Receive, review and decide on issues raised in relation to The Co-operative Group Pension (Average Career Earnings) Scheme and any other retirement benefit scheme within the Group and advise the Board on them as appropriate.

In respect of the Board Directors and Independent Professional Non-Executive Directors (IPNEDs), its responsibilities include:

- Ensuring there is timely review of the remuneration and expenses policy of elected members and agreeing the process and resource for such review, which shall be independent
- Ensuring that when compensation payments are made to the Group's elected members, an independent process is in place to ensure the policy and the interpretation of the policy is fair, reasonable and transparent and avoids conflicts of interests and that such payments are in the wider interests of the Society and membership as a whole
- Considering and recommending to the Group Board the appropriate recruitment process for the appointment of the IPNEDs on the Group's subsidiary boards
- Overseeing contractual arrangements including remuneration in respect of the IPNEDs
- Considering and developing role profiles in respect of Group Directors and members of any Subsidiary Board or Committee
- Agreeing a process for the development and training of Group Directors
- Agreeing a process for measuring Board effectiveness and individual Director appraisals, including an annual review of the effectiveness of the Group Chair, CFS Chair and the Group Deputy Chairs
- Ensuring there is a succession plan in place in respect of the position of Group Chair.

At the end of 2009, the Committee comprised Paul Flowers (Chair), Chris Herries, Len Wardle (Group Chair), Bob Burlton (CFS Chair), Allan Smith (Group Deputy Chair) and Stephen Watts (Group Deputy Chair). The Board believes that all members of the Committee are independent for the purpose of reviewing remuneration matters. The Group Chief Executive (Peter Marks), the Group Secretary (Moira Lees) and the Director of Human Resources (Richard Bide) also attend the meetings of the Committee, except when their own remuneration or terms and conditions are being considered. Other individuals are invited to attend for specific agenda items when necessary.

The Committee members are all non-executive. They have no personal financial interests in the Committee's decisions and they have no involvement in the day-to-day management of the Society. The Committee met eight times in the period under review.

To ensure that it receives independent advice on remuneration matters, the Committee retained Hewitt New Bridge Street as its adviser during the year. Hewitt New Bridge Street supplied survey data and advised on market trends and other general remuneration issues. Other than specialist advice in relation to the Group's remuneration issues, Hewitt New Bridge Street does not provide other services to the Society. Addleshaw Goddard was also retained to provide legal advice with respect to Executive service contracts.

Policy on Executives' Remuneration
In determining the remuneration policy for Executives, the Committee has considered a number of factors including:

- The importance of attracting, retaining and motivating senior Executives of the appropriate calibre to further the success of the Society
- The linking of reward to individual and business performance and the strengthening of co-operative values, which include a strong belief in stewardship of all the Society's resources and, therefore, ensures that Executives are not rewarded for the assumption of undue risk
- Ensuring that the interests of Executives are aligned with those of the Society and its members
- In conjunction with the CFS Remuneration Committee, ensuring that pay practices in the Society as a whole are coherent.

The current policy is to pay basic salaries at a level around the market median, when compared with other organisations of comparable size and complexity, and also organisations in the same business sector. The Committee supports the principle of performance-related pay and operates both an annual bonus plan and a long-term incentive plan, but does not consider it appropriate to follow the quantum available in plcs. Accordingly, the amounts payable under these plans are lower than in comparable plcs.

The Committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Society's business environment and in remuneration practice. The enlarged Society remains in a state of transition and, as a part of this process, the Committee will continue to keep under review an appropriate remuneration policy covering all major components of the remuneration package.

The main components of Executive remuneration are:

Basic salary

It is the Committee's policy to ensure that the basic salary for each Executive is appropriate and competitive for the responsibilities involved. Basic salaries for Executives are reviewed by the Committee, normally annually, having regard to competitive market practice (in particular, salary levels for similar positions in comparable companies), the level of salary increases elsewhere in the Society and individual performance for the financial year. The normal month for salary review is January. Basic salary is the only element of remuneration that is pensionable. Salaries received by Executives in respect of 2009 financial period are set out in Table 1.

Annual incentive plan

Each Executive is eligible to participate in an annual performance-related bonus plan. The Committee reviews and sets bonus targets and levels of eligibility annually. Each Executive is eligible to receive a bonus of up to 60% of salary. Bonus is only payable for achieving or exceeding agreed performance targets. Bonus of up to 45% of salary will be measured on financial performance. For Group Executives it will be based on underlying Group profit before tax. For Executives with business unit responsibilities, 15% of salary will be based on underlying Group profit after interest and 30% of salary on Divisional profit after interest. Profit before tax rather than a combination of profit and return on capital employed is being used for the annual bonus, as return on capital employed (Return On Net Operating Assets) is being used for the long-term incentive plan. The remaining 15% of salary will be measured using non-financial, co-operative value measures using the Group's Balanced Scorecard.

Long-term incentive plan

A long-term incentive plan, employing cumulative targets across a three-year period, was introduced for Executives in 2003. The three-year period of operation of the plan for financial years 2009–2011 is described below (details of the plan 2008–2010 were disclosed in the 2008 Report and Accounts).

The plan is measured on the achievement of specified Return On Net Operating Assets targets and the Group's Balanced Scorecard, ie growing employee engagement and growing corporate responsibility over a three-year period, as well as synergy benefits related to the Somerfield acquisition for certain Executives, starting 2009–2011 with potential payment in 2012. For Executives, the threshold payment level, subject to performance conditions being met, is 33.3% of salary for the Group Chief Executive and 16.7–33.3% of salary for other Executives (depending on the individual), with a maximum payment of up to 100% for the Group Chief Executive and 50–100% of salary for other Executives (depending on the individual) for substantially exceeding targets.

Service contracts

It is the Society's policy for the notice period in Executives' service contracts not to exceed one year. All the Executives have contracts which are terminable by one year's notice. In the event of termination, any payments due to an Executive would be based on the value of one year's notice, together with the value of other contractual benefits. Dates of appointment are disclosed in Table 1.

In normal circumstances, it is the Committee's policy to design service contracts for any newly recruited Executive in a similar form to the model which has been developed for existing Executives.

Share options

Because of the co-operative nature of the business, the Group does not operate a share option scheme.

Non-executive directorships

The Committee has determined that, subject to the Committee's approval, Executives may accept one non-executive directorship, or similar, with an external organisation, believing that this represents an important opportunity for professional development. Any fees received for such a role would normally be paid to the Society.

Pensions

The Group offers defined benefit pension arrangements to all employees. These are provided mainly through The Co-operative Group Pension (Average Career Earnings) Scheme ('the PACE Scheme'). However, following the merger with United Co-operatives on 29 July 2007, employees who at that date were members of one of the United Co-operatives final salary pension schemes (ie the Leeds Co-operative Society Limited Employees' Pension Fund, the Sheffield Co-operative Society Limited Employees' Superannuation Fund, the United Norwest Co-operatives Employees' Pension Fund, or the Yorkshire Co-operatives Limited Employees' Pension Fund – 'the United Schemes') continue in membership of the relevant scheme.

The PACE Scheme, which is a registered occupational pension scheme, provides pensions based on 1/60th of average pensionable earnings, revalued by inflation for each year of pensionable service from 6 April 2006 (the date the PACE Scheme was implemented). Benefits accrued as at 5 April 2006, in respect of membership of the scheme preceding the PACE Scheme, continue to be linked to final pensionable salary at a member's date of leaving or retirement, whichever is earlier. Pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

The United Schemes, which are also registered occupational pension schemes, broadly provide pensions based on 1/60th of final pensionable salary for each year of pensionable service. Pensions are also payable to dependants on death and a lump sum is payable if death occurs in service.

Executives who are members of the PACE Scheme currently contribute 6% of their pensionable salary, whilst Executives who are members of the United Schemes contribute between 8% and 9% of their pensionable salary depending on the relevant scheme. The Group pays the balance of the cost of providing benefits.

The Group offers Executives the facility of opting out of future pension accrual under the relevant registered pension scheme when the value of their accrued pension reaches the lifetime allowance under the tax rules, in favour of a non-pensionable salary supplement of 16% of basic salary.

Peter Marks was paid a salary supplement of 16% of basic salary in lieu of pension provision. David Hendry did not receive a salary supplement. All other Executives were members of either the PACE Scheme or one of the United Schemes during the year.

Supplementary life cover is provided to Executives (apart from David Hendry) in order to provide total life cover of 4 x salary when aggregated with benefits from the PACE Scheme or the relevant United Scheme, as appropriate.

Executives who are former United Co-operatives Executives and who are currently accruing pension benefits under one of the United Schemes were entitled to either an employer contribution of 5% of basic salary (as at 31 December each year to be paid on

1 April in the following year) into a defined contribution top-up pension scheme provided by Scottish Widows or an equivalent non-pensionable salary supplement in lieu of this benefit. Consequently, a non-pensionable salary supplement of 5% of basic salary less employers' national insurance was paid to Patrick Allen, Mike Austin, Tim Hurrell, John Nuttall and Martyn Wates. This arrangement has now ceased and no further payments will be made.

Additional pension details are available in Table 2.

Directors

The Directors do not have service contracts. The years of their first election are shown in Table 3. As a result of the Constitutional Review, the number of Directors was reduced from 32 to 20 with effect from 7 June 2009. Elections were therefore held during the year to fill the 20 seats and the result of voting dictated the terms of office for each. Directors elected in 2010 and onwards will be subject to a three-year term of office.

Following the recommendations of the Constitutional Review, the Directors' remuneration and expenses policy was the subject of an independent review during 2008 and was approved by members in General Meeting in October 2008. This policy was applicable to Directors from 7 June 2009. With effect from June 2009, the basic remuneration for a Director is £10,000 per annum. Directors appointed to serve on the Boards of CFS, Co-operative Food and Co-operative Specialist Businesses receive an additional annual fee of £15,000, £10,000 and £7,000 respectively and Directors serving on the various Board and CFS Sub-Committees also receive additional payments. The Chair and Deputy Chairs of the Group and CFS (the latter of whom is not a Group Director), also receive additional fees to reflect their additional responsibilities.

All fees are increased by RPI every year.

The Directors do not, by virtue of their Board position, participate in any of the Group's incentive plans or pension schemes.

The total fees received by each Director are set out in Table 3.

The Boards of the Group's Financial Services subsidiaries include four independent professional Non-Executive Directors and one professional Non-Executive Director appointed by the Group. Each of these Directors receives a payment of £54,236 per annum. It is the normal policy of the Board not to allow an independent professional Non-Executive Director to serve for more than nine years in aggregate. The senior independent Non-Executive Director of Co-operative Financial Services (David Davies) receives an additional payment of £5,000 per annum. The Chair of the CFS Audit & Regulatory Compliance Committee (Paul Hewitt) receives an additional payment of £10,000 per annum.

By Order of the Board

Paul Flowers
Committee Chair

Stephen Watts
Deputy Chair

Allan Smith
Deputy Chair

17 March 2010

Table 1 – Executives' emoluments

	Date of appointment (Note 1)	Basic salary £000	Other supplements (Note 2) £000	Performance-related bonus Annual £000	Performance-related bonus Long Term £000	Benefits in kind (Note 3) £000	2009 Total emoluments (Note 4) £000	2008 Total emoluments (Note 4) £000
Peter Marks	29 July 2007	864	139	528	–	34	1,565	1,435
Patrick Allen	29 July 2007	246	9	75	–	31	361	339
Mike Austin	29 July 2007	184	8	113	–	23	328	258
Richard Bide	15 September 2003	307		187	–	16	510	467
Neil Braithwaite	29 July 2007	230		70	–	20	320	305
David Hendry	29 July 2007	316		–	–	–	316	318
Tim Hurrell (Note 5)	30 July 2008	556	21	339	–	24	940	324
Moira Lees	28 November 2007	241		144	–	21	406	342
John Nuttall	29 July 2007	268	11	82	–	23	384	354
Lynda Shillaw	29 July 2007	263		160	–	16	439	392
Martyn Wates	24 September 2007	492	18	300	–	26	836	673

Note 1 Date of appointment may differ from date service commenced with Society.
Note 2 The figures for Patrick Allen, Mike Austin, Tim Hurrell, Peter Marks, John Nuttall and Martyn Wates include a salary supplement in lieu of certain pension benefits.
Note 3 Benefits in Kind include car or car allowance, fuel card, phone. In addition to the above, the Executives also receive life assurance.
Note 4 Excludes pension values (see Table 2).
Note 5 2008 emoluments for Tim Hurrell represent part-year payments.
Note 6 Figures for 2009 relate to the 51 week period ending 2 January 2010 whereas 2008 comparatives are for the 52 weeks ended 10 January 2009.
Note 7 Details of the emoluments for Neville Richardson, Chief Executive, Co-operative Financial Services can be found in the CFS Annual Report and Accounts.

Table 1 continued – Potential payouts under the LTIP

Name of Executive	Date of award	Maximum payment RONOA	Non-financial	Synergy	Total
Peter Marks (Note 1)	10/2/2009	£440,000	£220,000	£220,000	£880,000
	19/2/2008	£478,920	£159,640	–	£638,560
	Total				**£1,518,560**
Patrick Allen (Note 1)	10/2/2009	£93,750	£46,875	£46,875	£187,500
	19/2/2008	£100,260	£33,417	–	£133,677
	Total				**£321,177**
Mike Austin (Note 1)	10/2/2009	£70,500	£23,500	–	£94,000
	19/2/2008	£124,830	£41,610	–	£166,440
	Total				**£260,440**
Richard Bide (Note 1)	10/2/2009	£116,625	£58,313	£58,312	£233,250
	19/2/2008	£204,279	£68,093	–	£272,372
	Total				**£505,622**
Neil Braithwaite	10/2/2009	£87,000	£29,000	–	£116,000
	19/2/2008	£82,500	£27,500	–	£110,000
	Total				**£226,000**
David Hendry	10/2/2009	£120,750	£40,250	–	£161,000
	19/2/2008	£118,125	£39,375	–	£157,500
	Total				**£318,500**
Tim Hurrell (Note 1)	10/2/2009	£282,500	£141,250	£141,250	£565,000
	19/2/2008	£246,894	£82,298	–	£329,192
	Total				**£894,192**
Moira Lees	10/2/2009	£90,000	£45,000	£45,000	£180,000
	19/2/2008	£75,000	£25,000	–	£100,000
	Total				**£280,000**
John Nuttall (Note 1)	10/2/2009	£102,375	£34,125	–	£136,500
	19/2/2008	£157,238	£52,412	–	£209,650
	Total				**£346,150**
Lynda Shillaw	10/2/2009	£99,750	£49,875	£49,875	£199,500
	19/2/2008	£90,750	£30,250	–	£121,000
	Total				**£320,500**
Martyn Wates (Note 1)	10/2/2009	£250,000	£125,000	£125,000	£500,000
	19/2/2008	£247,219	£82,406	–	£329,625
	Total				**£829,625**

Note 1 2008 award includes an additional amount to take account of lost LTIP opportunity resulting from the 2007 merger.

Note 2 The above amounts are the maximum payable and are dependent on achieving stretch targets linked to RONOA and the Society's Balanced Scorecard as outlined on page 24 .

Note 3 At the time of the Group's acquisition of Fairways Group UK Limited in 2006, David Hendry retained a minority interest in Fairways subject to the Group's right to acquire that interest on specified terms in 2010. The Group has now exercised that right and £6.75m has been paid to Mr Hendry in consequence. Simultaneously, Mr Hendry's employment has been transferred from Fairways to the Group on standard Executive terms and conditions, including participation in the 2008–2010 and 2009–2011 LTIP schemes.

Table 2 – Pension details of the Executive

	Years of service	Total accrued pension at 2 January 2010	Increase in accrued pension during the year	Increase in accrued pension during the year (net of inflation)	Transfer value of previous column at 2 January 2010 net of members' contributions	Transfer value of total accrued pension at 10 January 2009	Transfer value of total accrued pension at 2 January 2010	Increase in transfer values net of members' contributions
		£000	£000	£000	£000	£000	£000	£000
Peter Marks (Note 4)	42	-	–	–	–	–	–	–
Patrick Allen	5	37	11	11	102	281	420	116
Mike Austin	26	55	4	3	28	599	671	58
Richard Bide	6	22	5	5	56	261	336	56
Neil Braithwaite	12	47	5	5	51	513	677	150
David Hendry (Note 5)	3	–	–	–	–	–	–	–
Tim Hurrell	13	110	36	35	714	1,548	2,358	762
Moira Lees	28	109	20	20	278	1,325	1,661	322
John Nuttall	22	68	12	11	148	800	1,005	184
Lynda Shillaw	3	12	4	4	21	66	104	22
Martyn Wates	14	136	35	34	300	947	1,342	356

Note 1 The total accrued pension is that which would be paid annually on retirement at normal retirement age based on service to 2 January 2010 and includes any transferred-in benefits as appropriate. Under the terms of their contracts, existing Group Executives at 17 January 2007 may take these benefits from age 60 and new Executives after 17 January 2007 may take these benefits from age 65. The transfer values in the table above have been calculated on this basis. Years of service include, where appropriate, pre-merger service with United Co-operatives.

Note 2 Members have the option of paying additional voluntary contributions to their respective pension scheme. Neither these contributions nor the benefits arising from them are shown in the above table.

Note 3 All transfer values have been calculated in accordance with the current transfer value method and basis in force for the scheme applicable to the Executive. This is set by the Trustee(s), after taking actuarial advice, to be consistent with the requirements of legislation and the rules of the scheme.

Note 4 Peter Marks was paid a non-pensionable salary supplement of 16% of basic salary in lieu of pension provision.

Note 5 David Hendry is not a member of an occupational pension scheme and does not receive a salary supplement.

Table 3 – Directors' remuneration (including compensation)

	Year first elected	Term expires	2009 remuneration £000	2008 remuneration £000	2009 Loss of office £000
Joyce Baruch (Notes 1 & 8)	2007	N/A	10	21	75
Jenny Barnes (Note 2)	2009	2012	18	N/A	N/A
Steven Bayes (Note 2)	2009	2011	17	N/A	N/A
Graham Bennett (Note 1)	1984	N/A	17	35	104
Duncan Bowdler	2007	2010	28	18	N/A
Marilynne Burbage (Note 2)	2009	2010	17	N/A	N/A
Allen Brett (Note 1)	2007	N/A	20	34	74
Bob Burlton (Notes 7 & 8)	1992	N/A	125	135	132
Simon Butler (Note 1)	1996	N/A	25	39	104
Eric Calderwood	2006	2012	26	20	N/A
Herbert Daybell (Note 2)	2009	2012	19	N/A	N/A
David Doyle (Note 1)	2006	N/A	11	20	70
John Fitzgerald (Note 4)	2005	2012	20	16	N/A
Douglas Fletcher (Notes 3 & 4)	1998	N/A	14	27	81
Paul Flowers	2008	2010	32	16	N/A
John George (Note 1)	2000	N/A	9	20	70
Patrick Grange (Note 5)	2007	2011	30	25	N/A
Mike Harling (Note 1)	1998	N/A	9	20	70
Ray Henderson (Note 2)	2009	2012	17	N/A	N/A
Chris Herries (Note 2)	2009	2010	18	N/A	N/A
Frank Jones (Note 1)	2004	N/A	11	20	N/A
Nigel Keane (Note 2)	2009	2011	17	N/A	N/A
Ursula Lidbetter (Notes 2 & 4)	2009	2011	12	N/A	N/A
John Macbeth (Note 1)	2007	N/A	8	22	60
Ian Mason (Note 1)	2007	N/A	14	20	57
Terry Morton (Note 1)	1997	N/A	21	29	80
Bertie Murray (Note 1)	2004	N/A	12	23	67
Russell Porteous (Note 1)	2003	N/A	11	18	66
David Pownall	2007	2012	23	26	N/A
Stuart Ramsay (Note 2)	2009	2011	17	N/A	N/A
Alban Rees (Note 1)	2000	N/A	11	20	66
Brian Rees (Note 1)	2001	N/A	11	20	66
Ben Reid (Note 4)	2000	2012	29	16	N/A
Richard Samson (Note 4)	2005	2010	20	16	N/A
Allan Smith (Notes 4 & 6)	2004	2010	25	16	N/A
John Smith (Note 1)	2000	N/A	9	20	70
Kathryn Smith (Note 1)	1997	N/A	17	34	97
Robin Stewart (Note 1)	1989	N/A	14	20	49
Jeanette Timmins (Note 1)	2004	N/A	9	20	70
Len Wardle (Note 8)	1992	2011	135	120	N/A
Stephen Watts	2000	2010	50	55	N/A

Note 1 Director stepped down effect from 7 June 2009 and received Compensation for Loss of Office payment in addition to their fee.
Note 2 Director appointed with effect from 7 June 2009.
Note 3 Douglas Fletcher stepped down from the Board on 7 June 2009 and received a Compensation for Loss of Office payment of £81,000 which was payable direct to his employing society – Plymouth & South West Co-operative Society Limited. Subsequently in September 2009, Plymouth & South West Co-operative Society transferred its engagements to The Co-operative Group.
Note 4 The remuneration of some Directors is paid, at their request, direct to their employers who release them to act as Directors of the Group.
Note 5 Patrick Grange stepped down as a Group Deputy Chair with effect from 6 June 2009.
Note 6 Allan Smith was appointed as a Group Deputy Chair on 7 June 2009.
Note 7 Bob Burlton stepped down as a Group Director on 7 June 2009 but retained his seat as a Director and Chair of the CFS Board. Upon stepping down as a Group Director, Bob received a Compensation for Loss of Office payment of £132,167.
Note 8 Includes Society cars.

Independent auditors' report to the members of Co-operative Group Ltd

We have audited the financial statements of Co-operative Group Ltd (the Society) for the period ended 2 January 2010, which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated balance sheet, the Consolidated statement of changes in equity, the Consolidated cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Society's members, as a body, in accordance with section 9 of the Friendly and Industrial and Provident Societies Act 1968. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors
The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 36.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Industrial and Provident Societies Act 1965 to 2002 and the Industrial and Provident Societies (Group Accounts) Regulations 1969. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that information presented in the Business review, Financial review, Key performance indicators, Operational risk and Principal risks and uncertainties that is cross-referred from the Business review section of the Directors' report.

In addition we report to you if, in our opinion, the Society has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the statement on page 30 reflects the Society's compliance with paragraphs D1.1 (paragraph 5), D2.1, D2.4, D3.1 (paragraph 3) and D3.2 of the Co-operatives^{UK} Limited's Corporate Governance Code of Best Practice issued in May 2005, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Society's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit 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 statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion
In our opinion:

- The financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the Group's affairs as at 2 January 2010 and of its profit for the period then ended;
- The financial statements have been properly prepared in accordance with the Industrial and Provident Societies Acts 1965 to 2002 and Industrial and Provident Societies (Group Accounts) Regulations 1969; and
- The information given in the Directors' Report is consistent with the financial statements.

Jonathan Hurst (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
Manchester

17 March 2010

Consolidated income statement
for the period ended 2 January 2010

	Notes	51 weeks ended 2 January 2010 Before significant items £m	Significant items (Notes 3 & 6) £m	Total £m	52 weeks ended 10 January 2009 Before significant items £m	Significant items (Notes 3 & 6) £m	Total £m
Gross sales		**13,673.8**		**13,673.8**	10,435.2		10,435.2
Less:							
Value Added Tax		**(637.6)**		**(637.6)**	(462.4)		(462.4)
Agency share of sales		**(509.3)**		**(509.3)**	(573.8)		(573.8)
Revenue	1	**12,526.9**		**12,526.9**	**9,399.0**		**9,399.0**
Premiums ceded to reinsurers	2	**(37.7)**		**(37.7)**	(37.6)		(37.6)
Net revenue	1	**12,489.2**		**12,489.2**	**9,361.4**		**9,361.4**
Operating income	6	**876.5**	**62.4**	**938.9**	868.5	–	868.5
Fair value amortisation	3	**99.1**	**–**	**99.1**	–	–	–
Operating expenses	3	**(12,852.4)**	**(171.5)**	**(13,023.9)**	(9,837.1)	(117.4)	(9,954.5)
Operating profit		**612.4**	**(109.1)**	**503.3**	**392.8**	**(117.4)**	**275.4**

Operating profit:							
Before fair value amortisation		***513.3***	***(109.1)***	***404.2***	*392.8*	*(117.4)*	*275.4*
Fair value amortisation		***99.1***	***–***	***99.1***	*–*	*–*	*–*
		612.4	***(109.1)***	***503.3***	*392.8*	*(117.4)*	*275.4*

	Notes	2010 Total £m	2009 Total £m
Financial expenses – interest payable	9	**(107.9)**	(36.0)
Financial expenses – fair value movement	10	**(34.5)**	(83.0)
Net financial income – other	11	**40.7**	60.7
Net financial expenses		**(101.7)**	**(58.3)**
Share of profit of associates and joint ventures	19	**0.3**	0.5
Profit before payments to and on behalf of members		**401.9**	**217.6**
Payments to and on behalf of members	12	**(107.1)**	(101.7)
Profit before tax		**294.8**	**115.9**
Income tax (expense)/credit		**(120.8)**	55.0
Less: tax attributable to policyholders' returns		**6.4**	(52.1)
Total taxation	13	**(114.4)**	**2.9**
Profit after tax but before loss on discontinued operations		**180.4**	**118.8**
Loss on discontinued operations, net of tax	14	**(20.1)**	(6.4)
Profit for the period		**160.3**	**112.4**
Attributable to:			
Equity holders of the parent		**155.5**	107.1
Minority interests		**4.8**	5.3
Profit for the period		**160.3**	**112.4**

Both profit before tax and total taxation are after deducting policyholder tax (tax payable by CIS in respect of its long-term business).

Consolidated statement of comprehensive income

for the period ended 2 January 2010

	Notes	2009 £m	2008 £m
Profit for the period		**160.3**	112.4
Other comprehensive income:			
Changes in available-for-sale investments		**62.2**	(36.0)
Actuarial gains and losses on employee pension scheme		**(545.6)**	(146.2)
Revaluation of self-occupied properties	43	**–**	(4.8)
Revaluation of self-occupied property transferred to assets held for sale	43	**–**	14.8
Revaluation of self-occupied properties transferred to unallocated divisible surplus		**–**	(10.0)
Changes in cashflow hedges		**(48.4)**	134.5
Cash flow hedges transferred to profit or loss		**–**	0.8
Revaluation of property, plant and equipment	16	**–**	9.7
Foreign currency translation differences for foreign operations		**0.3**	1.0
Tax on items taken directly to consolidated statement of comprehensive income	13	**147.2**	10.2
Other comprehensive income for the period, net of tax		**(384.3)**	(26.0)
Total comprehensive income for the year		**(224.0)**	86.4
Total comprehensive income attributable to:			
Equity holders of the parent		**(227.5)**	78.0
Minority interest		**3.5**	8.4
		(224.0)	86.4

Consolidated balance sheet
As at 2 January 2010

	Notes	2009 £m	2008 £m
Assets			
Trading Group assets			
Property, plant and equipment	16	**2,517.1**	1,887.3
Intangible assets	17	**1,575.9**	729.0
Biological assets		**0.4**	0.3
Investment property	18	**321.6**	322.6
Investments in associates and joint ventures	19	**25.1**	23.3
Other investments	19	**4.6**	4.2
Derivatives	20	**10.6**	17.1
Retirement benefits	21	**5.1**	406.4
Deferred tax assets	22	**284.3**	53.7
Total Trading Group non-current assets		**4,744.7**	3,443.9
Inventories	23	**557.3**	426.7
Biological assets		**2.7**	2.6
Income tax receivable		**9.9**	–
Trade and other receivables	24	**527.2**	526.9
Cash and cash equivalents		**346.9**	167.5
Assets classified as held for sale	25	**12.1**	29.7
Total Trading Group current assets		**1,456.1**	1,153.4
Total Trading Group assets		**6,200.8**	4,597.3
Financial Services assets			
Cash and balances at central banks		**1,703.0**	164.7
Derivatives	20	**1,704.3**	1,230.4
Loans and advances to banks	26	**1,781.5**	1,886.7
Loans and advances to customers	27	**34,070.2**	10,244.4
Fair value adjustments for hedged risk	27	**66.1**	–
Investments	28	**25,469.8**	21,195.3
Investments in associates and joint ventures	19	**2.0**	–
Reinsurance contracts	29	**3,019.0**	3,121.4
Income tax		**36.3**	29.0
Intangible assets	17	**216.8**	99.1
Property, plant and equipment	16	**190.6**	80.3
Deferred tax assets	22	**103.8**	5.8
Prepayments and other receivables	30	**560.6**	644.8
Assets classified as held for sale	31	**–**	50.0
Total Financial Services business assets		**68,924.0**	38,751.9
Total assets		**75,124.8**	43,349.2

	Notes	2009 £m	2008 £m
Liabilities			
Trading Group liabilities			
Interest-bearing loans and borrowings	35	**1,829.7**	422.4
Trade and other payables	36	**483.3**	316.9
Derivatives	20	**96.0**	37.1
Provisions	37	**415.0**	209.5
Retirement benefits	21	**252.7**	146.0
Deferred tax liabilities	22	**301.3**	326.6
Total Trading Group non-current liabilities		**3,378.0**	1,458.5
Interest-bearing loans and borrowings	35	**47.5**	310.5
Income tax payable		**–**	20.0
Trade and other payables	36	**1,454.7**	1,065.1
Provisions	37	**56.5**	14.0
Total Trading Group current liabilities		**1,558.7**	1,409.6
Total Trading Group liabilities		**4,936.7**	2,868.1
Financial Services liabilities			
Amounts owed to credit institutions	38	**7,159.2**	2,893.8
Customer accounts	39	**30,821.2**	11,667.2
Capital bonds	40	**1,647.1**	–
Derivatives	20	**1,094.2**	514.7
Insurance and participation contracts	29	**16,364.1**	16,697.8
Debt securities in issue	41	**3,334.3**	568.0
Investment contracts	42	**259.9**	190.9
Unallocated divisible surplus	43	**1,052.8**	622.2
Other borrowed funds	44	**946.5**	358.4
Income tax payable		**81.9**	109.2
Other liabilities and accruals	45	**2,678.6**	2,774.4
Deferred tax liabilities	22	**126.5**	118.3
Retirement benefit obligations	21	**36.7**	3.2
Provisions	46	**62.2**	30.1
Total Financial Services business liabilities		**65,665.2**	36,548.2
Total liabilities		**70,601.9**	39,416.3
Equity			
Members' share capital	32	**71.9**	67.9
Retained earnings		**4,237.1**	3,664.7
Other reserves	33	**178.6**	166.6
Total equity attributable to equity holders of the parent		**4,487.6**	3,899.2
Minority interests		**35.3**	33.7
Total equity	34	**4,522.9**	3,932.9
Total equity and liabilities		**75,124.8**	43,349.2

Board's certification

The financial statements on pages 44 to 164 are hereby signed on behalf of the Board pursuant to Section 3(a)(1) of the Friendly and Industrial Provident Societies Act 1968.

Len Wardle Chair, **Stephen Watts** Deputy Chair, **Peter Marks** Group Chief Executive, **Moira Lees** Group Secretary

17 March 2010

Consolidated statement of changes in equity

for the period ended 2 January 2010

	Share capital £m	Translation reserve £m	Hedging reserve £m	2009 Revaluation reserve property plant and equipment £m	Available for sale investments reserve £m	Retained earnings £m	Total shareholder interest £m	Minority interest £m	Total equity £m
Balance at 11 January 2009	67.9	0.8	104.3	94.4	(32.9)	3,664.7	3,899.2	33.7	3,932.9
Profit or Loss						155.5	155.5	4.8	160.3
Other comprehensive income:									
Changes in available-for-sale assets									
Gains less losses on available-for-sale assets					74.6		74.6	(1.0)	73.6
Gains recycled to profit or loss on impairment					(2.6)		(2.6)		(2.6)
Cumulative gains transferred to the income statement					(4.9)		(4.9)		(4.9)
Revaluation of equity shares					(3.2)		(3.2)		(3.2)
Transferred to other operating income on disposal of equity shares					(0.7)		(0.7)		(0.7)
Changes in cashflow hedges									
Net changes in fair value recognised directly in equity			(47.6)				(47.6)	(0.8)	(48.4)
Actuarial losses on employee pension scheme						(545.6)	(545.6)		(545.6)
Revaluation of property, plant and equipment				–			–		–
Foreign currency translation differences		0.3					0.3		0.3
Tax on items taken directly to other comprehensive income		(0.1)	13.3		(17.1)	150.6	146.7	0.5	147.2
Total other comprehensive income	–	0.2	(34.3)	–	46.1	(395.0)	(383.0)	(1.3)	(384.3)
Contributions by and distributions to members:									
Arising from transfer of engagements	4.1					812.6	816.7		816.7
Shares issued and interest credited less shares withdrawn	(0.1)						(0.1)		(0.1)
Members' share interest						(0.7)	(0.7)		(0.7)
Dividend Financial Services – minority interests							–	(0.9)	(0.9)
Dividend Trading group – minority interests							–	(1.0)	(1.0)
Total contributions by and distributions to members	4.0	–	–	–	–	811.9	815.9	(1.9)	814.0
Balance at 2 January 2010	**71.9**	**1.0**	**70.0**	**94.4**	**13.2**	**4,237.1**	**4,487.6**	**35.3**	**4,522.9**

	Share capital £m	Translation reserve £m	Hedging reserve £m	2008 Revaluation reserve property plant and equipment £m	Available for sale invest-ments reserve £m	Retained earnings £m	Total share-holder interest £m	Minority interest £m	Total equity £m
Balance at 13 January 2008	67.2	–	9.5	87.3	(6.4)	3,612.2	3,769.8	27.6	3,797.4
Profit or Loss						107.1	107.1	5.3	112.4
Other comprehensive income:									
Changes in available-for-sale assets									
Gains less losses on available-for-sale assets					(75.2)		(75.2)	1.0	(74.2)
Losses recycled to profit or loss on impairment					42.8		42.8		42.8
Cumulative gains transferred to the income statement					(7.7)		(7.7)		(7.7)
Net losses transferred to gains less losses from investment securities					3.1		3.1		3.1
Changes in cashflow hedges									
Net changes in fair value recognised directly in equity			130.2				130.2	3.3	133.5
Net losses transferred from equity to profit or loss			0.8				0.8		0.8
Actuarial losses on employee pension scheme						(146.2)	(146.2)		(146.2)
Revaluation of property, plant and equipment				9.7			9.7		9.7
Foreign currency translation differences		1.0					1.0		1.0
Tax on items taken directly to other comprehensive income		(0.2)	(36.2)	(2.6)	10.5	40.9	12.4	(1.2)	11.2
Total other comprehensive income	–	0.8	94.8	7.1	(26.5)	(105.3)	(29.1)	3.1	(26.0)
Contributions by and distributions to members:									
Arising from transfer of engagements	0.8					51.9	52.7		52.7
Shares issued and interest credited less shares withdrawn	(0.1)						(0.1)		(0.1)
Members' share interest						(1.2)	(1.2)		(1.2)
Dividend Financial Services – minority interests							–	(0.9)	(0.9)
Dividend Trading group – minority interests							–	(1.4)	(1.4)
Total contributions by and distributions to members	0.7	–	–	–	–	50.7	51.4	(2.3)	49.1
Balance at 10 January 2009	67.9	0.8	104.3	94.4	(32.9)	3,664.7	3,899.2	33.7	3,932.9

Refer to Note 33 for explanations of the nature and purpose of each reserve.

Consolidated statement of cash flows
for the period ended 2 January 2010

	Notes	2009 Financial Services £m	2009 Trading Group activities £m	2009 Total £m	2008 Financial Services £m	2008 Trading Group activities £m	2008 Total £m
Net cash from operating activities	47,48	**(2,493.3)**	**507.2**	**(1,986.1)**	294.3	240.5	534.8
Cash flows from investing activities							
Acquisition of property, plant and equipment		**(23.2)**	**(349.7)**	**(372.9)**	(9.6)	(291.2)	(300.8)
Proceeds from sale of property, plant and equipment		**0.1**	**191.3**	**191.4**	6.0	117.0	123.0
Purchase of intangible assets		**(84.0)**	**–**	**(84.0)**	(45.8)	–	(45.8)
Acquisition of investment		**(180.0)**	**(1.8)**	**(181.8)**	–	(8.5)	(8.5)
Interest (paid)/received		**(0.7)**	**0.1**	**(0.6)**	–	–	–
Internal dividends (paid)/received		**(76.8)**	**76.8**	**–**	(42.3)	42.3	–
Disposal of business		**–**	**529.0**	**529.0**	–	34.1	34.1
Acquisition of business net of cash acquired	50	**–**	**(1,698.0)**	**(1,698.0)**	–	(39.8)	(39.8)
Cash and cash equivalents arising on transfer of engagements	49	**1,535.6**	**2.5**	**1,538.1**	–	8.3	8.3
Proceeds from sale and maturity of investment securities		**3,162.4**	**–**	**3,162.4**	14,156.8	–	14,156.8
Purchase of investment securities		**(1,814.8)**	**–**	**(1,814.8)**	(14,074.2)	–	(14,074.2)
Net cash from investing activities		**2,518.6**	**(1,249.8)**	**1,268.8**	(9.1)	(137.8)	(146.9)
Cash flows from financing activities							
Interest paid on borrowings		**(27.0)**	**(106.5)**	**(133.5)**	(17.3)	(37.3)	(54.6)
Issue/(Repayment) of share capital	32	**180.0**	**(0.1)**	**179.9**	–	(0.1)	(0.1)
Repayment of subordinated loan stock		**(105.0)**	**–**	**(105.0)**	–		–
Decrease in corporate investor shares	35	**–**	**(10.9)**	**(10.9)**	–	(36.1)	(36.1)
Preference dividends paid		**(5.6)**	**–**	**(5.6)**	(5.6)	–	(5.6)
Dividends paid to minority shareholders in subsidiary undertaking		**(0.9)**	**(1.0)**	**(1.9)**	(0.9)	(1.4)	(2.3)
Payments to and on behalf of members		**–**	**(96.1)**	**(96.1)**	–	(93.8)	(93.8)
Issue of borrowings		**–**	**1,081.9**	**1,081.9**	–	77.8	77.8
Finance leases receipts/(repaid)		**–**	**15.1**	**15.1**	–	(1.4)	(1.4)
Net cash from financing activities		**41.5**	**882.4**	**923.9**	(23.8)	(92.3)	(116.1)
Net increase/(decrease) in cash and cash equivalents		**66.8**	**139.8**	**206.6**	261.4	10.4	271.8
Cash and cash equivalents at beginning of year		**2,316.9**	**207.1**	**2,524.0**	2,055.5	196.7	2,252.2
Cash and cash equivalents at end of year		**2,383.7**	**346.9**	**2,730.6**	2,316.9	207.1	2,524.0
Analysis of cash and cash equivalents							
Cash and balances with central banks		**1,706.8**	**–**	**1,706.8**	164.7	–	164.7
Less mandatory deposits with Bank of England		**(34.0)**	**–**	**(34.0)**	(9.9)	–	(9.9)
Loans and advances to banks	26	**462.5**	**–**	**462.5**	1,589.7	–	1,589.7
Short-term investments		**252.0**	**–**	**252.0**	579.8	–	579.8
Cash and cash equivalents per balance sheet		**4.8**	**346.9**	**351.7**	–	167.5	167.5
Amounts due to credit institutions		**(8.4)**	**–**	**(8.4)**	(7.4)	–	(7.4)
Cash invested intercompany		**–**	**–**	**–**	–	39.6	39.6
		2,383.7	**346.9**	**2,730.6**	2,316.9	207.1	2,524.0

Cash invested intercompany relates to Trading Group cash balances held with The Co-operative Bank.

Cash and cash equivalents include deposits of £67.1m (2008: £73.8m) held in trustee-administered bank accounts of the Society, which can only be utilised to meet liabilities in respect of funeral bonds issued. Provisions for these liabilities are included in trade and other payables (see Note 36).

Accounting policies

Policies applicable to all businesses

1 Accounting basis
The Co-operative Group Limited is an Industrial and Provident Society domiciled in England and Wales. The address of the Society's registered office is New Century House, Manchester M60 4ES.

The Group accounts have been prepared in accordance with the Industrial and Provident Societies Acts 1965 to 2002, the Industrial and Provident Societies (Group Accounts) Regulations 1969, and applicable International Financial Reporting Standards as endorsed by the EU (IFRS) for the period ended 2 January 2010. They consolidate the accounts of Group undertakings at the period-end and, as permitted by statute and IAS 1, the account formats have been adapted as necessary to give a fair presentation of the state of affairs and result of the Group. As allowed by Industrial and Provident statute, a separate set of financial statements for the Society are not included.

The financial statements follow the provisions of the Revised Statement of Recommended Practice on Accounting for Insurance Business (SORP) issued by the Association of British Insurers in 2005 (as amended in December 2006), insofar as these are compatible with the requirements of IFRS.

The accounts are presented in pounds sterling. They are prepared under the historical cost basis as modified by the revaluation of available-for-sale financial assets, financial assets and liabilities valued at fair value through profit or loss, derivative financial instruments, certain items of property, plant and equipment, biological assets, investment properties and, where applicable, assets held for sale and disposal groups.

The Group's operations comprise two key divisions: Trading Group and Financial Services (which is broken down into further segments). Each of these divisions is material in itself and operating in very different industry sectors and regulatory environments.

The conventional financial statement formats for the Banking and Insurance operations differ from those of the Trading Group. In order to reflect the performance of the Group as a single economic entity, the income of the Banking and Insurance Divisions, as defined in accounting policies 26, 27 and 31, has been included as revenue in the consolidated income statement. Operating expenses are analysed by nature, as defined by IAS 1.The segmental note analysis also separately discloses Group operating costs that relate to all three businesses. As permitted by IAS 1 in the case of diverse groups such as The Co-operative Group, a mixed presentation has been applied to the balance sheet: the assets and liabilities of the Trading Group are analysed as current or non-current, the assets and liabilities of Financial Services are analysed in order of liquidity. Similarly, the cash flow statements of the Trading and Financial Services Divisions have been presented separately because of the differing nature of their operations. The reconciliations to cash from operating activities in Notes 47 and 48 have been performed separately for Trading and Financial Services. These reconciliations are from operating profit in order that the cash flows of these operations can be linked more easily to their results as disclosed in the segmental analysis in Note 1. Investment properties held by the long-term business to earn long-term rentals or for long-term capital appreciation are included within Investments in the financial services assets.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, except where stated otherwise.

Going concern
The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review on pages 6 to 16. The financial risks facing the Group, its liquidity position and borrowing facilities are described principally in Note 54 to the accounts.

In addition Note 54 also includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives and its financial instruments and hedging activities.

As noted in the Statement on Going Concern on page 33, the directors are required to assess whether the Society has adequate resources to continue in operational existence for the foreseeable future. In forming this view, the directors have considered the Trading Group and the Financial Services businesses (CFS) separately and then the Group as a whole.

The Trading Group has detailed procedures for assessing its capital and funding requirements, which are monitored regularly. Following the refinancing in 2008 to fund the Somerfield acquisition, the Trading Group meets its day to day working capital needs through a number of facilities totalling £2,083m. Capital repayments in relation to these facilities commence in February 2011 with £100m repayable in 2011 and 2012. The remainder of the facilities are due for repayment between July 2013 and December 2018. The Trading Group has prepared detailed forecasts and projections for the period to July 2011 which, taking account of reasonably possible changes in trading performance in the current economic environment, show that the Trading Group should be able to operate within the level of its current available facilities.

In common with many financial institutions, the General Insurance business is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The forecasts and objectives, taking into account a number of potential changes in trading performance, insurance and investment risk, show that the General Insurance business should be able to operate at an adequate level of regulatory capital for the foreseeable future. The General Insurance business has also considered a number of stress tests on capital and these provide assurance that it is sufficiently capitalised.

In common with many financial institutions, the Co-operative Bank meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources, and is required to maintain a sufficient buffer over regulatory capital requirements in order to continue to be authorised to carry on its business. The bank's forecasts and objectives, taking into account a number of potential changes in trading performance and funding retention, show that the bank should be able to operate at adequate levels of both liquidity and capital, for the foreseeable future. The bank has also considered a number of stress tests on capital and liquidity and these provide assurance that the bank is sufficiently capitalised and is comfortably in excess of liquidity stress tests.

Taking all these elements of the Group together, and after making all appropriate enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future and they continue to adopt the going concern basis in preparing the Group's financial statements.

Critical accounting estimates and judgements in applying accounting policies
The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The Group makes estimates and assumptions that affect the reported assets and liabilities. Estimates and judgements are continually assessed and reviewed and are based on historical experience and reasonable expectations of future events.

Judgements made by management in the application of IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are described in the following notes stated below:

- Pension assumptions (Note 21)
- Provision for claims (Note 37)
- Goodwill and impairment (Note 17)
- Closure and restructuring provisions (Notes 37 and 46)
- Ultimate liability from claims made under insurance contracts – details of the methodology, key assumptions and sensitivities are provided in Note 29
- Estimate of future benefit payments from long-term insurance contracts (Note 29)
- Fair value of investment contracts (Note 42)
- Fair value of unlisted financial assets (Note 54)
- Co-operative Bank impairment provision on loans and advances and structured investments (Note 3)
- Co-operative Bank Financial Services Compensation Scheme levy (Notes 3 and 46)
- Co-operative Bank financial asset and liability classification (Accounting policy 7 – Derivatives and other financial instruments).

The Co-operative Group has applied all endorsed IFRS that are effective for the Group's financial statements for the period ended 2 January 2010 and the comparative year.

Restatement and changes in accounting policies
In accordance with IFRS 5, the income statement comparatives have been restated to show the results of businesses that have become discontinued in the current accounting period.

The Group adopted IFRS 8, Operating Segments as of 11 January 2009. The Group now determines and presents operating segments based on the management information that is provided to the Group Chief Executive, who is the Group's chief operating decision maker. Previously, operating segments were determined and presented in accordance with IAS 14 Segment Reporting. Comparative segment information has been re-presented in conformity with the transitional requirements of this standard.

In accordance with IFRS 8, an operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. Each operating segment's result is reviewed regularly by the Group's Chief Executive Officer to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Segment results that are reported to the Group Chief Executive include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated assets comprise mainly corporate assets (primarily the Group's deferred tax assets).

The adoption of IFRS 8 only impacts presentation and disclosure aspects and not the Group's profit or net assets.

The Group has applied revised IAS 1 Presentation of Financial Statements (2007) in these financial statements. As a result, comparative information has been re-presented so that it is in conformity with the revised standard. The change in the accounting standard has only impacted presentation and not the Group's profit or net assets.

IAS 23 Borrowing costs (2007) has become effective since 11 January 2009. This standard requires the Group to capitalise all borrowing costs in relation to qualifying assets for which the commencement date of capitalisation is on or after 11 January 2009. Capitalisation was previously an option under IAS 23. As the Group does not specifically borrow funds for the purpose of obtaining a particular qualifying asset, this revision to the standard is not expected to impact the Group's profit or net assets.

The Group has applied IFRIC 13 Customer Loyalty Programmes from 11 January 2009. This IFRIC addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. Due to the cash nature of the Co-operative dividend, the new interpretation has no impact on the Group's profit or net assets.

In January 2009, the IASB issued IFRIC 18 Transfers of Assets from Customers with an effective date for all transfers on or after 1 July 2009. This adoption of this IFRIC has not had an impact on the Group's financial statements

In 2008, the IASB issued further amendments to IFRS 7: Improving Disclosures about Financial Instruments. The amendments are effective for accounting periods beginning on or after 1 January 2009. This standard enhances current financial instruments disclosures both for fair value measurement and liquidity risk. The amendments introduce increasing disclosure requirements in relation to fair value measurement, particularly when markets are inactive and enhancements to the information provided in relation to the nature and extent of liquidity risk. The Group voluntarily gave certain new disclosures for the year ending 10 January 2009. The Group has now adopted the amendments with prior year disclosures where appropriate.

Standards, amendments and interpretations issued but not yet effective
The Group has not early adopted the following standards and statements which have been endorsed by the EU, but are not yet effective. The adoption of these standards is not expected to have a material impact on the Group's accounts when adopted, except where stated:

Revised IFRS 3 *Business Combinations (2008)*
This standard incorporates the following changes:

- the definition of a business has been broadened, which may result in more acquisitions being treated as business combinations;
- contingent consideration will be measured at fair value, with subsequent changes in fair value recognised in profit or loss;
- transaction costs, other than share and debt issue costs, will be expensed as incurred;
- any pre-existing interest in an acquiree will be measured at fair value, with the related gain or loss recognised in profit or loss; and
- any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of an acquiree, on a transaction-by-transaction basis.

Revised IFRS 3 is effective prospectively for annual accounting periods beginning on or after 1 July 2009.

Amended IAS 27 *Consolidated and Separate Financial Statements (2008)*
This standard requires accounting for changes in ownership interests in a subsidiary that occur without loss of control, to be recognised as an equity transaction. When control of a subsidiary is lost, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss.

The amendment is effective for accounting periods beginning on 1 July 2009.

In November 2008, the IASB issued IFRIC 17 Distribution of non-cash Assets to Owners, with an effective date for all periods beginning on or after 1 July 2009. This will not have an effect on the Group's financial statements.

In April 2009, the IASB issued Improvements to IFRSs 2009, which comprises 15 amendments to 12 standards. Effective dates, early application and transitional requirements are addressed on a standard-by-standard basis. The majority of the amendments will be effective for the Group from 1 January 2010. The amendments are unlikely to have a material impact on the Group's financial statements.

In March 2009, the IASB amended IAS 39 Financial Instruments: Recognition and Measurement and IFRIC 9 Reassessment of Embedded Derivatives with effective date for all periods beginning on or after 1 July 2009. The Group will apply this amendment from 3 January 2010. As yet, management has yet to determine the full impact of this amendment.

2 Accounting dates

The financial statements are made up for the 51 weeks to 2 January 2010. Comparatives are for the 52 weeks to 10 January 2009. Since the financial period is virtually co-terminus with the calendar year 2009, the financial period figures are headed 2009 and the corresponding figures for the previous year are headed 2008. The year end date was changed to create a more coherent reporting deadline structure for the Group. The comparative amounts, as a result, are not entirely comparable with the results of 2009 as they are based on a longer period.

The Financial Services subsidiaries of the Group have prepared accounts with accounting periods ending 31 December. This differs from the parent of the group and other trading group subsidiaries which have accounting periods ending on the first Saturday of each new year. For the period ending 2 January 2010, there are no significant transactions or events which need to be adjusted for to reflect the difference in reporting dates.

3 Basis of consolidation

The consolidated financial statements include the Society and its subsidiary undertakings.

Subsidiaries are those entities controlled by the Group. Control exists when the Society has the power, directly or indirectly, 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 are presently exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

4 Transfer of engagements accepted from incoming societies

Assets and liabilities accepted under a transfer of engagements are restated at fair value, including any adjustments necessary to comply with the accounting policies of the Group.

5 Financial expenses

Financial expenses exclude interest in respect of Banking activities, which is shown within operating profit.

6 Significant items

Non-recurring items that are material by both size and nature are treated as significant items and disclosed separately on the face of the income statement except for the fair value amortisation which will recur over future years.

The separate reporting of significant items helps provide an indication of the Group's underlying business performance. Events which may give rise to the classification of items as significant include individually significant restructuring and integration costs and asset impairments.

7 Derivatives and other financial instruments

Information in respect of derivatives and other financial instruments has for clarity been prepared separately for the Trading and Corporate, Banking and Insurance divisions. The policies applied are consistent across the Group.

Trading activities

Financial instruments (excluding derivatives)

The Trading Group classifies its financial assets and liabilities (excluding derivatives) as either:

1 Loans and receivables

Loans and receivables are initially recognised at fair value, being cost inclusive of attributable transaction costs and subsequently carried at amortised cost using the effective interest method.

2 Available-for-sale

Available-for-sale financial assets are equity investments, intended to be held for an indefinite period of time. These are measured at fair value with movements in the carrying value brought into equity as they arise, except for changes in value arising from impairment, which are recognised in the income statement. On disposal, gains and losses recognised previously in equity are transferred to the income statement. The fair value of equity investments is their quoted market price (bid value) at the balance sheet date.

3 Financial assets and liabilities at fair value through profit or loss

These are:

- acquired or incurred principally for the purpose of selling or repurchasing in the near term;
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking; or
- upon initial recognition designated at fair value through profit or loss to eliminate or significantly reduce a measurement of recognition inconsistency.

These are measured at fair value with movements in the carrying value brought into the income statement as they arise.

No assets are classified as held to maturity.

The Trading Group measures all of its financial liabilities (excluding derivatives) at amortised cost, except quoted debt, which is measured at fair value through the profit and loss.

The quoted debt is designated at fair value through the income statement because this significantly reduces a measurement inconsistency (accounting mismatch) that would arise from measuring interest rate swaps or recognising gains and losses on them on different bases. There are a number of interest rate swaps whose execution and maturity dates link into the quoted debt.

Also, this group of financial assets and/or liabilities is managed and its performance is evaluated on a fair value basis in accordance with the risk management strategy.

Derivative financial instruments
The Trading Group uses derivative financial instruments to provide an economic hedge to its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its treasury policy, the Trading Group does not hold or issue derivative financial instruments for trading purposes.

Derivatives entered into include swaps and forward rate agreements. Derivative financial instruments are measured at fair value and any gains or losses are included in the income statement.

Fair values are based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cash flow models. For further details refer to Note 54.

Interest payments or receipts arising from interest rate swaps are recognised within net financial income/(expenses) in the period in which the interest is incurred or earned.

Banking activities
Financial instruments (excluding derivatives)
The bank classifies its financial assets (excluding derivatives) as either:
- loans and receivables;
- available-for-sale; or
- financial assets at fair value through profit or loss.

No assets are classified as held to maturity.

The bank measures all of its financial liabilities at amortised cost, other than those within the wholesale trading portfolio, which are measured at fair value through profit or loss.

1 Loans and receivables
Loans and receivables to customers and banks (except for specific assets designated at fair value through profit or loss – see below) are measured at amortised cost, being the amount advanced plus any unpaid interest, commissions and fees charged to the customer less amounts repaid or written off; less impairment provisions for incurred losses and adjusted for the cumulative amortisation arising from effective interest rate adjustments. Effective interest rate adjustments arise when future cash flows are discounted through the expected life of the financial instrument.

2 Available-for-sale
Available-for-sale financial assets are non-traded investment securities, 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 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. 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.

3 Financial assets at fair value through profit or loss
These are:
- acquired or incurred principally for the purpose of selling or repurchasing in the near term;
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking; or
- upon initial recognition designated at fair value through profit or loss to eliminate or significantly reduce a measurement or recognition inconsistency.

They include pledged assets and derivative financial instruments that are not designated as effective hedges.

These 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 as they arise.

Financial asset and liability classification
The Co-operative Bank's accounting policies provide scope for assets and liabilities designated at inception into different accounting categories in certain circumstances as outlined above and defined as follows:
- In classifying financial assets and liabilities as 'trading', the Co-operative Bank has determined that it meets the description of trading assets for those assets and liabilities it acquires or incurs principally for the purpose of selling or repurchasing in the near term, or holds as part of a portfolio that is managed together for short-term profit or position taking as set out in 3 above.
- In designating financial assets or liabilities at fair value through profit or loss, the Co-operative Bank has determined that it has met one of the criteria for this designation as set out in 3 above.
- In classifying assets as Loans and Receivables at amortised cost, the Co-operative Bank has determined it meets the description as set out in 1 on the previous page.

The Co-operative Bank makes estimates and assumptions that affect the reported assets and liabilities. Critical estimates and judgements are continually assessed and reviewed, and are based on historical experience and reasonable expectations of future events.

Impairment provision
At the balance sheet date, the bank assesses its financial assets (including loans and advances to customers) for objective evidence that an impairment loss has been incurred.

The amount of the loss is the difference between:
- the asset's carrying amount;
- the present value of estimated future cash flows (discounted at the asset's original or variable effective interest rate).

The amount of the impairment loss 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.

The written-down value of the impaired loan is compounded back to the net realisable balance over time using the original effective interest rate. This is reported through interest and similar income within the income statement and represents the unwind of the discount.

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 virtually certain to be received. Provisions are released at the point when it is deemed that the risk of loss has reduced to the extent that a provision is no longer required.

Impairment losses on available-for-sale assets are recognised by transferring the difference between the amortised cost and current fair value out of equity to profit or loss. When a subsequent event causes the amount of impairment loss on an available-for-sale debt security to decrease, the impairment loss is reversed through profit or loss.

Derecognition

Financial assets are derecognised when:

- the rights to receive cash flows from the asset have ceased; or
- the Bank has transferred substantially all the risks and rewards of ownership of the assets.

When available for sale financial assets are derecognised (or impaired) the cumulative gain or loss, including that previously recognised in reserves, is recognised in the income and expenditure account.

Financial Liabilities

Financial liabilities are contractual obligations to deliver cash or some other 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

Certain non-derivative financial liabilities included within capital bonds have been designated at fair value 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.

A financial liability is extinguished when the obligation is discharged, cancelled or expires. Any difference between the carrying amount of a financial liability extinguished and the consideration paid is recognised through the income statement.

Borrowed funds

Borrowings are recognised initially at 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 23) 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 effective interest method.

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 offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

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 from banks, other deposits or shares, as appropriate. The difference between sale and repurchase price is accrued over the life of the agreements using the effective interest rate method.

Securities purchased under agreements to re-sell (reverse repos) are classified as loans and advances to banks on the balance sheet, as appropriate.

Securities lent to counterparties are retained on the balance sheet.

Securities borrowed are not recognised on the balance sheet, unless they are sold to third parties, in which case the purchase and sale are recorded. The obligation to return them is recorded at fair value as a trading liability.

Derivative financial instruments and hedge accounting

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: The gain or loss on re-measurement to fair value is recognised immediately in the income statement except where derivatives qualify for cash flow hedge accounting.

Embedded derivatives: A derivative may be embedded in another financial 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, the embedded derivative is separated from the host and held on the 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 policy for that class of financial instrument.

Cash flow hedges: Where derivatives are designated as hedges of the exposure to variability in cash flows of a recognised asset and 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 immediately in the income statement.

Cumulative amounts recognised through equity are recycled to the income statement in the period in which the underlying hedged item matures and its associated gain or loss affects the income statement. When a hedging relationship is broken or the hedge becomes ineffective, the cumulative unrealised gain or loss remaining in equity continues to be held in equity, and is transferred to the income statement only when the forecast transaction is recognised. Fair values are based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cash flow models. For further details refer to Note 54.

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. Fair values are based on quoted market prices in active markets, and where these are not available, using valuation techniques such as discounted cash flow models.

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 re-pricing time periods based on expected re-pricing dates, by scheduling cash flows into the periods in which they are expected to occur. Using this analysis, the Bank determines the amount it wishes to hedge and designates assets or liabilities from each portfolio as the hedged item.

The Bank measures the change in fair value of the hedged portfolio on a monthly basis. 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. It is called 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.

Mortgage commitments: The Bank enters into derivative contracts to reduce the exposure to risk on mortgage commitments made (for example, where the Bank has made an irrevocable offer of a loan to a customer). Mortgage commitments and the corresponding derivative contracts are recorded at fair value with movements recognised in the income statement.

Insurance activities

Investments

i) Financial assets designated as available-for-sale

CISGIL (CIS General Insurance Limited) classifies all holdings in debt securities as available-for-sale. Initial measurement is at fair value, being purchase price upon the date on which CISGIL commits to purchase plus directly attributable transaction costs. Subsequent valuation is at fairvalue with differences between fair value and carrying value recognised in equity as they arise. Any impairment losses and foreign exchange gains and losses are recognised in theincome statement as they arise. On disposal, gains or losses previously recognised in equity are transferred to the income statement.

ii) Financial assets at fair value through profit or loss

Investments, other than those in debt securities, are classified as financial assets at fair value through profit or loss within CISGIL. CIS designates investments backing long-term business and shareholder reserves as financial assets at fair value through profit and loss on their initial recognition, other than loans and actuaries, advances to customers.

Initial measurement is at fair value, being purchase price upon the date that CISGIL and CIS commit to purchase. Directly attributable transaction costs are expensed immediately on recognition. Subsequent valuation is at fair value with realised and unrealised gains and losses arising from changes in fair value of the financial assets included in the income statement in the period in which they arise.

iii) Financial liabilities

Financial liabilities (other than investment contracts) primarily represent loans and borrowings. Initial measurement is at fair value, being consideration received plus any directly attributable transaction costs. Subsequently, financial liabilities are measured at amortised cost using the effective interest method.

Financial liabilities whose value is linked to the performance of, and measured by reference to, the fair value of a matching portfolio of assets are designated at fair value through profit or loss at inception.

iv) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that CIS intends to sell in the short term or that it has designated as at fair value through profit or loss.

Loans and receivables are initially recognised at fair value, being cost inclusive of attributable transaction costs and subsequently carried at amortised cost using the effective interest method.

v) Derivative financial instruments

Derivatives are accounted for as trading instruments. Derivatives are initially recognised at fair value on the date upon which the derivative contract is entered into and are subsequently remeasured at their fair value. Any resultant gain or loss is recognised in the income statement.

The fair value of listed investments is their quoted clean bid price at the balance sheet date. If the market for a financial asset is not active, fair value is established using appropriate valuation techniques. Financial instruments, assets and liabilities are recognised/derecognised by CIS/CISGIL on the date upon which it commits to purchase/sell the instruments.

CIS and CISGIL operate approved stock lending schemes whereby their securities are loaned to other institutions in accordance with the terms of agreements with those institutions. Under these arrangements, ownership of the securities passes to the borrower but CIS/CISGIL has the right to demand the return of the loaned securities at any time. It also retains the right to receive the income to which it would have been entitled had the securities not been loaned. Accordingly, the securities continue to be recognised as investments in the balance sheet. CIS/CISGIL also participate in sale and repurchase (repo) arrangements in connection with its portfolio of government guaranteed securities (gilts). Under these arrangements, CIS/CISGIL sells gilts but is contractually obliged to repurchase them at a fixed price on a fixed future date. Securities that are the subject of repo arrangements at the balance sheet date are included in investments in the balance sheets at their bid value and the associated liability is recognised, being the capital amount owing under the repo arrangements.

CIS and CISGIL require all stock lending and repo transactions to be fully collaterised in an agreed form for their duration and equivalent collateral is returned at the completion of the loan period. Authorised collateral for stock lending arrangements comprises DBV or certificates of deposit. For repo arrangements, collateral is required in the form of cash.

8 Employee benefits

Pension obligations

The Group operates defined benefit pension schemes whereby the benefits that employees receive on retirement depend on factors such as age, years of service and earnings.

A qualified actuary calculates the Group's net obligation in respect of the defined benefit schemes by estimating the amount of future benefits that employees have earned in return for their service to date. The benefit is then discounted to determine its present value, using a discount rate equal to the yield available as at the balance sheet date on appropriate AA credit-rated bonds. The net obligation is this value less the fair value of the scheme's assets.

The cost of benefits earned in return for service in the accounting period is calculated using the projected unit method and is recognised in the income statement. Benefit is attributed to periods of service under the plan's benefit formula. Where employee service will lead to a materially higher level of benefit in later years, benefit is attributed on a straight-line basis over the estimated remaining service life. The income statement also includes a cost in respect of the unwinding of the discount rate used to calculate the present value of the scheme's benefits and a credit in respect of the expected return on the scheme's assets.

When the benefits of the schemes are improved, the cost relating to past service is recognised immediately in the income statement.

Actuarial gains and losses that arise from experience adjustments and changes in actuarial assumptions subsequent to 11 January 2004 are recognised in full in the Group's statement of comprehensive income. The charge to the income statement includes current service cost, past service cost, the interest cost of the scheme liabilities and the expected return on scheme assets.

9 Foreign currencies

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into sterling at foreign exchange rates ruling at that date. Differences arising on translation are recognised in the income statement, except for differences on the translation of available-for-sale debt securities which are recognised in the statement of comprehensive income.

10 Intangible assets

i) Goodwill

Goodwill represents amounts arising on acquisition of subsidiaries, associates and joint ventures. In respect of business acquisitions that have occurred since 11 January 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Transfers of engagements involving mutual businesses are currently outside the scope of IFRS 3. The Group have continued to account for transfers of engagements of Co-operative businesses to the Society within the Trading Group in accordance with established practice within the Co-operative sector, whereby assets and liabilities accepted under a transfer of engagements are restated at fair value, including any adjustments necessary to comply with the accounting policies of the Group. The resulting surplus or deficit is taken directly to reserves. This treatment has been applied to the transfer of engagements of Plymouth and South West Society during the year.

The merger of the Co-operative Bank plc with the Britannia Building Society during the year was the first such transfer of engagement undertaken within the Co-operative Bank. This transaction falls within the scope of IFRS 3 as it was a business combination between a corporate entity and a mutual entity and hence all assets and liabilities acquired have been measured at fair value at the acquisition date in accordance with IFRS 3. In selecting an appropriate basis for the valuation of consideration, in the absence of any other applicable GAAP, IFRS 3 (2008 Revised) has been applied in accordance with the principles applicable to selection of accounting policies laid out in IAS 8. The consideration transferred has therefore been valued by reference to the fair value of the Group's interest in the acquiree using a valuation technique. The technique involves assessing the future net profit of the acquiree and then discounting to perpetuity using a discount rate that reflects current market assessment of the time value of money and risks specific to the acquiree.

In respect of acquisitions prior to 11 January 2004, goodwill is included on the basis of its deemed cost, which represents the amount recorded under previous UK GAAP.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but is tested annually for impairment. In respect of associates, the carrying value of goodwill is included in the carrying amount of the investment in the associate.

Negative goodwill arising on an acquisition is recognised directly in profit or loss.

ii) Software development

Costs incurred in the development of computer software for internal use are capitalised and classified as intangible assets where they are not an integral part of the related hardware and amortised over their useful life, which is generally three years.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs directly associated with the production of software products that are expected to generate economic benefits beyond one year are recognised as intangible assets. The expenditure capitalised includes direct employee costs. All other costs associated with developing or maintaining computer software programs are recognised within the income statement as an expense as incurred.

iii) Assets in the course of construction

Assets in the course of construction include directly attributable software development costs and purchased software that are not an integral part of the related hardware, as part of strategic projects that meet the capitalisation requirements under IAS 38 but have not been brought into use. The costs are held within the items in course of construction until the project has gone live or the related asset is brought into use. At that point it will be transferred out of this classification and will be amortised based on the useful economic life as defined by the intangible asset accounting policy specified in (ii).

iv) Customer lists

Customer lists represent the intrinsic value of the retail savings book in the Britannia Bank which was recognised on transfer of engagement. The asset will be amortised over the estimated useful life of three years.

v) Other intangible assets

Other intangible assets include pharmacy licences and Deferred Acquisition Cost (DAC) assets that are acquired by the Group and are stated at cost less accumulated amortisation (see below) and impairment losses. Expenditure on internally generated goodwill and brands (except the brand generated as a result of Britannia Building Society transfer of engagement) is recognised in the income statement as an expense as incurred. The Britannia brand has been deemed to have a fair value on transfer of engagement and will be subject to an annual impairment review.

vi) Subsequent expenditure
Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

vii) Amortisation
Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment at each balance sheet date. Other intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

• Software development costs	3–7 years
• Pharmacy licences	20 years
• General Insurance deferred acquisition cost	Up to 1 year
• Long-term business deferred acquisition cost assets (being the estimated life of a unit trust contract)	Up to 6 years

11 Property, plant and equipment
Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment. Cost includes purchase price plus any costs directly attributable to bringing the assets to the location and condition necessary for it to be capable of operating in the manner intended by management.

Depreciation is provided on the cost or valuation less estimated residual value of other tangible fixed assets (excluding freehold land) on a straight-line basis over the anticipated working lives of the assets.

Annual rates are, generally:

Property	
Freehold buildings	2%
Leasehold property	Period of lease (2½% buildings)
Group plant	
Plant and machinery	7½–33⅓%
Vehicles	15–33⅓%

The residual value, if insignificant, is reassessed annually.

Freehold land that is subject to potential development is held as a separate class of property, plant and equipment and is carried at fair value. Movements in fair value are recognised in the statement of comprehensive income.

12 Impairment
The carrying amounts of the Group's assets, other than assets held at fair value through profit or loss, biological assets, investment property, inventories and deferred tax assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated.

For goodwill, and for assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to cash-generating units, and then to reduce the carrying value of other fixed assets.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent of the asset's carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Calculation of recoverable amount
The recoverable amount is the greater of the net selling price and value in use. Estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and risks specific to the asset.

13 Leased assets
Leases where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Plant and vehicles acquired under finance leases are stated at an amount equal to the lower of fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and any impairment losses.

Depreciation is provided on the same basis as for owned assets. Minimum finance lease payments are apportioned between the finance charge and the redemption of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Property held under operating leases that would otherwise meet the definition of investment property may be classified as investment property on a property-by-property basis. Where such leases are treated as investment properties, the assets are held at fair value and the leases are accounted for as finance leases. Lease payments in respect of operating leases are charged to the profit and loss account on a straight-line basis over the period of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense and the aggregate benefit is recognised as a reduction of rental expense over the lease term on a straight-line basis.

For any leases where the Group is the lessor, the aggregate cost of incentives is recognised as a reduction of rental income over the lease term on a straight-line basis.

14 Discontinued operations and assets and liabilities held for sale
Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter generally the assets (or disposal group) are measured at the lower of their carrying amount and fair value less cost to sell. Any impairment loss on a disposal group is first allocated to goodwill, and then to remaining assets and liabilities on a pro rata basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property and biological assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

Discontinued operations are those operations that can be clearly distinguished from the rest of the Group, both operationally and for financial reporting purposes, that have either been disposed of or classified as held for sale and which represent a separate major line of business or geographical area or a subsidiary purchased with a view to resale. As certain Somerfield foodstores were acquired exclusively for resale in order to comply with the Office of Fair Trade review, these have been classified accordingly.

15 Bad and doubtful debts

The amount charged against operating profit comprises collective provisions against identifiable losses and, in the Banking activities, a collective provision to cover latent but unidentifiable losses due to doubtful debts. Both provisions are based on a year-end appraisal of debtors, loans and advances on the basis of objective evidence that a loss has been incurred. Debtors, loans and advances are shown in the balance sheet after deducting these provisions. Debts are written off when there is no realistic prospect of further recovery of the amounts owing.

16 Income tax

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax 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 equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

An element of tax attributable to CIS comprises tax attributable to both policyholders' returns and shareholder's profit or loss. The returns and associated tax of the life business and its subsidiaries are attributable to the life policyholders. The profit or loss of the other than life insurance business is attributable to the shareholder.

17 Deferred taxation

Deferred tax is provided, with no discounting, using the balance sheet liability 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 following temporary differences are not provided for: the initial recognition of assets or liabilities that affect neither accounting nor taxable profits, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided 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 reduced to the extent that it is no longer probable that the related tax benefit will be realised.

18 Dividends and payments to and on behalf of members

Shares issued by the Society are classified as debt or equity in accordance with the substance of the contractual rights and obligations conferred. All payments to holders of shares that are classified as debt, such as corporate investor shares, are charged to the income statement when the Society incurs the obligation to make such payments, and classified as financial costs.

Payments to members in their capacity as equity shareholders of the Parent Society, such as share interest, are treated as dividends, recognised as a liability when approved by the members in a general meeting and treated as an appropriation of profit.

Payments to non-members, or to equity shareholders in their capacity as customers or employees (rather than as members), are treated as charges in the income statement. Where payments are non-contractual and distinguishable from the operating activities of the business, and payment is dependent on, and subject to, member approval in a general meeting, these payments are termed 'Payments to and on behalf of members', charged below operating profit (where material) and recognised when such payments are approved by the membership.

19 Segment reporting

Segmental information is presented so that each segment is a component of the Group which engages in business activities which it may earn revenue and incur expenses and whose operating results are regularly reviewed by the Group's Chief Executive Officer. The Group has not aggregated the financial results of certain segments as allowed under IFRS 8.

20 Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and balances with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

21 Provisions

A provision is recognised in the balance sheet when the Group 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.

22 Biological assets

Biological assets are stated at fair value less estimated point-of-sale costs, with any resultant gain or loss recognised in the income statement. Point-of-sale costs include all costs that would be necessary to sell the assets, excluding costs necessary to get the assets to market.

23 Investment properties

Property held for long-term rental yields that is not occupied by the Group 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 current prices in an active market for similar properties in the same location and condition. 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 an investment property becomes owner-occupied, 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 owner-occupancy 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 uplift recognised in the statement of comprehensive income.

24 Inventories

Inventories are stated at the lower of cost, including attributable overheads, and net realisable value.

25 Joint ventures

A joint venture is a contractual arrangement whereby the Group and one or more other parties undertake an economic activity that is subject to joint control. Joint control exists when the strategic financial and operating policy decisions relating to the activity require the unanimous consent of the parties sharing control.

The Group conducts its joint venture arrangements through jointly controlled entities and accounts for them using the equity method of accounting. Where the Group transacts with its jointly controlled entities, unrealised profits and losses are eliminated to the extent of the Group's interest in the joint venture.

Policies applicable to Financial Services activities

26 Revenue – Banking

Revenue comprises interest receivable, fees and commissions receivable from customers.

27 Revenue recognition – Banking

Interest income is recognised on an effective interest rate (EIR) basis, inclusive of directly attributable incremental transaction costs, fees, discounts and premiums where appropriate. The EIR basis spreads the interest income over the expected life of the 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 Group estimates cash flows considering all contractual terms of the instrument (for example prepayment options) but does not consider future credit losses.

On applying this approach to the mortgage portfolio, judgements are made in relation to estimating the average life of that portfolio. These judgements are made based on specific factors including product terms and historical repayment data. The estimates are updated in each reporting period to reflect actual performance. A key judgement area is the average life of the mortgage portfolio. A change in the average life by one year would have an increase of 0.2% in gross interest income.

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 accrued and included in the effective interest calculation upon completion or taken in full at the date the commitment period expires and completion does not occur.

All other fee and commission income that is not included in the effective interest calculation is recognised on an accruals basis as the service is provided.

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.

28 Assets leased to customers – finance leases

Assets leased to customers are included within ‘loans and advances to customers’ and valued at an amount equal to the net investment in the lease, less any provisions for impairment. 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.

29 Borrowed funds

Borrowings are recognised initially at 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.

Preference shares are classified as financial liabilities and are 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 effective interest method.

30 Insurance contracts

All financial guarantees in respect of intra-group funding between the bank and its subsidiaries are treated as insurance contracts in accordance with IFRS 4.

31 Revenue – Insurance

Revenue comprises premium income arising from insurance and participating contracts.

32 Revenue and income recognition – Insurance

Premium income from insurance and participating contracts

The accounting policy in relation to the revenue arising from insurance and insurance participating contracts is set out within the insurance-specific accounting policies (33 and 34).

Fee and commission income

Fees and commission received by CISGIL relate primarily to commission on outward reinsurance contracts and are earned over the lifetime of the related policy. Commission and fees in respect of fund management activity and sales of units are recognised in the period in which the services are provided.

Investment income

Interest income on assets at fair value through profit or loss is recognised in the income statement as it accrues on an effective interest basis. Where assets are designated as available for sale, income is recognised in the income statement based upon effective yield over the life of the asset, inclusive of any discount premium on purchase.

Dividend income is recognised in the income statement when the right to receive payment is established – this is the date on which the related investment is marked ex-dividend.

Rental income from investment properties is recognised in the income statement as it accrues.

33 Classification of contracts

Contracts under which CIS/CISGIL accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts.

Contracts under which the transfer of insurance risk to CIS/CISGIL from the policyholder is not significant are classified as investment contracts.

A contract that qualifies as insurance remains an insurance contract until all the risks and obligations are extinguished or expire. However, an investment contract, classified as such on inception, could be reclassified as an insurance contract if it subsequently meets the definition provided above.

34 General insurance business

All contracts of general insurance business are classified as insurance contracts. General insurance business is accounted for on an annual basis.

i) Claims

Claims paid are stated net of salvage and subrogation recoveries.

ii) Claims outstanding

Claims outstanding comprise provisions representing the estimated ultimate cost of settling:

- claims notified but not settled by the balance sheet date (‘outstanding claims’)
- claims incurred as a result of events prior to the balance sheet date but not notified as at that date (‘IBNR’ claims).

Provisions include attributable claims handling expenses. Claims provisions are set at a level such that no adverse run-off deviations are envisaged.

Adverse run-off deviations, which are material in the context of the business as a whole, are disclosed separately.

Anticipated reinsurance recoveries, and estimates of salvage and subrogation recoveries, are disclosed separately within assets under the headings of 'reinsurance assets' and 'insurance receivables and other assets' respectively.

iii) Unexpired risk provision
Additional provision is made for unexpired risks where the claims and expenses likely to arise after the end of the financial period in respect of contracts concluded before that date are expected to exceed the unearned premiums carried forward for those contracts. Provisions for unexpired risks are calculated separately for categories of business managed together and are determined after taking account of future investment income.

Such provisions ensure that the carrying amount of liabilities less related deferred acquisition costs is sufficient to cover the estimated future cash flows including claims handling expenses, and therefore meets the minimum requirements of the liability adequacy test as set out in IFRS 4.

iv) Acquisition costs
Costs directly associated with the acquisition of new business including commission payable are capitalised and amortised in accordance with the rate at which the gross premiums written associated with the underlying contract are earned.

35 Long-term insurance business
i) Insurance and participating contracts
CIS has adopted FRS 27 'Life assurance', in so far as it is compatible with the requirements of IFRS. Accordingly, participating contract liabilities are stated on a realistic basis.

ii) Premiums
Premiums are accounted for on a due basis. For unit-linked business, the due date for payment is taken as the date the related liability is established.

iii) Claims
Claims incurred include maturities, deaths, surrenders and annuity payments. Maturity and annuity claims are recognised as they fall due for payment. Deaths and surrenders are accounted for upon notification. Consistent treatment exists between the recognition of a claim in the income statement and the calculation of future contractual liabilities. Claims incurred include related internal and external claims handling expenses.

iv) Long-term business provision
The long-term business provision is calculated having regard to the principles laid down in Chapter 1.2 of the Prudential Sourcebook for Insurers (INSPRU). It principally comprises the realistic value of CIS's participating contract liabilities and is calculated by determining asset shares and the cost of options guarantees and smoothing of investment returns. Major classes of non-participating business are valued using a gross premium valuation method. This approach meets the minimum requirements of the liability adequacy test.

Further details of the methods used to value long-term business contract liabilities are given in Note 54.

v) Participating contracts
A participating contract is one that gives the policyholder a right to receive, as a supplement to guaranteed minimum payments, additional payments: (a) that are likely to form a significant portion of the total contractual payments, (b) whose amount or timing is contractually at the discretion of the issuer; and that are contractually based on: (i) the performance of a specified pool of contracts or a specified type of contract; (ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or (iii) the profit or loss of the company that issued the contracts.

vi) Unallocated Divisible Surplus (UDS)
CIS's long-term business is transacted on a mutual basis and all surpluses arising on long-term business are allocated, as appropriate, to participating contract holders. Its mutual status means that the long-term business fund has no equity and the UDS represents amounts due to policyholders, the allocation of which is yet to be determined. Accordingly, the UDS is classified as a liability.

vii) Non-participating contracts
Insurance contracts without discretionary features are non-participating contracts. The value of future profits that are expected to arise on nonparticipating contracts (being the present value of future cash flows under these contracts) has been deducted when assessing the value of liabilities in respect of participating contracts.

viii) Non-participating Investment contracts
a) Liability measurement
The initial measurement amount of a financial liability is the fair value of the consideration received. The liabilities are designated at fair value at inception on the basis that the liabilities are managed on a fair value basis. Fair value is measured by reference to the carrying value of the assets supporting the liabilities.

b) Revenue
Amounts received from and paid to holders of investment contracts are accounted for as deposits received (or repaid) and are not included in premiums and claims in the income statement.

Other revenue associated with investment management and other services is recognised in the income statement in the period in which services are provided.

ix) Acquisition costs
Incremental costs incurred in the provision of investment management services are not deferred but are recognised when the related service is provided. Incremental costs directly related to the costs of acquiring new business in relation to unit trust management are deferred and recognised over the estimated contract life. The carrying amount is tested for impairment at each reporting date.

x) Reinsurance
Contracts with reinsurers that give rise to a significant transfer of insurance risk are accounted for as reinsurance contracts. Amounts recoverable under such contracts are recognised in the same period as the related claim. Amounts recoverable under reinsurance contracts are assessed for impairment at each balance sheet date. If objective evidence of impairment exists, reinsurance assets are reduced to the level at which they are considered to be recoverable and an impairment loss is recognised in the income statement.

xi) Long term business profits
The whole of the profit of the long-term business are applied for the sole benefit of the long term business policyholders. Similarly, any losses incurred within the fund are borne by the policyholders.

Policies applicable to Trading activities
36 Gross sales and revenue
Gross sales is a non-GAAP measure representing the amounts receivable by the Group for goods and services supplied to customers, net of discounts but including VAT. It also includes the gross value of sales made on an agency basis, principally relating to travel and concession sales with a reduction to the value of commission receivable shown separately in arriving at revenue.

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, VAT and other sales tax or duty. The following criteria must be met before revenue is recognised:

Sale of goods
Revenue is recognised at the point of sale.

Rental income
Rental income arising from operating leases on investment properties is accounted for on a straight-line basis over the lease term.

Agency fees and commissions
Agency fees and commissions are earned in the Travelcare Division. Turnover represents the gross amount of commissions earned and is recognised on booking.

Dividends
Revenue is recognised when the Group's right to receive payment is established.

37 Funeral bonds
Funeral bond investments are held at fair value with movements in fair value included in financial income. A liability for the cost of funeral delivery is charged at the date of bond sale, based on the estimated third-party cost at the projected date of bond redemption. This is subject to a liability adequacy test at least annually. The liability is discounted and the unwinding of the discount is included in financial expenses. Other changes in the liability are included in operating profit.

1 Operating segments

The Trading Group has 13 reportable segments, each of which offer different products and services. The results of each segment are reported to the Group Chief Executive every four weeks. The Group has disclosed financial information for all segments although certain segments could have been aggregated under IFRS 8.

A summary of the operational and financial performance of each business unit can be found on pages 6 to 16.

Unallocated segment assets relate to taxation, derivatives and retirement benefit assets.

2009	Food Retail £m	Pharmacy £m	Funeral-care £m	Specialist businesses – retail (see page 64) £m	Specialist businesses – commercial (see page 64) £m	Property and Farms (see page 64) £m	Corporate Member-ship and Federal £m	Trading Group £m	CFS (see page 67) £m	Group costs and other adjust-ments £m	Total £m
Gross revenue – sales of goods:											
– including internal sales	7,515.8	745.0	287.4	297.3	352.6	79.4	4,656.5	13,934.0			13,934.0
– excluding internal sales	7,515.8	745.0	287.4	296.2	313.4	57.2	1,271.5	10,486.5		(13.8)	10,472.7
Interest and similar income									952.0	(0.6)	951.4
Fee and commission income									217.6	(2.5)	215.1
Gross earned premiums									887.7		887.7
Revenue	7,515.8	745.0	287.4	296.2	313.4	57.2	1,271.5	10,486.5	2,057.3	(16.9)	12,526.9
Premiums ceded to reinsurers									(37.7)		(37.7)
Net revenue	7,515.8	745.0	287.4	296.2	313.4	57.2	1,271.5	10,486.5	2,019.6	(16.9)	12,489.2
Segment trading profit	240.0	22.1	38.7	11.0	3.3	87.3	(64.5)	337.9	177.2	(1.4)	513.7
Internal rent, interest on working capital and group operating costs	46.4	7.8	5.0	(5.0)	2.5	(64.7)	8.0			(41.2)	(41.2)
Underlying segment trading profit	286.4	29.9	43.7	6.0	5.8	22.6	(56.5)	337.9	177.2	(42.6)	472.5
Change in value of investment properties						3.5		3.5			3.5
Property disposal profits						36.1		36.1			36.1
Financial Services Compensation Scheme levy									(3.7)		(3.7)
Short-term investment fluctuations									4.9		4.9
Fair value amortisation									99.1		99.1
Segment operating profit before significant items	286.4	29.9	43.7	6.0	5.8	62.2	(56.5)	377.5	277.5	(42.6)	612.4
Significant items (net)	(26.0)	(2.3)		(6.1)	(0.1)	(0.3)	(20.5)	(55.3)	(53.8)		(109.1)
Segment operating profit after significant items	260.4	27.6	43.7	(0.1)	5.7	61.9	(77.0)	322.2	223.7	(42.6)	503.3
Net financial expenses											(101.7)
Share of profit of associates and joint ventures											0.3
Payments to and on behalf of members											(107.1)
Profit before tax											294.8
Segment assets – continuing	4,038	1,010	366	291	102	715	96	6,618	66,804	104	73,526
Segment assets – discontinued	10						2	12			12
Less overdraft pools netted in cash and cash equivalents								(740)			(740)
Unallocated assets								300	2,016	11	2,327
Total assets	4,048	1,010	366	291	102	715	98	6,190	68,820	115	75,125
Additions to non-current assets	229.8	34.5	15.6	9.5	5.8	19.7		314.9	357.7		672.6
Depreciation	(194.9)	(7.2)	(16.1)	(5.1)	(4.2)	(2.9)	(6.0)	(236.4)	(26.4)		(262.8)
Amortisation		(24.1)		(0.1)				(24.2)	(21.4)		(45.6)

1 Operating segments continued

	2009											
	Travel £m	Life Planning £m	Legal services £m	Specialist businesses – retail £m	Motors £m	Sunwin Services £m	E-store £m	Clothing £m	Specialist businesses – commercial £m	Property £m	Farms £m	Property and farms £m
Gross revenue – sales of goods:												
– including internal sales	246.1	30.9	20.3	297.3	197.7	63.5	83.3	8.1	352.6	33.4	46.0	79.4
– excluding internal sales	246.1	29.8	20.3	296.2	197.7	28.0	83.3	4.4	313.4	33.4	23.8	57.2
Segment trading profit	2.5	4.7	3.8	11.0	(2.4)	4.1	1.6	0.0	3.3	84.7	2.6	87.3
Internal rent and interest on working Capital	(4.8)	(0.2)		(5.0)	1.4	0.4	0.4	0.3	2.5	(66.3)	1.6	(64.7)
Underlying segment trading profit	(2.3)	4.5	3.8	6.0	(1.0)	4.5	2.0	0.3	5.8	18.4	4.2	22.6
Change in value of investment properties										3.5		3.5
Property disposal profits										36.1		36.1
Segment operating profit before significant items	(2.3)	4.5	3.8	6.0	(1.0)	4.5	2.0	0.3	5.8	58.0	4.2	62.2
Significant items (net)	(6.1)			(6.1)		(0.1)			(0.1)	(0.3)		(0.3)
Segment operating profit after significant items	(8.4)	4.5	3.8	(0.1)	(1.0)	4.4	2.0	0.3	5.7	57.7	4.2	61.9
Segment assets – continuing	182	90	19	291	39	24	30	9	102	661	54	715
Segment assets – discontinuing												
Total assets	182	90	19	291	39	24	30	9	102	661	54	715
Additions to non-current assets	9.1	0.3	0.1	9.5	0.3	4.8	0.6	0.1	5.8	13.0	6.7	19.7
Depreciation	(4.1)	(0.5)	(0.5)	(5.1)	(0.4)	(3.0)	(0.5)	(0.3)	(4.2)	(1.5)	(1.4)	(2.9)
Amortisation			(0.1)	(0.1)								

* Segment trading profit is segment operating profit before significant items, property disposals, group operating costs, the Financial Services Compensation levy, short-term investment fluctuations, fair value amortisation and investment property valuation changes.

Federal operations (included within Corporate Membership & Federal) relate to the activities of a joint buying group that is operated by the Group for retail Co-operative Society members. All transactions between reportable segments are performed at arms length. Internal rent is charged at an arms length by the Property division dependent on usage of property. Interest on working capital is an internal charge to the other businesses dependent on usage of working capital. It is charged by the Corporate & Membership division. Internal rent and interest on working capital are deducted from the segment trading profit which the chief operating decision maker reviews. They are added back to reconcile to profit before tax.

Each segment derives its revenue and profits from the sale of retail goods and services. Healthcare also derives revenue and profits from the manufacturing and distribution of medical products.

Additions to non-current assets excludes additions to financial instruments, deferred tax assets, post employment benefit assets and rights arising under insurance contracts.

The Group has no external revenue or non-current assets outside the United Kingdom, except non-current assets in the Tiajin Tasly Sants joint venture which had no revenue in the period (2008: £nil), see Note 19. The Group does not have a major customer which accounts for 10% or more of revenue.

1 Operating segments continued

	Food Retail £m	Pharmacy £m	Funeralcare £m	Specialist businesses – retail (see page 66) £m	2008 Specialist businesses – commercial (see page 66) £m	Property and Farms (see page 66) £m	Corporate Membership and Federal £m	Trading Group £m	CFS (see page 67) £m	Group costs and other adjustments £m	Total £m
Gross revenue – sales of goods:											
– including internal sales	4,526.8	743.5	273.7	293.6	302.1	84.0	4,577.2	10,800.9			10,800.9
– excluding internal sales	4,526.8	743.5	273.7	292.6	289.0	60.9	1,296.7	7,483.2		(23.7)	7,459.5
Interest and similar income									830.2	(4.0)	826.2
Fee and commission income									216.5	(2.4)	214.1
Gross earned premiums									899.2		899.2
Revenue	4,526.8	743.5	273.7	292.6	289.0	60.9	1,296.7	7,483.2	1,945.9	(30.1)	9,399.0
Premiums ceded to reinsurers									(37.6)		(37.6)
Net revenue	4,526.8	743.5	273.7	292.6	289.0	60.9	1,296.7	7,483.2	1,908.3	(30.1)	9,361.4
Segment trading profit	171.9	29.3	34.6	16.3	(1.0)	91.8	(65.2)	277.7	147.0	0.3	425.0
Internal rent, interest on working capital and group operating costs	47.2	8.5	4.6	(7.4)	2.6	(66.1)	10.6			(30.0)	(30.0)
Underlying segment trading profit	219.1	37.8	39.2	8.9	1.6	25.7	(54.6)	277.7	147.0	(29.7)	395.0
Change in value of investment properties						(62.3)		(62.3)			(62.3)
Property disposal profits						58.4		58.4			58.4
Financial Services Compensation Scheme levy									(10.5)		(10.5)
Short-term investment fluctuations									12.2		12.2
Fair value amortisation											
Segment operating profit before significant items	219.1	37.8	39.2	8.9	1.6	21.8	(54.6)	273.8	148.7	(29.7)	392.8
Significant items	(6.3)	(0.4)		(8.4)		0.8	(25.1)	(39.4)	(78.0)		(117.4)
Segment operating profit after significant items	212.8	37.4	39.2	0.5	1.6	22.6	(79.7)	234.4	70.7	(29.7)	275.4
Net financial expenses											(58.3)
Share of profit of associates and joint ventures											0.5
Payments to and on behalf of members											(101.7)
Profit before tax											115.9
Segment assets – continuing	2,134	747	506	81	94	548	227	4,337	38,424	(313)	42,448
Segment assets – discontinued					4			4			4
Unallocated assets								522	375		897
Total assets	2,134	747	506	81	98	548	227	4,863	38,799	(313)	43,349
Additions to non-current assets	198.1	25.7	13.6	10.2	10.0	8.5	25.1	291.2	9.6		300.8
Depreciation	(93.9)	(6.1)	(15.6)	(5.2)	(3.0)	(2.6)	(28.3)	(154.7)	(24.9)		(179.6)
Amortisation		(24.3)		(0.1)				(24.4)	(89.8)		(114.2)

1 Operating segments continued

	2008											
	Travel £m	Life Planning £m	Legal services £m	Specialist businesses – retail £m	Motors £m	Sunwin Services £m	E-store £m	Clothing £m	Specialist businesses – commercial £m	Property £m	Farms £m	Property and farms £m
Gross revenue – sales of goods:												
– including internal sales	261.5	17.9	14.2	293.6	209.2	33.6	54.0	5.3	302.1	34.2	49.8	84.0
– excluding internal sales	261.5	17.2	13.9	292.6	209.2	21.7	54.0	4.1	289.0	34.1	26.8	60.9
Segment trading profit	12.5	2.1	1.7	16.3	(1.7)	0.2	1.0	(0.5)	(1.0)	87.9	3.9	91.8
Internal rent and interest on working Capital	(7.2)	(0.2)	–	(7.4)	1.7	0.5	0.1	0.3	2.6	(67.9)	1.8	(66.1)
Underlying segment trading profit	5.3	1.9	1.7	8.9	–	0.7	1.1	(0.2)	1.6	20.0	5.7	25.7
Change in value of properties										(62.3)		(62.3)
Property disposal profits										58.4		58.4
Segment operating profit before significant items	5.3	1.9	1.7	8.9		0.7	1.1	(0.2)	1.6	16.1	5.7	21.8
Significant items (net)	(8.4)			(8.4)						0.8		0.8
Segment operating profit after significant items	(3.1)	1.9	1.7	0.5		0.7	1.1	(0.2)	1.6	16.9	5.7	22.6
Segment assets – continuing	49	18	14	81	34	27	25	8	94	502	46	548
Segment assets – discontinuing							4		4			
Unallocated assets												
Total assets	49	18	14	81	34	27	29	8	98	502	46	548
Additions to non-current assets	8.4	0.9	0.9	10.2	1.0	7.7	0.2	1.1	10.0	6.8	1.7	8.5
Depreciation	(4.3)	(0.4)	(0.5)	(5.2)	(0.4)	(2.1)	(0.3)	(0.2)	(3.0)	(1.2)	(1.4)	(2.6)
Amortisation	(0.1)			(0.1)								

1 **Operating segments** continued

CFS

CFS has four reportable segments which are reviewed separately by the CEO. For each of the business units, the Group's CEO reviews internal management reports every four weeks. A summary of the operational and financial performance of Retail and CAM can be found on pages 10 to 11.

	2009						2008					
	Retail £m	**CAM £m**	**Other Share-holder £m**	**Total Share-holder £m**	**Long-Term Business £m**	**Total £m**	Retail £m	CAM £m	Other Share-holder £m	Total Share-holder £m	Long-Term Business £m	Total £m
Interest and similar income				**952.0**		**952.0**				830.2		830.2
Fee and commission income				**217.6**		**217.6**				216.5		216.5
Gross earned premiums				**396.9**	**490.8**	**887.7**				401.3	497.9	899.2
Revenue				**1,566.5**	**490.8**	**2,057.3**				1,448.0	497.9	1,945.9
Premiums ceded to reinsurers				**(21.5)**	**(16.2)**	**(37.7)**				(18.5)	(19.1)	(37.6)
Net revenue				**1,545.0**	**474.6**	**2,019.6**				1,429.5	478.8	1,908.3
Segment trading profit before significant items, FSCS levy and STIFs	**5.6**	**122.6**	**49.0**	**177.2**		**177.2**	46.2	37.2	63.6	147.0		147.0
Financial services compensation scheme levy				**(3.7)**		**(3.7)**				(10.5)		(10.5)
Short-term investment fluctuations				**4.9**		**4.9**				12.2		12.2
Amortisation of fair adjustments				**99.1**		**99.1**				–		–
Segment operating profit before significant items				**277.5**		**277.5**				148.7		148.7
Significant items				**(53.8)**		**(53.8)**				(78.0)		(78.0)
Operating profit after significant items				**223.7**		**223.7**				70.7		70.7
Segment assets	**18,026**	**26,687**	**1,462**	**46,175**	**20,947**	**67,122**	7,003	8,941	972	16,916	21,618	38,534
CFS eliminations						**(318)**						(110)
Unallocated assets						**2,016**						375
Total assets	**18,026**	**26,687**	**1,462**	**46,175**	**20,947**	**68,820**	7,003	8,941	972	16,916	21,618	38,799

The whole of the profits of the long term business are applied for the sole benefit of the long term business policyholders. Similarly, any losses incurred within the fund are borne by the policyholders. This means that the segment trading result for the long term business is always nil. Within the segmental analysis and certain notes to the accounts, CFS result is analysed between: Retail; CAM; Other Shareholder and Long-Term Business. Other Shareholder includes the results of CFS Management Services Limited, CFS Services Limited, CFS Limited and investment activity attributable to the Shareholder element of CIS Limited.

CFS monitor segment revenue only on a net basis (interest receivable net of interest payable). Therefore gross revenue is presented above at total CFS level and not on a segmental basis.

2 Premiums – Financial Services

	2009 £m	2008 £m
Gross premiums		
Non-participation contracts	**36.5**	39.1
Participation contracts	**454.3**	458.8
General insurance written premiums	**424.3**	394.4
Change in unearned premium provision	**(27.4)**	6.9
Gross premium revenue	**887.7**	899.2
Outward reinsurance premiums		
Non-participation contracts	**(16.2)**	(19.1)
Premium ceded	**(23.2)**	(19.2)
Change in unearned premium provision	**1.7**	0.7
Premium ceded to reinsurers	**(37.7)**	(37.6)
Net earned premiums	**850.0**	861.6
Analysis of gross written premiums		
Premiums under individual contracts	**475.1**	485.6
Premiums under Group contracts	**15.7**	12.3
	490.8	497.9
Life contracts		
Premiums from life assurance business	**376.3**	362.3
Premiums from pensions business	**112.5**	133.4
Premiums from permanent health business	**2.0**	2.2
	490.8	497.9
General insurance contracts		
Property	**239.9**	141.2
Motor	**136.8**	231.1
Other	**20.2**	29.0
	887.7	899.2

3 Operating expenses

Fair value amortisation

Britannia net assets have been restated to fair value on merger. This includes adjustments to reflect the interest rates charged and received on both assets and liabilities where a different rate may be prevalent in today's market. These adjustments unwind over future periods and in 2009 represent a credit to the income statement of £99.1m (2008: £nil).

	Trading Group		CFS		Group	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Cost of inventories sold	**(7,300.5)**	(5,250.5)			**(7,300.5)**	(5,250.5)
Interest expense and similar charges			**(478.7)**	(447.3)	**(478.7)**	(447.3)
Fee and commission expense (Note 5)			**(92.2)**	(60.6)	**(92.2)**	(60.6)
Net claims paid and benefits (Note 4)			**(1,296.7)**	(1,580.9)	**(1,296.7)**	(1,580.9)
Technical charges (includes change in reinsurance assets)			**70.6**	1,621.2	**70.6**	1,621.2
Unallocated divisible surplus (Note 43)			**(430.6)**	433.4	**(430.6)**	433.4
Gains less losses arising from financial instruments and other assets (Note 8)			**467.3**	(1,798.9)	**467.3**	(1,798.9)
Investment expenses and charges			**(71.2)**	(61.2)	**(71.2)**	(61.2)
Impairment losses on loans and advances			**(116.1)**	(96.8)	**(116.1)**	(96.8)
Impairment losses on investments			**8.5**	(76.7)	**8.5**	(76.7)
Financial Services Compensation Scheme levy			**(3.7)**	(10.5)	**(3.7)**	(10.5)
Employee benefits expense (Note 21)	**(1,369.0)**	(1,040.0)	**(332.4)**	(273.5)	**(1,701.4)**	(1,313.5)
Depreciation and amortisation expense	**(260.6)**	(179.1)	**(47.8)**	(115.0)	**(308.4)**	(294.1)
Operating lease rentals	**(149.0)**	(65.2)	**(20.7)**	(14.1)	**(169.7)**	(79.3)
Subscriptions and donations	**(4.7)**	(2.1)			**(4.7)**	(2.1)
Auditors' remuneration and expenses (see detailed analysis below)	**(1.3)**	(1.2)	**(2.2)**	(1.5)	**(3.5)**	(2.7)
Direct operating expenses of investment property:						
Generated rental income	**(1.8)**	(1.4)	**(1.1)**		**(2.9)**	(1.4)
Did not generate income	**(0.8)**	(0.8)	**(0.1)**		**(0.9)**	(0.8)
Other operating expenses	**(1,105.3)**	(745.5)	**(312.3)**	(68.9)	**(1,417.6)**	(814.4)
Total	**(10,193.0)**	(7,285.8)	**(2,659.4)**	(2,551.3)	**(12,852.4)**	(9,837.1)
Significant items excluded from the above analysis are as follows:						
Restructuring costs					**(39.2)**	(79.9)
Integration costs					**(113.7)**	(46.6)
Goodwill and fixed-asset impairment					**(13.2)**	(4.4)
Gains on pension scheme settlements and curtailments					**–**	19.0
Brand costs					**(5.4)**	(5.5)
					(171.5)	(117.4)

3 Operating expenses continued
Auditors' remuneration and expenses

	Trading Group		CFS		Group	
	2009 £000	2008 £000	**2009 £000**	2008 £000	**2009 £000**	2008 £000
Audit of financial statements	**621**	443	**968**	577	**1,589**	1,020
Other services: amounts receivable by auditors and their associates in respect of:						
Audit of financial statements of subsidiaries pursuant to such legislation	**334**	238	**428**	147	**762**	385
Other services pursuant to such legislation		–	**144**	137	**144**	137
Other services relating to taxation	**183**	280	**43**	27	**226**	307
Services relating to information technology	**40**	21	**115**	378	**155**	399
Services relating to litigation	**27**	–	**6**	13	**33**	13
Services relating to recruitment and remuneration	**–**	–	**–**	7	**–**	7
Services relating to corporate finance transactions entered into or proposed	**20**	–	**77**	–	**97**	–
All other services	**50**	197	**477**	182	**527**	379
Total	**1,275**	1,179	**2,258**	1,468	**3,533**	2,647

Services relating to corporate finance transactions entered into which were capitalised by the Group and are not included in the above analysis were £5.0m for Banking (2008: £1.4m) and £nil for Trading & Corporate (2008: £0.3m).

Significant items
Restructuring costs relate to extensive restructuring and modernisation of the CFS business.

Goodwill impairments relate to Food (£1.4m), Travel (£3.9m) and Pharmacy (£2.0m) businesses (Food business in 2008). The key impairment relates to the Medinland business in Travel due to a decline in volumes. Food impairment relates to one individual store and four small acquisitions. Pharmacy impairments relate to five branches.

All businesses reviewed cash loss-making stores and branches within their portfolios based on past performance and future outlook and as a result of this a £5.8m impairment to fixtures and fittings has been recognised in the Food business.

As a result of the acquisition of Somerfield and the transfer of engagements of both Britannia and Plymouth and South West Co-operative, significant integration costs have been incurred in 2009 relating principally to redundancies and closure costs. The 2008 integration costs largely related to the transfer of engagements of United Co-operatives Limited.

CFS operating expenses
The loan portfolios are reviewed on a continuous basis to assess impairment. In determining whether an impairment provision should be recorded, judgements 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 prior to the balance sheet date.

- Bank collective provisions
  Personal advances are identified as impaired by taking account of the age of the debt's delinquency, by product type. The provision is calculated by applying a percentage rate to different categories and ages of impaired 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, 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 spot balance for the relevant arrears bucket.
- Bank individual provisions
  Mortgage accounts are identified as impaired by taking account of the age of the debt's delinquency on a case-by-case basis based on arrears data held within the mortgages system. Individual provisions are also raised on a case-by-case basis for each mortgage account in arrears. Each Corporate account is assessed and allocated a 'risk grade' to enable The Co-operative Bank to monitor the overall quality of its lending assets. Those of lesser quality, where the lending is potentially at risk and provisions for future loss 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.

3 Operating expenses continued

- Bank impairment on structured investments

  The Co-operative Bank's investment portfolio comprises Bank and Building Certificates of Deposit (CDs), Floating Rate Notes (FRNs) and government issued securities. Additionally the Co-operative Bank has a small portfolio of 3 structured investments (SIVs) and 1 Credit Trading vehicle (CTV) investment. Further analysis is provided below. The accounting treatment for these assets is primarily available-for-sale which means that they are fair valued in the balance sheet with movement passing through reserves, unless the assets are deemed to be impaired which results in movements being recognised in the income statement. The reduction in liquidity in wholesale markets or 'credit crunch' has lead to a loss of active markets and availability of traded prices for particular assets. These CTV investments have been reclassified as loans and receivables and are held in the balance sheet at amortised cost less any associated impairment. Except for those assets reclassified to loans and receivables the Bank's CDs, FRNs and Government Issued Securities are valued daily based upon an observable market price feed data, with all non-moving valuations validated against an alternative price source. No significant assumptions are required. The Bank has fully provided against all three of its SIVs. The CTV was reclassified to Loans & Receivables on 27 July 2008 as a result of amendments to IAS 39 and is accounted for on an amortised cost basis.

Impairment has been assessed by:

- Is there evidence that a loss event has occurred; and
- Does the loss event have a negative impact on future cash flows?

Each of The Co-operative Bank's Structured Investments and the Credit Trading Vehicle meet these criteria and therefore an impairment provision has been made. These assessments have particularly given consideration to evidence of any significant financial difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

Further information on The Co-operative Bank's accounting policy on impairment is given on page 54.

At 2 January 2010, The Co-operative Bank holds three Structured Investments and one Credit Trading Vehicle as shown below:

	Investment (currency)	**Investment (sterling)**	**Investment provision held (sterling)**	**Balance sheet value**
Structured Investment 1	£20.0	20.0	20.0	–
Structured Investment 2	US$ 20.0	12.4	12.4	–
	€20.0	17.8	17.8	–
Structured Investment 3	US$ 35.0	21.7	21.7	–
Credit Trading Vehicle	£25.0	25.0	8.5	16.5
		96.9	**80.4**	**16.5**

The Co-operative Bank owns less than 2.5% of the capital held of each of these investments and therefore they are not consolidated.

Financial Services Compensation Scheme levy

The Financial Services Compensation Scheme provides compensation to customers of financial institutions in the event that an institution is unlikely, or is likely to be unable, to pay claims against it. As a result of a number of institutions failing during 2008, the FSCS has borrowed £19.7bn on an interest only basis until September 2011 from HM Treasury in order to meet its obligations to the depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions. The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation costs. The annual levies are based upon the individual institutions proportion of protected deposits of the total market protected deposits at 31 December of each year. The Co-operative Bank has provided for £20.6m (2008: £10.5m) for its share of levies that will be raised by the FSCS including the interest on the loan from the HM Treasury in respect of the levy years to 31 March 2010. The provision includes estimates for the interest FSCS will pay on the loan and of the Co-operative Bank's market participation in the relevant period.

At the date of these financial statements, it is not possible to estimate whether there will be ultimately additional levies on the industry, the level of The Co-operative Bank's market participation or other factors that may affect amounts or the timing of amounts that may ultimately become payable, nor the effect that such levies may have upon the operating results in any particular period.

4 Net claims paid – General Insurance and Long-term Business

	2009 £m	2008 £m
Gross claims paid		
Long-term insurance contracts:		
– death benefits	**134.7**	140.9
– surrender benefits	**470.7**	629.6
– maturity claims	**346.1**	500.8
– annuity and other benefits	**198.0**	183.0
	1,149.5	1,454.3
General insurance contracts:		
– current and prior year claims	**293.4**	277.7
Claims paid and benefits	**1,442.9**	1,732.0
Less recovered from reinsurers		
Long-term Business:		
– death benefits	**(11.7)**	(13.2)
– annuity and other benefits	**(121.9)**	(125.2)
	(133.6)	(138.4)
General Insurance:		
– current and prior year claims	**(12.6)**	(12.7)
Amounts recovered from reinsurers	**(146.2)**	(151.1)
Net claims paid and benefits	**1,296.7**	1,580.9

5 Fee and commission expense – Financial Services

	2009 £m	2008 £m
Commission	**96.6**	61.4
Change in deferred commission	**(4.4)**	(0.8)
	92.2	60.6

6 Operating income

	Trading Group		CFS		Group	
	2009 £m	2008 £m	2009 £m	2008 £m	2009 £m	2008 £m
Investment income (Note 7)	**–**	–	**757.0**	781.3	**757.0**	781.3
Net gain/(loss) on disposal of property, plant and equipment	**36.1**	58.4	**(1.5)**	(4.6)	**34.6**	53.8
Change in value of investment property	**3.5**	(62.3)	**3.5**	–	**7.0**	(62.3)
Rental income of investment property	**18.7**	19.7	**2.1**	–	**20.8**	19.7
Other operating income*	**–**	–	**57.1**	76.0	**57.1**	76.0
	58.3	15.8	**818.2**	852.7	**876.5**	868.5
Significant items excluded from the above analysis are as follows:						
Gain on disposal of stores to meet regulatory requirements relating to Somerfield acquisition	**62.4**	–	**–**	–	**62.4**	–

* This includes fee and commission income, and income from service activities and other operating income.

7 Investment income

	2009 £m	2008 £m
Financial assets:		
Interest income from debt securities at fair value through profit or loss	**357.3**	365.3
Dividend income from equities at fair value through profit or loss	**138.0**	172.5
Interest income from loans at amortised cost	**0.6**	1.0
Rental income from investment property	**118.2**	121.8
Cash and cash equivalents interest income	**14.2**	62.5
Fair value income from deposit with credit institutions	**0.5**	3.8
Interest income from financial assets designated available for sale:		
Listed debt securities	**55.8**	50.5
Unlisted debt securities	**0.4**	0.4
Interest income from derivative financial instruments	**63.8**	1.4
Other	**8.2**	2.1
	757.0	781.3

8 Gains less losses arising from financial instruments and other assets

	2009 £m	2008 £m
Net gains/(losses) on remeasurement of financial instruments and other assets at fair value		
Listed equities	**944.8**	(1,758.9)
Unlisted equities	**42.9**	(47.0)
Listed debt securities	**58.8**	(304.9)
Unlisted debt securities	**(224.8)**	480.7
Derivatives	**(587.5)**	872.6
Investment property – financial services	**(1.8)**	(557.4)
Net gains arising on available-for-sale listed debt securities	**4.3**	5.9
Foreign exchange	**5.5**	5.3
Net losses on remeasurement of financial liabilities at fair value through profit and loss	**223.9**	(483.1)
Other investments	**1.2**	(12.1)
	467.3	(1,798.9)

Property held for long-term rental that is not occupied by CIS is classified as investment property and included within investments for Financial Services. For further details refer to Note 28.

9 Financial expenses – interest payable

	2009 £m	2008 £m
Loans repayable within five years	**(90.6)**	(9.1)
Loans repayable wholly or in part after five years	**(16.5)**	(23.0)
Corporate investor share interest	**(0.8)**	(3.9)
	(107.9)	(36.0)

10 Financial expenses – fair value movement

	2009 £m	2008 £m
Fair value movement on quoted debt	**(32.8)**	23.4
Fair value movement on interest rate swaps	**(7.9)**	(13.1)
Fair value movement on funeral bonds	**(18.1)**	(13.8)
Exchange gain/(loss) on Yen borrowings/deposits and other forex contracts	**24.3**	(79.5)
	(34.5)	(83.0)

11 Net financial income-other

	2009 £m	2008 £m
Net pension finance income (see Note 21 for further analysis)	**47.5**	61.7
Unwinding of discount	**(6.8)**	(1.0)
	40.7	60.7

12 Payments to and on behalf of members

	2009 £m	2008 £m
To corporate members	**(19.6)**	(24.9)
To individual members	**(54.5)**	(46.9)
Community distribution	**(10.0)**	(10.0)
To employees who are members	**(23.0)**	(19.9)
Total payments to and on behalf of members	**(107.1)**	(101.7)

Full details of payments to members and proposed distributions relating to profits earned in 2009 are shown in the Financial Review on page 23.

13 Income tax expense

	2009 £m	2008 £m
Current tax charge	**14.9**	87.0
Deferred tax credit	**93.7**	(92.4)
Total tax excluding tax attributable to policyholders' returns	**108.6**	(5.4)
The tax charge/(credit) is represented by:		
Continuing business	**114.4**	(2.9)
Discontinuing business	**(5.8)**	(2.5)
	108.6	(5.4)

13 Income tax expense continued

The tax on the Group's net profit before tax differs from the theoretical amount that would arise using the rate of corporation tax of 28% (2008: blended 28.4%) as follows:

	2009 £m	2008 £m
Profit before tax	**294.8**	115.9
Current tax at 28% (2008: 28.4%)	**82.5**	32.9
Different basis of tax for UK life insurance – policyholder tax – current year	**47.5**	(48.9)
Different basis of tax for UK life insurance – policyholder tax – prior year	**(41.1)**	(3.2)
Non-taxable profit on disposal of investments/assets	**(16.3)**	2.9
Expenses not deductible for tax	**12.5**	3.3
Depreciation and amortisation on non-qualifying assets	**22.0**	12.4
Non-taxable investment income	**(5.1)**	(9.8)
Adjustment in respect of previous periods	**(2.6)**	11.9
Preference dividend	**1.6**	1.6
Tax on discontinuing operations	**(5.8)**	(2.5)
Foreign exchange	**18.8**	(57.7)
Other	**1.0**	(0.2)
Restatement of deferred tax to 28%	**–**	(0.2)
Total tax charge/(credit)	**115.0**	(57.5)
Less tax attributable to policyholders' returns	**(6.4)**	52.1
	108.6	(5.4)

Tax on items taken directly to consolidated statement of comprehensive income

	2009 Tax (expense) /benefit £m	2008 Tax (expense) /benefit £m
Changes in available-for-sale assets	**(16.8)**	10.1
Actuarial gains and losses on employee pension scheme	**150.6**	40.9
Revaluation of self-occupied properties	**–**	1.3
Revaluation of self-occupied property transferred to assets held for sale	**–**	(4.1)
Revaluation of self-occupied properties transferred to unallocated divisible surplus	**–**	2.8
Effective portion of cash flow hedges transferred to the cash flow hedging reserve	**13.5**	(37.7)
Cash flow hedges transferred to profit or loss	**–**	(0.2)
Revaluation of property, plant and equipment	**–**	(2.7)
Foreign currency translation differences for foreign operations	**(0.1)**	(0.2)
	147.2	10.2

Of the tax taken directly to the consolidated statement of comprehensive income, £162.0m relates to deferred taxation, as set out overleaf.

13 Income tax expense continued

Deferred taxation

Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2008: 28%).

	2009 £m	2008 £m
At beginning of period	**385.4**	640.8
Income statement charge/(credit)		
– CIS Life Business	**40.5**	(145.9)
– Group (excluding CIS Life Business)	**93.7**	(92.4)
Charged to equity:		
Retirement benefit obligations (per above)	**(150.6)**	(41.0)
Other (per above)	**(11.4)**	21.2
Unrealised appreciation on investment property	**–**	–
Fair value on transfer of engagements – Plymouth & South West (Note 49)	**(3.7)**	2.7
Fair value acquisition – Somerfield (Note 50)	**(182.0)**	–
Fair value on transfer of engagements – Britannia (Note 49)	**(132.2)**	–
At end of period	**39.7**	385.4

The deferred tax charge in the income statement comprises the following differences:

	2009 £m	2008 £m
Original and reversal of temporary differences	**(24.5)**	(58.0)
Retirement benefit obligations	**53.2**	31.3
Unrealised appreciation on investments and rolled-over gains	**(4.9)**	(16.3)
Unrealised appreciation on investments	**11.6**	(45.3)
Utilisation of tax losses	**5.0**	–
Capital allowances on assets leased to customers	**0.4**	(1.6)
Capital allowances on fixed assets	**44.2**	(3.9)
Adjustments to tax charge in respect of previous periods	**8.7**	0.9
Change in tax rate to 28%	**–**	0.5
	93.7	(92.4)

14 Loss on discontinued operations, net of tax

The Group was required to dispose of a number of former Somerfield foodstores following local competition reviews by the Office of Fair Trading. The performance of these foodstores has been classified as a discontinued operation as they were acquired exclusively with a view to resale. Discontinued operations in 2008 related to the disposal of Department & Home Stores and MCS Wholesale. Department & Home Stores contributed a loss of £2.9m to the operating result in 2009.

Results of discontinued operation	2009 £m	2008 £m
Net revenue	**195.4**	6.4
Expenses	**(192.7)**	(9.2)
Other operating income	**0.7**	–
Results from operating activities	**3.4**	(2.8)
Significant items	**(19.5)**	(3.6)
Interest payable	**(9.8)**	–
Results from operating activities, net of income tax	**(25.9)**	(6.4)
Loss on sale of discontinued operations	**–**	(2.5)
Income tax on discontinued operations	**5.8**	2.5
Loss for the period	**(20.1)**	(6.4)

Significant items in 2009 relate to redundancies. The interest payable relates to the interest on the bridging loan, which was directly attributable to the stores acquired with a view to resale.

The loss from the discontinued operations are attributable entirely to the owners of the Group.

14 Loss on discontinued operations, net of tax continued

	2009 £m	2008 £m
Cash flows from/used in discontinued operations:		
Net cash from operating activities	**2.3**	(3.0)
Net cash from investing activities	**–**	–
Net cash used in financing activities	**(9.8)**	–
Net cash used in discontinued operations	**(7.5)**	**(3.0)**

	2009 £m	2008 £m
Effect of disposal on the financial position of the Group		
Property, plant and equipment	**475.8**	0.1
Investments	**–**	2.0
Inventories	**–**	0.4
Trade and other receivables	**–**	0.5
Trade and other payables	**–**	(0.2)
Net assets and liabilities	**475.8**	2.8
Consideration received, satisfied in cash	**475.8**	–
Cash and cash equivalents disposed of	**–**	–
Net cash inflow	**475.8**	–

15 Emoluments of directors

The total remuneration of the directors was as follows:

	2009 £000	2008 £000
Salaries	**839**	808
Payments to societies for directors' services	**119**	107
	958	915

Directors' emoluments fall into the ranges shown below:

	2009	2008
£nil to £5,000	**–**	–
£5,001 to £10,000	**6**	1
£10,001 to £15,000	**10**	–
£15,001 to £20,000	**12**	8
£20,001 to £25,000	**3**	14
£25,001 to £30,000	**6**	4
£30,001 to £35,000	**1**	3
£35,001 to £40,000	**–**	1
£40,001 to £45,000	**–**	–
£45,001 to £50,000	**1**	–
£50,001 to £55,000	**–**	–
£55,001 to £60,000	**–**	1
£60,001 to £120,000	**–**	–
£120,001 to £125,000	**1**	1
£125,001 to £130,000	**–**	–
£130,001 to £135,000	**1**	1
	41	34

Details of directors' and Executives' remuneration can be found on pages 37 to 42.

16 Property, plant and equipment

	Group 2009 £m	2008 £m
Trading and Corporate activities	**2,517.1**	1,887.3
Financial Services	**190.6**	80.3
Total	**2,707.7**	1,967.6

	Group 2009 £m	2008 £m
The net book value of property comprises:		
Freehold	**1,480.3**	1,097.1
Long leasehold	**28.3**	22.6
Short leasehold	**22.7**	10.6
	1,531.3	1,130.3
Plant includes assets held under finance leases as follows:		
Cost	**20.4**	1.9
Accumulated depreciation	**(3.9)**	(0.5)
Net book value	**16.5**	1.4

For period ended 2 January 2010

	Property £m	Group Plant £m	Total £m
Cost or valuation:			
At 10 January 2009	1,349.5	1,771.1	3,120.6
Additions	59.0	263.8	322.8
Arising on transfer of engagements (Note 49)	119.7	24.6	144.3
Business acquisitions (Note 50)	783.9	294.3	1,078.2
Business disposals	(487.4)	(17.1)	(504.5)
Transfers in from investment properties	0.4	–	0.4
Transfer to/from assets held for sale	(46.9)	(1.2)	(48.1)
Other disposals and transfers	(47.9)	(83.9)	(131.8)
At 2 January 2010	**1,730.3**	**2,251.6**	**3,981.9**
Depreciation:			
At 10 January 2009	215.7	933.8	1,149.5
Charge for the period	27.6	235.2	262.8
Impairment	2.3	3.5	5.8
Business disposals	–	–	–
Transfer to/from assets held for sale	(21.3)	(1.0)	(22.3)
Other disposals and transfers	(27.5)	(96.3)	(123.8)
At 2 January 2010	**196.8**	**1,075.2**	**1,272.0**
Less assets held by discontinued businesses	**(2.2)**	**–**	**(2.2)**
Net book value			
At 2 January 2010	**1,531.3**	**1,176.4**	**2,707.7**
At 10 January 2009	1,130.3	837.3	1,967.6

Included in other disposals and transfers are £12.1m of assets held for sale at period end. Within Property, land of £49.1m is held at valuation (2008: £49.1m). The historical cost equivalent is £1.5m (2008: £1.5m). The impairment charge of £5.8m (2008: £3.1m) in the period related to loss making stores in the Food Retail business. No impairment charge went through the statement of comprehensive income in the period (2008: £nil).

16 Property, plant and equipment continued
For year ended 10 January 2009

	Property £m	Group Plant £m	Total £m
Cost or valuation:			
At 12 January 2008	1,394.2	1,568.4	2,962.6
Additions	3.8	327.1	330.9
Arising on transfer of engagements	43.8	9.8	53.6
Revaluation	9.7	–	9.7
Business acquisitions	5.6	–	5.6
Business disposals	(0.1)	–	(0.1)
Transfers to investment properties	(8.6)	–	(8.6)
Other disposals and transfers	(98.9)	(134.2)	(233.1)
At 10 January 2009	**1,349.5**	**1,771.1**	**3,120.6**
Depreciation:			
At 12 January 2008	204.7	898.3	1,103.0
Charge for the year	20.3	159.3	179.6
Impairment	0.5	2.6	3.1
Business disposals	–	–	–
Other disposals and transfers	(9.8)	(126.4)	(136.2)
At 10 January 2009	**215.7**	**933.8**	**1,149.5**
Less assets held by discontinued businesses	**(3.5)**	**–**	**(3.5)**
Net book value			
At 10 January 2009	**1,130.3**	**837.3**	**1,967.6**
At 12 January 2008	1,183.7	670.1	1,853.8

17 Intangible assets

	Group	
	2009 £m	2008 £m
Trading and Corporate activities	**1,575.9**	729.0
Financial Services	**216.8**	99.1
Total	**1,792.7**	828.1
Deferred acquisition costs (see (a) below)	**48.5**	40.0
Other intangible assets (see (b) below)	**1,744.2**	788.1
Total intangible assets	**1,792.7**	828.1
a) Deferred acquisition costs		
At the beginning of the period	**40.0**	46.4
Additions	**77.2**	66.5
Amortisation	**(68.7)**	(72.9)
At the end of the period	**48.5**	40.0

Within the general insurance business costs directly associated with the acquisition of new business, including commission, are capitalised and amortised in accordance with the rate at which the gross premiums written associated with the underlying contract are earned.

Long term insurance business deferred acquisition costs are no longer represented as an explicit asset under the realistic basis of reporting actuarial liabilities. Acquisition costs relating to investment contracts are recognised when incurred as the Directors do not consider these costs to be recoverable from future income.

Other deferred acquisition costs of the long term business will be realised over a period of up to five years (2008: four and ¾ years), being the expected term of a unit trust contract. Of the total value £7.2m (2008: £6.3m) is expected to be recovered after more than one year.

17 Intangible assets continued

b) Other intangible assets

For period ended 2 January 2010

	Group							
	Goodwill £m	**Licences £m**	**Intellectual property £m**	**Computer software £m**	**Customer list**	**Brand £m**	**Assets in course of construction £m**	**Total £m**
Cost:								
At 10 January 2009	397.6	501.8	0.8	74.4	–	–	30.5	1,005.1
Arising on acquisitions (Note 50)	869.4	1.4	–	–	–	–	–	870.8
Arising on transfer of engagements (Note 49)	0.6	–	–	–	44.0	2.0	–	46.6
Additions	10.0	–	–	3.2	–	–	83.7	96.9
Disposals	(2.6)	–	–	(3.8)	–	–	–	(6.4)
Transfers	–	–	–	15.3	–	–	(18.2)	(2.9)
At 2 January 2010	**1,275.0**	**503.2**	**0.8**	**89.1**	**44.0**	**2.0**	**96.0**	**2,010.1**
Amortisation:								
At 10 January 2009	126.5	44.5	0.2	45.8	–	–	–	217.0
Charge for the period	–	24.1	0.1	17.7	3.7	–	–	45.6
Impairment charge	7.3	–	–	–	–	–	–	7.3
Disposals	(0.2)	–	–	(3.8)	–	–	–	(4.0)
At 2 January 2010	**133.6**	**68.6**	**0.3**	**59.7**	**3.7**	**–**	**–**	**265.9**
Net book value:								
At 2 January 2010	**1,141.4**	**434.6**	**0.5**	**29.4**	**40.3**	**2.0**	**96.0**	**1,744.2**
At 10 January 2009	271.1	457.3	0.6	28.6	–	–	30.5	788.1

For year ended 10 January 2009

	Group					
	Goodwill £m	Licences £m	Intellectual property £m	Computer software £m	Assets in course of construction £m	Total £m
Cost:						
At 12 January 2008	386.8	477.3	0.8	57.4	9.8	932.1
Arising on acquisitions	10.9	23.2	–	–	–	34.1
Arising on transfer of engagements	–	2.9	–	–	–	2.9
Additions	–		–	15.2	30.6	45.8
Disposals	(0.1)	(1.6)	–	(3.7)	(4.4)	(9.8)
Transfers	–	–	–	5.5	(5.5)	–
At 10 January 2009	**397.6**	**501.8**	**0.8**	**74.4**	**30.5**	**1,005.1**
Amortisation:						
At 12 January 2008	125.2	20.3	–	32.6	–	178.1
Charge for the year	–	24.2	0.2	16.9	–	41.3
Impairment charge	1.3	–	–	–	–	1.3
Disposals	–	–	–	(3.7)	–	(3.7)
At 10 January 2009	**126.5**	**44.5**	**0.2**	**45.8**	**–**	**217.0**
Net book value:						
At 10 January 2009	**271.1**	**457.3**	**0.6**	**28.6**	**30.5**	**788.1**
At 12 January 2008	261.6	457.0	0.8	24.8	9.8	754.0

The main components of the £1.14bn (2008: £271m) of goodwill are Somerfield (£868m), Alldays (£87m), Conveco (£18m), and Balfour (£16m) within Co-operative Food, and Fairways (£10.5m) within Co-operative Funeralcare. The remaining goodwill largely represents a number of single store acquisitions (£38m) and small group acquisitions (£51m) in Food, £18m of pharmacies and smaller funeral branch acquisitions. Goodwill is not amortised but is subject to impairment reviews at least annually. Amortisation charges are recognised in operating expenses within the income statement and impairment charges in significant items.

17 Intangible assets continued

For the purposes of impairment testing of goodwill, the Group is regarded as several cash-generating units. Components of goodwill range from individual cash generating units, where stores/branches were acquired individually, to groups of cash generating units, where groups of stores/branches were acquired as part of one transaction. Impairment testing is carried out at the level at which management monitor these components of goodwill. The impairment charge of £7.3m in the current period relates to the impairment of goodwill in Food (£1.4m), Travel (£3.9m) and Pharmacy (£2.0m) businesses following a review of the recoverable amount based on discounted future cash flows expected to be generated from the stores/branches. The key impairment relates to the Medinland acquisition in Travel due to a decline in volumes. Food impairment relates to one individual store and four small scale acquisitions. Pharmacy impairments relate to five branches. The impairment charge of £1.3m in 2008 related to Co-operative Food. No impairment charge went through the statement of comprehensive income in the period (2008: £nil).

In the Trading businesses, the cash generating units' recoverable amounts are based on value in use using projections of the Group's performance based on the three-year plans approved by the Board.The discount rate is based on the cost of capital for each business and range from 7.5–12% (2008: a range between 8–12%). Business-specific growth rates are used to extrapolate cash flows beyond the three-year plan. The cash flows for each business have been risk adjusted as appropriate to their respective industry. For large acquisitions, buying benefits and synergies are included in cash flows when performing impairment testing at acquisition level.

For Food, the key assumption used in the review for potential impairment of goodwill arising on the acquisition of Somerfield was that future EBITDA growth was projected as 2% from 2010, taken into perpetuity and discounted to present value. Buying benefits and synergies have been included in cash flows. Sensitivity analysis has been performed for the Somerfield goodwill figure and for both a 1% increase in discount rate and a decrease in EBITDA growth to 1% the cash flows remain well in excess of the current carrying value. For other individual stores/smaller groups annual cashflows have been inflated for growth by 1% per annum taken into perpetuity and discounted to present value. Loss making stores are assumed to close within two years.

For Co-operative Funeralcare, average selling price increases and wage and cost inflation have been applied as per the assumptions in the three year plan, cash flows have been projected for 10 years and into perpetuity from year 11 and discounted back to present value. Sensitivity analysis has been performed with both the growth rate and discount rate adjusted by +/– 1%, and under these sensitivities significant headroom is maintained.

Licences relate to the Pharmacy business. For the purposes of impairment testing of the Pharmacy licences, the recoverable amount was determined by discounting future cash flows expected to be generated from continuing use of the licences, assuming growth in profits of 3% per annum for 20 years. Sensitivity analysis demonstrated that a +/- 1% adjustment to the discount rate would have resulted in an additional impairment charge of £0.6m/reduction of £0.1m. A +/– 1% adjustment to the profit growth rate would have reduced impairment by £0.1m/increased by £0.7m.

The Bank's goodwill recognised in the period relates to the transfer of engagements of Britannia Building Society. Further detail is provided in Note 49. The Britannia goodwill has been allocated, to a number of different businessess within the Co-operative Bank. Its recoverable amount has been calculated by considering the value in use of the Bank as a whole. The key assumptions used in the calculation are shown below. These have been determined using past experience, understanding of the business and its industry, and recognition of current market events with respect to retail deposit-taking business:

- Modest growth in assets of 2.5% per annum
- Net interest margin of 1.37% by 2013 thereafter growing by 1.5bps per annum until 2024
- Loss provisions of 0.10% of total average assets each year
- Discount rate of 11% has been applied to the additional payments that would have been made to the members of Britannia Building Society.

The calculations have been flexed to assess the sensitivities to reasonable changes in the already conservative assumptions. This sensitivity analysis did not indicate any likely impairment of the goodwill.

Asset in the course of construction and computer software

All additions to assets in the course of construction and computer software relate to additions from internally developed assets.

Assets in the course of construction includes an amount of £77.6m (10 January 2009: £16.1m) relating to the Business Transformation Project; a project to design and install a new banking system mainframe. These assets are not yet ready for use and so no amortisation has been charged to date. The anticipated amortisation period for these assets is 10 years from the date they are ready for use.

The carrying amount of the intangible assets represents various computer software development projects.

As part of the Change Portfolio a number of large projects are currently developing software. All projects have been reviewed at the end of the period for impairment.

17 Intangible assets continued

Impairment testing for assets in course of construction

Value in use was determined by discounting the future cash flows generated from the continuing use of the asset.

The value in use of assets in course of construction has been computed using the pre-tax discount rate of 12% pa (10 January 2009: 12%). Any cashflow estimate exceeding the period covered by the most recent forecasts was computed by extrapolating the projections based on the budgets/forecasts using a steady growth rate for subsequent years, not exceeding the long-term growth rate of 2.5% pa assumed for the industries in which the group operates.

Sensitivity analysis of the carrying value

A sensitivity analysis has been performed on the assumptions used to determine the value in use for each asset in the course of construction as at 2 January 2010. Management has concluded that value in use is most sensitive to the discount rate. It is possible that changes in these assumptions could cause impairment of carrying cost. An increase of a percentage point in the discount rate would have decreased the value in use by £19.8m.

18 Investment properties – Trading and Corporate activities

	Group	
	2009 £m	2008 £m
Valuation at beginning of period	**322.6**	385.6
Revaluation surplus/(deficit) recognised in income statement	**3.5**	(62.3)
Arising on transfer of engagements (Note 49(ii))	**12.9**	–
Additions	**0.9**	3.2
Transfers in from property, plant and equipment	**–**	12.4
Transfers to property, plant and equipment	**(0.4)**	(3.8)
Disposals	**(17.9)**	(12.5)
Valuation at end of period	**321.6**	322.6

Investment properties have been valued as at 2 January 2010. The valuation was carried out by a mixture of external chartered surveyors: Colliers Conrad Ritblat Erdman and Smiths Gore, as well as in-house valuers, on the basis of open market value in accordance with the RICS Appraisal and Valuation Manual.

The properties are valued individually, and yields therefore vary on a property-by-property basis. The transfers in from fixed assets arise from the end of owner-occupancy at former trading and administrative locations. If an investment property becomes owner-occupied, it is reclassified as property, plant and equipment, and it's fair value at the dates of reclassification becomes it's cost for subsequent accounting purposes.

The mean ERV yield over the whole estate at the period-end is 6.7% (2008: 6.5%).

In the case of investment properties it is assumed that uplifts on valuation principally reflect future rentals.

Investment properties do not include those within Insurance activities. Details of these are included in Note 28.

18 Investment properties – Trading and Corporate activities continued

The valuation of investment properties comprises:

	Group 2009 £m	Group 2008 £m
Freehold	**307.3**	305.1
Long leasehold	**14.1**	15.5
Mixed tenure	**0.2**	2.0
	321.6	322.6

If investment properties were carried at historical cost, the cost and accumulated depreciation would be:

	Group 2009 £m	Group 2008 £m
Cost	**217.9**	211.1
Accumulated depreciation	**(17.9)**	(14.7)
Net historic cost value	**200.0**	196.4

19 Investments in associates and joint ventures

The Group's share of profit in relation to associates and joint ventures for the period was £0.3m (2008: £0.5m).

Movements in investments in associates and joint ventures and other investments in the Trading Group are as follows:

	2009		2008	
	Investments in associates and joint ventures £m	**Other investments £m**	Investments in associates and joint venture £m	Other investments £m
At beginning of period	**23.3**	**4.2**	13.5	3.9
Additions	**1.2**	**0.5**	8.3	0.3
Disposals	**(0.1)**	**(0.1)**	–	–
Share of profit	**0.4**	**–**	0.5	–
Translation adjustments	**0.3**	**–**	1.0	–
At end of period	**25.1**	**4.6**	23.3	4.2

Movements in investments in associates and joint ventures in CFS are as follows:

	2009 Investments in associates and joint ventures £m	2008 Investments in associates and joint ventures £m
At beginning of period	**–**	–
Arising on transfer of engagements	**2.1**	–
Share of losses	**(0.1)**	–
At end of period	**2.0**	–

19 Investments in associates and joint ventures continued

Summary financial information for significant joint ventures and associates (not adjusted for percentage held by the Group) are disclosed below:

	Ownership	Current assets £m	Non-current assets £m	Total assets £m	Current liabilities £m	Non-current liabilities £m	Total liabilities £m	Income £m	Expenditure £m
2009									
Britannia Personal Lending Limited	**49%**	**24.0**	**38.8**	**62.8**	**34.4**	**28.4**	**62.8**	**1.5**	**1.7**
Co-operative Holidays Limited	**50%**	**0.8**	**–**	**0.8**	**0.9**	**–**	**0.9**	**–**	**0.1**
Grangefern Properties	**50%**	**1.2**	**20.8**	**22.0**	**1.1**	**16.4**	**17.5**	**2.2**	**1.2**
SEA Estates	**50%**	**1.1**	**7.5**	**8.6**	**9.6**	**–**	**9.6**	**1.0**	**4.5**
Tiajin Tasly Sants Pharmaceutical Distributors	**60%**	**4.1**	**22.4**	**26.5**	**0.5**	**10.0**	**10.5**	**–**	**–**
2008									
Britannia Personal Lending Limited	49%	–	–	–	–	–	–	–	–
Co-operative Holidays Limited	50%	–	–	–	–	–	–	–	–
Grangefern Properties	50%	1.3	20.9	22.2	0.9	17.6	18.5	2.2	1.4
SEA Estates	50%	–	–	–	–	–	–	–	–
Tiajin Tasly Sants Pharmaceutical Distributors	60%	6.9	10.1	17.0	0.1	–	0.1	–	–

The Group holds 60% of the ordinary share capital of Tasly Sants Pharmaceutical Distributors Ltd, incorporated in The People's Republic of China. The principal activity of Tasly Sants Pharmaceutical Distributors Ltd is to manufacture generic medicines. The entity's result is not consolidated fully by the Group as despite having a 60% share interest, the Group has joint control of the board. The entity has a year end date of 31 December.

The Group holds 50% of the ordinary share capital of Grangefern Properties Limited, incorporated in England and Wales. The entity's principal activity is property investment and development.

The Group holds 50% of the ordinary share capital of SEA Estates LLP, incorporated in England and Wales. The entity's principal activity is property investment and development.

The Group holds 50% of the ordinary share capital of Co-operative Holidays Limited, incorporated in England and Wales. The entity's principal activity is to act as an 'inhouse' tour operator.

The Group owns 49% of the ordinary shares in Britannia Personal Lending Limited, incorporated in England and Wales. Its principal activity is unsecured personal lending. The entity has a year end date of 31 December.

All the above entities are jointly managed and controlled by the Group and a third party and are accounted for as joint ventures under the equity method.

There were no contingent liabilities or commitments in respect of these joint ventures as at 2 January 2010.

20 Derivatives

	2009		2008	
Group	**Assets £m**	**Liabilities £m**	Assets £m	Liabilities £m
Trading and Corporate activities (a)	**10.6**	**(96.0)**	17.1	(37.1)
Financial Services (b)	**1,704.3**	**(1,094.2)**	1,230.4	(514.7)

20 Derivatives continued

a) Trading and Corporate activities

Derivatives held for non-trading purposes for which hedge accounting has not been applied.

	Contractual/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Interest-rate swaps	1,160.7	10.5	(95.9)
Forward currency transactions	12.2	0.1	(0.1)
Total recognised derivative assets/(liabilities)	**1,172.9**	**10.6**	**(96.0)**

Interest rate swaps and forward currency transactions are measured at fair value through the income statement.

The objectives and policies for financial instruments are included within Note 54 on risk management.

b) Financial Services

Derivative financial instruments

CFS has entered into various derivatives as principal either as a trading activity, which includes proprietary transactions and customer facilitation, or as a hedging activity for the management of interest rate risk and foreign exchange rate risk. Positive and negative fair values have not been netted as the Group does not have a legal right of offset.

Derivatives held for trading purposes:
The trading transactions include interest rate swaps, swaptions, caps and floors, forward rate agreements, futures and FTSE options. 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 in CFS. Derivatives used to manage interest rate related positions include swaps, caps and floors, forward rate agreements and exchange traded futures. Foreign exchange rate positions are managed using forward currency transactions and swaps.

	2009 Fair values		2008 Fair values	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Derivatives held for trading:				
Interest rate swaps	**148.7**	**(345.3)**	276.1	(64.9)
Interest rate options	**3.7**	**(3.7)**	3.3	(3.3)
Interest rate swaptions	**290.6**	**–**	471.4	(1.8)
Interest rate futures	**–**	**–**	–	(336.8)
Forwards	**1.2**	**(11.2)**	–	–
Financial futures contracts	**11.8**	**(19.0)**	1.7	(18.1)
Total return swaps	**104.0**	**(162.2)**	231.9	–
Forward currency contracts	**–**	**–**	–	(34.4)
FTSE Options	**170.0**	**–**	114.3	–
Total derivative assets/(liabilities) held for trading	**730.0**	**(541.4)**	1,098.7	(459.3)
Derivatives held for non-trading:				
Derivatives designated as cash flow hedges				
Interest rate swaps	**117.1**	**(69.6)**	112.0	(29.5)
Derivatives designated as fair value hedges				
Interest rate swaps	**121.0**	**(434.3)**	–	(1.5)
Derivatives held for non-trading purposes for which hedge accounting has not been applied				
Interest rate swaps	**11.8**	**(14.4)**	1.7	(12.6)
Embedded derivatives – options	**5.4**	**(4.0)**	9.5	(8.0)
OTC interest rate options	**–**	**(0.3)**	–	–
Equity Swaps	**61.3**	**(6.8)**	–	–
Forward currency transactions	**657.7**	**(23.4)**	8.5	(3.8)
Total derivative assets/(liabilities) held for non-trading	**974.3**	**(552.8)**	131.7	(55.4)
Total recognised derivative assets/(liabilities)	**1,704.3**	**(1,094.2)**	1,230.4	(514.7)

21 Employee benefits and retirement benefit obligations

	Group	
	2009	2008
The average number employed by the Group in the UK was:		
Full-time	**40,726**	35,780
Part-time	**58,421**	44,878
	99,147	80,658

	2009 **£m**	2008 £m
Wages and salaries	**1,556.0**	1,194.1
Social security costs	**92.7**	67.4
Pension costs	**52.7**	52.0
	1,701.4	1,313.5

The pension assets and liabilities in the balance sheet are comprised as follows:

	2009 **£m**	2008 £m
Trading Group assets		
Surplus from the Co-operative Group Pension Scheme (PACE)	**1.6**	401.2
Add back EFRBS liabilities relating to CFS	**3.5**	3.2
Surplus from the Lothian Borders & Angus scheme	**–**	2.0
	5.1	406.4
Trading Group liabilities		
Deficit in Somerfield pension schemes	**54.3**	–
Deficit in United Norwest Scheme	**108.9**	104.0
Deficit in other former United Co-operatives pension schemes	**43.0**	42.0
Deficit in Plymouth & South West scheme	**44.9**	–
Deficit in Lothian, Borders & Angus scheme	**1.6**	–
	252.7	146.0
Financial Services liabilities		
Deficit in Britannia pension scheme	**33.2**	–
EFRBS liabilities from the PACE scheme	**3.5**	3.2
	36.7	3.2

The Group operates a number of defined benefit pension schemes, the assets of which are held in separate trustee-administered funds. There are now nine principal schemes operated by the Group following the transfer of engagements of United Co-operatives Limited, Lothian Borders & Angus, Plymouth & South West and the acquisition of the Somerfield and Britannia groups of companies. These are The Co-operative Group Pension (Average Career Earnings) Scheme (PACE), United Norwest Co-operatives Employees' Pension Fund, the Yorkshire Co-operatives Limited Employees' Superannuation Fund, the Leeds Co-operative Society Limited Employee Pension Fund, the Sheffield Co-operative Society Limited Employees' Superannuation Fund, the Lothian Borders & Angus scheme, the Somerfield Limited group occupational pension schemes, the Britannia pension schemes and the Plymouth & South West pension schemes. All of the former United Co-operatives pension schemes are closed to new entrants. In addition there exists the United Norwest Co-operatives Limited 1989 Discretionary Early Retirement Benefits Scheme (closed to new entrants from 5 November 1995), which provides additional benefits for long-serving employees who commenced employment prior to 6 November 1994, and the Leeds Co-operative Society Limited Managerial Staff Pensions Scheme.

Details of the principal schemes are given below.

The pension costs are assessed in accordance with actuarial advice using the projected unit method.

The most recent valuation of the schemes was carried out by a qualified actuary. The date of the last full valuations of the nine principal schemes are shown below. The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescale covered, may not necessarily be borne out in practice.

21 Employee benefits and retirement benefit obligations continued

	PACE Scheme	United Norwest Scheme	Somerfield Schemes	Britannia Scheme	Yorkshire Scheme	Sheffield Scheme	Leeds Scheme	Lothian Borders & Angus Scheme	Plymouth & South West Schemes
Date of last full actuarial valuation	April 2007	January 2008	April 2007	April 2008	January 2008	January 2008	January 2008	January 2009	March 2007

The actuarial valuations of the schemes have been updated to 2 January 2010 in accordance with IAS 19.

	2009	2008
The principal assumptions used to determine the liabilities of the Group's pension schemes were:		
Discount rate	**5.60%**	5.70%
Rate of increase in salaries	**5.30%**	4.75%
Future pension increases where capped at 5.0% pa	**3.80%**	3.25%
Future pension increases where capped at 2.5% pa	**2.50%**	2.50%
Assumptions used to determine net pension cost for the PACE scheme are:		
Discount rate	**5.70%**	5.65%
Expected long-term return on scheme assets	**6.40%**	6.40%
Rate of increase in salaries	**4.75%**	5.15%
Assumptions used to determine net pension cost for the former United Co-operatives schemes are:		
Discount rate	**5.70%**	5.65%
Expected long-term return on scheme assets	**6.50%**	6.50%
Rate of increase in salaries	**4.75%**	5.15%
Assumptions used to determine net pension cost for the Somerfield schemes are:		
Discount rates	**5.80%**	–
Expected long-term return on scheme assets	**5.10%**	–
Rate of increase in salaries	**4.75%**	–

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the PACE scheme, Plymouth scheme and the former United Co-operatives schemes at 2 January 2010 are:

Life expectancy at age 65	**Male**	**Female**
Member currently aged 65 (current life expectancy)	**20.4**	**23.2**
Member currently aged 45 (life expectancy at age 65)	**21.3**	**24.1**

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Britannia Scheme at 2 January 2010 are:

Life expectancy at age 65	**Male**	**Female**
Member currently aged 65 (current life expectancy)	**21.7**	**24.0**
Member currently aged 45 (life expectancy at age 65)	**22.8**	**24.9**

The average life expectancy (in years) for mortality tables used to determine scheme liabilities for the Somerfield scheme at 2 January 2010 are:

Life expectancy at age 65	**Male**	**Female**
Member currently aged 65 (current life expectancy)	**20.8**	**21.7**
Member currently aged 45 (life expectancy at age 65)	**23.0**	**23.0**

The fair value of the scheme's assets, which are intended to be realised in the future, may be subject to significant change before they are realised.

	Group	
	2009 £m	2008 £m
Trading and Corporate activities	**(247.6)**	260.4
Financial Services	**(36.7)**	(3.2)
Net pension (deficit)/asset	**(284.3)**	257.2

21 Employee benefits and retirement benefit obligations continued

Net pension finance income of £47.5m in the income statement includes £58.0m in respect of the PACE scheme, £4.4m net pension finance cost in respect of the four defined benefit schemes operated by the former United Co-operative Group, £5.3m net pension finance cost in respect of Somerfield and a net pension finance cost of £0.8m for all remaining schemes and includes £332.1m interest on liabilities and £379.6m expected return on scheme assets.

The current service cost is recognised in the operating expenses line in the income statement, gains on settlements and curtailments in the comparative year were included in significant items, expected return on scheme assets and interest on liabilities are both included in net financial income – other.

(i) The Co-operative Group Pension Scheme (PACE)

	2009 £m	2008 £m
The amounts recognised in the balance sheet are as follows:		
Present value of funded obligations	**(5,509.0)**	(4,799.9)
Present value of unfunded liabilities	**(3.8)**	(3.5)
Fair value of plan assets	**5,514.4**	5,204.6
Net retirement benefit asset	**1.6**	401.2

A movement in the discount rate of 0.1% would impact the scheme's liabilities by £108m, an adjustment to price and salary inflation of 0.1% would impact liabilities by £95m. The introduction of a minimum future improvement 'underpin' to the mortality assumption of 1% pa would increase the funded liabilities by £200m.

The pension scheme assets include property occupied by the Group with a fair value of £1.1m (2008: £1.1m).

	2009 £m	2008 £m
The amounts recognised in the income statement are as follows:		
Current service cost	**36.4**	39.3
Interest on liabilities	**264.9**	283.0
Expected return on scheme assets	**(322.9)**	(348.9)
Gains on settlement and curtailments	**–**	(10.0)
	(21.6)	(36.6)
Actual return on scheme assets	**429.7**	(185.9)

	2009 £m	2008 £m
Changes in the present value of the scheme liabilities are as follows:		
Opening defined benefit liabilities	**4,803.4**	5,077.3
Current service cost	**36.4**	39.3
Interest on liabilities	**264.9**	283.2
Contributions by members	**20.4**	20.2
Actuarial losses/(gains) recognised in equity	**581.3**	(408.6)
Benefits paid	**(193.6)**	(198.0)
Gains on settlements and curtailments	**–**	(10.0)
Closing defined benefit liabilities	**5,512.8**	4,803.4

	2009 £m	2008 £m
Changes in the fair value of the scheme assets are as follows:		
Opening fair value of scheme assets	**5,204.6**	5,511.7
Expected return on scheme assets	**322.9**	348.9
Actuarial gains/(losses) recognised in equity	**106.8**	(535.2)
Contributions by the employer	**53.2**	58.0
Contributions by members	**20.4**	20.2
Benefits paid	**(193.5)**	(199.0)
Closing fair value of scheme assets	**5,514.4**	5,204.6

21 Employee benefits and retirement benefit obligations continued

The Group expects to contribute £54.4m to its PACE scheme in 2010.

	2009	2008
The weighted-average asset allocations at the period-end were as follows:		
Equities	**35%**	42%
Liability-driven investments	**54%**	54%
Alternative growth	**6%**	4%
Property	**4%**	0%
Cash	**1%**	0%
Total scheme assets	**100%**	100%

To develop the expected long-term rate of return on assets assumption, the Group considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.4% (2008: 6.4%) assumption for the year ended 2 January 2010.

	2009 £m	**2008 £m**	**2007 £m**	**2006 £m**	**2005 £m**
Amounts recognised in the balance sheet:					
Defined benefit liabilities	**(5,512.8)**	(4,803.4)	(5,077.3)	(5,056.9)	(4,810.9)
Scheme assets	**5,514.4**	5,204.6	5,511.7	5,344.0	5,030.5
Surplus	**1.6**	401.2	434.4	287.1	219.6
History of experience gains and losses:					
Experience adjustment on scheme liabilities	**–**	–	65.5	(238.8)	163.0
% of scheme liabilities	**–**	–	1%	5%	3%
Experience adjustment on scheme assets	**106.8**	(535.2)	(24.3)	130.1	686.7
% of scheme assets	**2%**	10%	0%	2%	14%

(ii) United Norwest Co-operatives Employees' Pension Fund

	2009 £m	2008 £m
The amounts recognised in the balance sheet are as follows:		
Present value of funded obligations	**(425.2)**	(355.1)
Fair value of plan assets	**316.3**	251.1
Net retirement benefit deficit	**(108.9)**	(104.0)

The pension scheme assets include property occupied by the Group with a fair value of £nil (2008: £nil)

	2009 £m	2008 £m
The amounts recognised in the income statement are as follows:		
Current service cost	**8.4**	10.2
Interest on liabilities	**19.8**	21.8
Expected return on scheme assets	**(16.6)**	(18.7)
Gains on settlement and curtailments	**–**	(9.0)
	11.6	4.3
Actual return on scheme assets	**45.8**	(38.4)

21 Employee benefits and retirement benefit obligations continued

	2009 £m	2008 £m
Changes in the present value of the scheme liabilities are as follows:		
Opening defined benefit liabilities	**355.1**	384.8
Current service cost	**8.4**	10.2
Interest on liabilities	**19.8**	21.8
Contributions by members	**3.9**	4.4
Actuarial losses/(gains)	**50.9**	(44.9)
Benefits paid	**(12.9)**	(12.2)
Gains on settlement and curtailments	**–**	(9.0)
Closing defined benefit liabilities	**425.2**	355.1

	2009 £m	2008 £m
Changes in the fair value of the scheme assets are as follows:		
Opening fair value of scheme assets	**251.1**	285.2
Expected return on scheme assets	**16.6**	18.7
Actuarial gains/(losses)	**29.2**	(57.1)
Contributions by the employer	**28.4**	12.1
Contributions by members	**3.9**	4.4
Benefits paid	**(12.9)**	(12.2)
Closing fair value of scheme assets	**316.3**	251.1

The Group expects to contribute £26.5m to the United Norwest pension scheme in 2010.

	2009	2008
The weighted-average asset allocations at the period-end were as follows:		
Equities	**48%**	43%
Diversified growth	**22%**	15%
Bonds	**23%**	32%
Property	**5%**	7%
Cash	**2%**	3%
Total scheme assets	**100%**	100%

To develop the expected long-term rate of return on assets assumption, the Group considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.5% (2008: 6.5%) assumption for the period ended 2 January 2010.

	2009 £m	2008 £m	2007 £m
Amounts recognised in the balance sheet:			
Defined benefit liabilities	**(425.2)**	(355.1)	(384.8)
Scheme assets	**316.3**	251.1	285.2
Deficit	**(108.9)**	(104.0)	(99.6)
History of experience gains and losses:			
Experience adjustment on scheme liabilities	**–**	9.3	–
% of scheme liabilities	**0.0%**	2.6%	0.0%
Difference between expected and actual return on scheme assets	**29.2**	(57.1)	0.8
% of scheme assets	**9.2%**	(22.7%)	0.3%

21 Employee benefits and retirement benefit obligations continued

(iii) Somerfield pension schemes

The Somerfield pension schemes comprise of four sections:

1 A defined benefit section for employees who were members of the original Somerfield Pensions Scheme, closed to new entrants in 1999/2000;

2 A defined benefit section for employees who were members of the Kwik Save Retirement Benefits Scheme closed to new entrants and merged into the Somerfield Pension Scheme in 1999;

3 A closed defined benefit section providing lump sum retirement and death benefits for some Kwik Save employees. This was a separate scheme until merged into the Somerfield Pension Scheme on 5 April 2006; and

4 A defined contribution section.

	2009 £m
The amounts recognised in the balance sheet are as follows:	
Present value of funded obligations	(581.8)
Fair value of plan assets	527.5
Net retirement benefit asset	**(54.3)**

The pension scheme assets include property occupied by the Group with a fair value of £nil (2008: £nil).

	2009 £m
The amounts recognised in the income statement are as follows:	
Current service cost	1.9
Interest on liabilities	25.0
Expected return on scheme assets	(19.7)
	7.2
Actual return on scheme assets	**69.5**

	2009 £m
Changes in the present value of the scheme liabilities are as follows:	
Defined benefit liabilities acquired upon acquisition of Somerfield	519.1
Current service cost	1.9
Interest on liabilities	25.0
Contributions by members	1.3
Actuarial losses	51.5
Benefits paid	(17.0)
Closing defined benefit liabilities	**581.8**

	2009 £m
Changes in fair value of the scheme assets are as follows:	
Scheme assets acquired upon acquisition of Somerfield	456.9
Expected return on scheme assets	19.7
Actuarial gains	49.8
Contribution by the employer	16.8
Contributions by members	1.3
Benefits paid	(17.0)
Closing defined scheme assets	**527.5**

The Group expects to contribute £20.2m to the Somerfield pension schemes in 2010.

21 Employee benefits and retirement benefit obligations continued

	2009
The weighted-average asset allocations at the period-end were as follows:	
Equities	13%
Bonds	71%
Other*	16%
Total scheme assets	**100%**

* As well as cash and current assets, this category includes cash based investments held by the bond managers for the purpose of managing the swaps portfolios. There is also a small holding in a specialist tactical asset allocation fund.

To develop the expected long-term rate of return on assets assumption, the Group considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. This resulted in the selection of the 5.1% assumption for the period ended 2 January 2010.

	2009 £m
Amounts recognised in the balance sheet:	
Defined benefit liabilities	(581.8)
Scheme assets	527.5
Deficit	**(54.3)**
History of experience gains and losses:	
Experience adjustment on scheme liabilities	2.8
% of scheme liabilities	0.5%
Experience adjustment on Scheme assets	49.8
% of scheme assets	9.4%

Only one years' history has been disclosed because these schemes only became part of the Group in 2009.

(iv) Britannia Building Society pension schemes

	2009 £m
The amounts recognised in the balance sheet are as follows:	
Present value of funded obligations	(478.1)
Present value of unfunded obligations	(4.7)
Fair value of plan asset	449.6
Net retirement benefit asset	**(33.2)**

The pension scheme assets include property occupied by the Group with a fair value of £nil (2008: £nil).

	2009 £m
The amounts recognised in the income statement are as follows:	
Current service cost	3.9
Interest on liabilities	11.0
Expected return on scheme assets	(10.8)
	4.1
Actual return on scheme assets	**37.0**

21 Employee benefits and retirement benefit obligations continued

	2009 £m
Changes in the present value of the scheme liabilities are as follows:	
Opening defined benefit liabilities	411.9
Current service cost	3.9
Interest on liabilities	11.0
Contributions by members	1.0
Actuarial losses	58.7
Benefit paid	(3.7)
Closing defined benefit liabilities	**482.8**

	2009 £m
Changes in fair value of the scheme assets are as follows:	
Opening fair value of scheme assets	411.9
Expected return on scheme assets	10.8
Actuarial gains	26.3
Contribution by the employer	3.3
Contributions by members	1.0
Benefits paid	(3.7)
Closing defined benefit assets	**449.6**

The Group expects to contribute £8.1m to the Britannia pension schemes in 2010.

	2009 £m
The weighted-average asset allocations at the period-end were as follows:	
Equities	26%
Diversified growth	20%
Liability driven investments	54%
Total scheme assets	**100%**

To develop the expected long-term rate of return on assets assumption, the Group considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.4% assumption for the period ended 2 January 2010.

	2009 £m
Amounts recognised in the balance sheet:	
Defined benefit liabilities	(482.8)
Scheme assets	449.6
Deficit	**(33.2)**
History of experience gains and losses:	
Experience adjustment on scheme liabilities	–
% of scheme liabilities	0.0%
Experience adjustment on Scheme assets	26.2
% of scheme assets	6.0%

Only one years' history has been disclosed because Britannia only became part of the Group in 2009.

21 Employee benefits and retirement benefit obligations continued

(v) Yorkshire Co-operatives Limited Employees' Superannuation Fund, Sheffield Co-operative Society Limited Employees' Superannuation Fund, Leeds Co-operative Society Limited Employee Pension Fund, United Norwest Co-operatives Limited 1989 Discretionary Early Retirement Benefits Scheme and Lothian Borders & Angus Co-operative Society Limited Employees' Pension Fund, the Plymouth & South West Co-operative Society Limited Employees Superannuation Fund and the Brixham Co-operative Society Limited Employees Pension Scheme.

	2009 £m	2008 £m
The amounts recognised in the balance sheet are as follows:		
Present value of funded obligations	**(304.8)**	(164.8)
Present value of unfunded liabilities	**(11.5)**	(11.5)
Fair value of scheme assets	**226.9**	136.3
Net retirement benefit deficit	**(89.4)**	(40.0)

The pension scheme assets include property occupied by the Group with a fair value of £nil (2008: £nil)

	2009 £m	2008 £m
The amounts recognised in the income statement are as follows:		
Current service cost	**2.1**	2.5
Interest on liabilities	**10.7**	7.9
Expected return on scheme assets	**(9.6)**	(6.8)
	3.2	3.6
Actual return on scheme assets	**24.4**	(9.6)

	2009 £m	2008 £m
Changes in the present value of the scheme liabilities are as follows:		
Opening defined benefit liabilities	**176.3**	142.5
Defined benefit liabilities acquired upon transfer of engagements	**104.6**	37.5
Current service cost	**2.1**	2.5
Interest on liabilities	**10.7**	7.9
Contributions by members	**1.1**	0.8
Actuarial losses/(gains)	**29.4**	(9.0)
Benefits paid	**(7.9)**	(5.9)
Closing defined benefit liabilities	**316.3**	176.3

	2009 £m	2008 £m
Changes in the fair value of the scheme assets are as follows:		
Opening fair value of scheme assets	**136.3**	108.1
Scheme assets acquired upon transfer of engagements	**62.1**	39.5
Expected return on scheme assets	**9.6**	6.8
Actuarial gains/(losses)	**14.9**	(16.4)
Contributions by the employer	**10.8**	3.5
Contributions by members	**1.1**	0.7
Benefits paid	**(7.9)**	(5.9)
Closing fair value of scheme assets	**226.9**	136.3

The Group expects to contribute £10m to the Yorkshire, Sheffield, Leeds, Lothian Borders & Angus and Plymouth & South West pension schemes in 2010.

21 Employee benefits and retirement benefit obligations continued

	2009	2008
The weighted-average asset allocations at the period-end were as follows:		
Equities	**50%**	44%
Diversified growth	**5%**	7%
Bonds	**34%**	42%
Property	**5%**	5%
Cash	**4%**	2%
Liability-driven investments	**2%**	0%
Total scheme assets	**100%**	100%

To develop the expected long-term rate of return on assets assumption, the Group considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. This resulted in the selection of the 6.4% assumption for the period ended 2 January 2010.

	2009 £m	2008 £m	2007 £m
Amounts recognised in the balance sheet:			
Defined benefit liabilities	**(316.3)**	(176.3)	(142.5)
Scheme assets	**226.9**	136.3	108.1
Deficit	**(89.4)**	(40.0)	(34.4)
History of experience gains and losses:			
Experience adjustment on scheme liabilities	**(1.6)**	1.0	(0.4)
% of scheme liabilities	**0.5%**	0.6%	0.3%
Difference between expected and actual return on scheme assets	**14.9**	(16.4)	(2.8)
% of scheme assets	**6.6%**	(12.0%)	(3.0%)

Three years' history has been disclosed for the Yorkshire, Sheffield and Leeds schemes, two years for the Lothian Borders & Angus scheme and one for the Plymouth & South West scheme – this being the period that has elapsed since they became part of the Group.

22 Deferred taxation

	Group 2009 £m	2008 £m
Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2008: 28%).		
Net deferred tax comprises:		
Deferred tax asset		
Trading and Corporate activities	**(284.3)**	(53.7)
Financial Services	**(103.8)**	(5.8)
	(388.1)	(59.5)
Deferred tax liability		
Trading and Corporate activities	**301.3**	326.6
Financial Services	**126.5**	118.3
	427.8	444.9
Net deferred tax liabilities	**39.7**	385.4
Comprised of:		
Other temporary differences	**(61.1)**	14.7
Temporary differences arising on derivatives and interest	**(41.4)**	(27.8)
Other temporary differences arising on fair value and merger with Britannia Building Society	**(33.8)**	–
Retirement benefits obligations	**(79.6)**	72.0
Capital allowances on fixed assets	**13.0**	101.2
Capital allowances on assets leased to customers	**4.0**	4.4
Unrealised gains on investments, investment properties and rolled-over gains	**356.2**	231.2
Claims equalisation reserve	**5.9**	8.8
Tax losses	**(103.0)**	–
Acquisition costs deferred	**(20.5)**	(19.1)
	39.7	385.4

The main components of the deferred tax liability are capital allowances on property, plant and equipment of £17m (2008: £101.1m), unrealised appreciation of investments of £141.7m (2008: £98.8m), potential liability on rolled-over gains of £219m (2008: £146m) and retirement benefit obligations of £32.7m (2008: £112.9m).

These liabilities are offset by deferred tax assets arising in respect of acquisition costs of £20.5m (2008: £19.1m), timing differences arising on derivatives and interest of £41.4m (2008: £27.8m), net retirement benefit obligations of £112.3m (2008: £40.9m net liability) carried forward tax losses of £103m, largely arising on acquisition of Somerfield and Britannia (2008: £nil), £33.8m arising on fair value differences arising on the acquisition of Britannia and other timing differences £61.1m (2008: £13.1m net of derivatives) relating to taxation of special purpose vehicles under the securitisation regime of £11.4m, deferred tax relief on other accounts provisions including holiday and onerous lease provisions of £49.6m. The primary reason for the comparative increase in the other temporary differences relates to the acquisition and merger of Somerfield and Britannia respectively.

23 Inventories

	Group 2009 £m	2008 £m
Raw materials and consumables	**7.3**	9.3
Work in progress	**0.2**	0.1
Finished goods and goods for resale	**549.8**	417.3
	557.3	426.7

The period-end inventories provision is £33.5m (2008: £15.4m) of which the vast majority relates to Food Retail in both 2009 and 2008. £2.3m (2008: £4.3m) additional provision has been charged to the income statement in the period and £16.0m (2008: £nil) acquired as part of business acquisitions in the period.

24 Trade and other receivables – Trading and Corporate activities

	2009 £m	2008 £m
Trade receivables	**312.9**	320.4
Prepayments and accrued income	**121.4**	84.4
Other receivables	**92.9**	122.1
	527.2	526.9

Trade receivables and other receivables are classified as loans and receivables.

Trade receivables are stated net of an impairment provision of £8.8m (2008: £7.5m). £1.4m (2008: charge £1.9m) has been charged to the income statement in the period.The provision is calculated in line with individual businesses' impairment policies and any adjustment to the level of provision is recognised within the income statement in operating profit.

Trade receivables include amounts totalling £24.9m (2008: £115.6m), which are overdue but not considered to be impaired, age analysed as follows:

	2009 £m	2008 £m
Amounts overdue:		
Less than 3 months	**22.2**	113.0
3 to 6 months	**1.4**	1.3
More than 6 months	**1.3**	1.3
	24.9	115.6

Amounts overdue but not impaired typically comprise high volume/low value balances for which the individual trading businesses do not seek collateral but continue to work with counterparties to secure settlement. No other receivables are overdue.

25 Assets held for sale and discontinued operations

Discontinued operations

The Group completed the acquisition of the Somerfield group of companies on 27 February 2009. Certain Foodstores were required to be disposed of by the Group following local competition reviews by the Office of Fair Trading. Stores that had not been sold by 2 January 2010 have been classified as assets held for sale. All stores are available for immediate sale in their present condition and an active programme, fully committed by management has been initiated to locate a buyer and actively market the store at a price that reflects its current fair value. £2.4m of the total assets held for sale are in Department and Home Stores.

Assets and liabilities held for sale

	2009 £m	2008 £m
Property, plant and equipment	**11.6**	29.7
Inventory	**0.5**	–
Assets held for sale	**12.1**	29.7

26 Loans and advances to banks – Financial Services

	Group 2009 £m	2008 £m
Items in the course of collection from other banks	**149.0**	148.5
Placements with other banks	**313.5**	1,441.2
Included in cash equivalents	**462.5**	1,589.7
Other loans and advances to banks	**1,319.0**	297.0
	1,781.5	1,886.7

27 Loans and advances to customers – Financial Services

	Group 2009 £m	2008 £m
Total Shareholder	**34,128.5**	10,234.7
Long-term Business	**7.8**	9.7
Loans and advances to customers including fair value adjustments for hedged risk	**34,136.3**	10,244.4
Fair value adjustment for hedged risk	**(66.1)**	–
Loans and advances to customers	**34,070.2**	10,244.4

Total Shareholder	2009 £m	2008 £m
Gross loans and advances	**34,322.5**	10,422.6
Less allowance for losses on loans and advances	**(194.0)**	(187.9)
	34,128.5	10,234.7

Fair-value adjustments for hedged risk

The Group 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. The changes in fair value of fixed-rate mortgages are disclosed on the balance sheet as fair-value adjustments for hedged risk immediately below the loans and advances to customers. Fair-value adjustments to loans and advance to customers attributable to portfolio-hedged risk in the Group are £66.1m (2008: £nil).

Securitisation

Loans and advances to customers include £9,492.7m securitised under the Co-operative Bank's securitisation and covered bonds programmes. The Co-operative Bank remains exposed to substantially all of the risks and rewards of ownership of these assets. Included within Group deposits by banks (Note 26) are £466.7m of loans from external third parties and within Group debt securities in issue (Note 28) are £2,683.7m of floating rate notes, all secured on these mortgage assets. In February 2010, the Group issued a new £2.5bn securitisation.

Concentration of exposure

The Group's exposure is virtually all within the United Kingdom. The following industry concentrations of gross advances before provisions, effective interest rate adjustments and suspended interest are considered significant.

Gross loans and advances	2009 £m	2008 £m
Property and construction	**4,498.1**	1,687.8
Retail, distribution and services	**446.9**	949.4
Business and other services	**3,675.2**	1,967.0
Personal	**25,702.3**	5,818.4
	34,322.5	10,422.6

27 Loans and advances to customers – Financial Services continued

Long-term business	2009 £m	2008 £m
Analysis of long-term business loans and advances to customers		
Secured by mortgages	**3.5**	4.0
Secured by insurance policies	**4.0**	5.4
Other loans	**0.3**	0.3
	7.8	9.7

Allowance for losses on loans and advances

	2009				2008			
	Individual Mortgage £m	**Individual Corporate £m**	**Collective £m**	**Total £m**	Individual Mortgage £m	Individual Corporate £m	Collective £m	Total £m
At beginning of period	**1.5**	**45.6**	**140.8**	**187.9**	0.3	35.3	125.1	160.7
Charge against profits	**1.5**	**33.4**	**81.2**	**116.1**	1.5	11.2	84.1	96.8
Amounts written off	**(0.7)**	**(26.5)**	**(79.2)**	**(106.4)**	(0.3)	(1.6)	(65.5)	(67.4)
Recoveries	**–**	**(0.1)**	**–**	**(0.1)**	–	0.2	–	0.2
Unwind of discount of allowance	**–**	**(1.4)**	**(2.4)**	**(3.8)**	–	(0.9)	(2.9)	(3.8)
Interest charged on impaired loans	**–**	**0.3**	**–**	**0.3**	–	1.4	–	1.4
At end of period	**2.3**	**51.3**	**140.4**	**194.0**	1.5	45.6	140.8	187.9

Loans and advances to customers include £48.2m (2008: £35.8m) of financial assets at fair value through profit or loss designated at initial recognition to eliminate or significantly reduce a measurement or recognition inconsistency.

Loans and advances to customers include finance lease receivables.

	2009 £m	2008 £m
Gross investment in finance leases, receivable:		
No later than one year	**32.8**	36.8
Later than one year and no later than five years	**75.9**	96.0
Later than five years	**73.3**	69.1
	182.0	201.9
Unearned future finance income on finance leases	**(40.6)**	(40.5)
Net investment in finance leases	**141.4**	161.4
The net investment in finance leases may be analysed as follows:		
No later than one year	**25.4**	27.9
Later than one year and no later than five years	**54.5**	74.8
Later than five years	**61.5**	58.7
	141.4	161.4

There are no unguaranteed residual values for any of the finance leases. The Co-operative 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 £1.7m (2008: £5.9m).

28 Investments – Financial Services

	Group 2009 £m	Group 2008 £m
Investments comprise:		
Fair value through profit or loss:		
Listed equities	**5,047.3**	4,528.9
Unlisted equities	**820.8**	298.0
Listed debt securities	**6,779.7**	6,780.7
Unlisted debt securities	**1,997.9**	2,274.2
	14,645.7	13,881.8
Available-for-sale:		
Unlisted equities	**9.0**	13.0
Listed debt securities	**2,470.9**	1,408.2
Unlisted debt securities	**2,991.8**	1,362.1
	5,471.7	2,783.3
Total fair value through profit or loss and available-for-sale investments	**20,117.4**	16,665.1
Loans at amortised cost	**2,486.2**	124.0
Deposits with credit institutions	**1,288.1**	2,922.4
Investment properties	**1,578.1**	1,483.8
	25,469.8	21,195.3

The above investments are held by Co-operative Insurance Society Ltd, CIS General Insurance Limited, CFS Management Services Limited, CFS Services Limited and The Co-operative Bank plc.

Investment properties have been valued as at 2 January 2010. DTZ, an external independent valuation firm, value the portfolio annually.

At the balance sheet date, CIS and CISGIL had securities with a market value of £271.7m (2008: £249.3m) on loan under approved stock lending arrangements. Eligible collateral totalling £278.8m (2008: £264.2m) was held as security.

Government guaranteed securities with a market value of £1,057.1m (2008: £1,512.4m), which were the subject of repurchase contracts, are included in debt securities in the analysis above. Collateral is received in the form of cash and deposits with credit institutions include certificates of deposit with a market value of £1,069.6m (2008: £1,828.0m) purchased with the collateral. A liability of £1,071.2m (2008: £1,814.4m) is included within financial liabilities in respect of the associated repurchase liability.

Pursuant to the amendments to IAS39 and IFRS7, during 2008 the Co-operative Bank reclassified specific available-for-sale investment securities to loans and receivables at amortised cost. The Bank identified particular assets that would have met the definition of loans and receivables (if they had not been designated as available for sale) for which at 27 July 2008 it considered it had the intention and ability to hold them for the foreseeable future or until maturity, due to the market in such an instrument being considered to be inactive.

As per the amendment to IAS39, the reclassifications were made with effect from 27 July 2008 at fair value at that date. The table below sets out the carrying value and fair values for the Group at the balance sheet date.

	2009 Amounts reclassified in 2008	2009 Carrying value	2009 Fair value	2008 Carrying value	2008 Fair value
Available-for-sale financial assets transferred to loans and receivables	**131.9**	**134.8**	**138.0**	123.4	112.3

At the date of transfer fair value equated to carrying value. As at 2 January 2010 and 10 January 2009, fair value is based on quoted market prices being the only indicator of fair value that is available.

29 Insurance contracts liabilities and reinsurance assets – Financial Services
a) Analysis of insurance and participating contract liabilities

	2009 £m	2008 £m
Gross		
Long-term insurance contracts:		
– Insurance contracts	**2,426.6**	2,388.9
– Insurance participation contracts	**12,494.7**	12,931.8
– Investment participation contracts	**573.3**	494.0
	15,494.6	15,814.7
General insurance contracts:		
– Claims reported (including claims settlement)	**457.1**	434.7
– Claims incurred but not reported	**165.1**	229.3
– Claims settlement expenses	**17.3**	18.9
– Unearned premiums	**220.9**	193.5
– Provision for unexpired risks	**9.1**	6.7
Total gross insurance liabilities	**16,364.1**	16,697.8
Recoverable from reinsurers		
Long-term insurance contracts:		
– Insurance contracts	**(1,822.9)**	(1,779.4)
– Insurance participation contracts	**(1,148.6)**	(1,301.4)
	(2,971.5)	(3,080.8)
Recoverable from reinsurers:		
– Claims reported	**(20.5)**	(22.6)
– Claims incurred but not reported	**(21.8)**	(14.5)
– Unearned premiums	**(5.2)**	(3.5)
	(47.5)	(40.6)
Total reinsurers' share of insurance liabilities	**(3,019.0)**	(3,121.4)
Net		
Long-term insurance contracts:		
– Insurance contracts	**603.7**	609.5
– Insurance participation contracts	**11,346.1**	11,630.4
– Investment participation contracts	**573.3**	494.0
	12,523.1	12,733.9
General insurance contracts:		
– Claims reported (including claims settlement)	**436.6**	412.1
– Claims incurred but not reported	**143.3**	214.8
– Claims settlement expenses	**17.3**	18.9
– Unearned premiums	**215.7**	190.0
– Provision for unexpired risks	**9.1**	6.7
	822.0	842.5
Total net insurance liabilities	**13,345.1**	13,576.4

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

b) General insurance contracts – assumptions, changes in assumptions and sensitivity

i) Basis of assessing liabilities

CISGIL has been established to write new and renewing General Insurance business formerly written by CIS, a fellow subsidiary within the CFS group. CISGIL has access to historical data and trends relating to the General Insurance business of CIS for which it has now assumed responsibility.

CISGIL uses a combination of recognised actuarial and statistical techniques to assess the ultimate cost of claims. These include:
- Projecting historic claims payment and recoveries data;
- Adjusting case estimates for future inflation and onto a provisioning basis;
- Deriving average costs per claim to apply to claim numbers;
- Projecting historic claims incurred data (payment plus estimates) – Chain Ladder techniques; and
- Bornhuetter Ferguson/Cape Cod techniques.

Extensive use of detailed claims data including individual case estimates is made to derive patterns in average claim costs and timings between occurrence and estimate/payment of claims and settlement. The most common method used is the Chain Ladder method. This technique involves the analysis of historical claims development trends and the selection of estimated development factors based on this historical pattern. The selected development factors are then applied to cumulative claims data for each accident year that is not yet fully developed to produce an estimated ultimate claims cost for each accident year. A degree of judgement is required in selecting the most appropriate development factors.

The chain ladder method can be quite volatile for relatively undeveloped origin periods so a Bornhuetter-Ferguson/Cape Cod method is often used in such cases. This method uses some prior expectation of the ultimate claims, and stabilises the projected ultimate by weighting between the prior expected ultimate and the projected based on the assumed development factors. The Cape Cod method differs from the Bornhuetter-Ferguson method in that it uses a trending of ratios (such as the Average Cost) to arrive at a prior expected ultimate for use in the projections.

The EIROS reserve was based on a report produced for the industry by EMB (an actuarial consultancy) at the end of 2008, which gave EMB's estimate of both the undiscounted and discounted IBNR reserves as at end Q3 2008. This was the most recent report available when we calculated our end 2009 reserves.

The average period to settlement of claims is:
- 12.1 years for Employers' liability
- 15.5 years for Public and Product's liability
- 12.5 years in total.

In all cases, the discount rate is 4.5%.

The criteria adopted for estimating the period that will elapse before the claims are settled used the run-off pattern from previous experience.

As outlined in Note 54, there is significant uncertainty in the assessment of liabilities and provisions are set to be adequate to cover the eventual cost. Sensitivity analysis is performed to assist the selection of key parameters and, hence, the provisions adopted. There is a governance process in place to ensure that provisions are subject to detailed review regarding the appropriateness of key assumptions and the quantum of the provisions established.

ii) Key assumptions

Principal assumptions underlying the claims provisions include:
- Explicit allowance for future inflation at rates varying from 0–8.25% pa according to the claim type. The range of future inflation rates is largely unchanged from that used at the previous period-end; and
- For bodily injury claims, allowance has been made for:
  i) Use of the Ogden Tables at a discount rate of 2.25%;
  ii) Increased awards for general damages in accordance with the 8th edition of the JSB guidelines;
  iii) A small proportion of large claims being settled by periodic payments; and
  iv) The speeding up of recognition of the size of claims.

The gross insurance provision for claims and loss adjustment expenses arising in respect of previous years of £418.3m (2008: £445.0m) includes a movement of £30.6m (2008: £58.3m) arising from changes in assumptions and release of surplus. Details are as follows:
- Reduction in volume of motor claims, £3.4m
- Reduction in severity of motor claims, £16.2m
- The extent of the expected speeding up of payment pattern for fire and accident did not materialise, £8.1m
- Movement on large claim for fire and accident claims, £2m
- Discounting of long-term liabilities, £2.5m
- Movement on claims handling expenses, £1.6m.

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

iii) Sensitivity analysis

There is greater uncertainty over motor claims provisions than other provisions as they typically involve claims for bodily injury and associated legal costs and therefore typically have a longer period to settlement. Motor provisions represent the most significant proportion of the total General Insurance outstanding claims liabilities (gross of salvage and subrogation). Sensitivity information is given for motor claims provisions together with limited information for all other classes. The following table indicates the effect on gross claims provisions (gross of reinsurance and salvage and subrogation) and the net provisions (net of reinsurance but gross of salvage and subrogation) of changes in key assumptions. Impacts to net technical provisions have an equivalent impact to profitability. Amendments to reserving methodology have meant that sensitivity analyses of average cost per claim for third-party property damage and the effect of changing the Ogden rate for liability business are no longer available.

Assumption

	Change in parameter	Effect on gross provision £m	% Effect	Effect on net provision £m	% Effect
Motor					
Average cost of claims for last three years – bodily injury	10%	20.3	4.90%	20.3	5.30%
Average cost of claims for last three years – legal	10%	14.9	3.60%	14.9	3.80%
Mean term to settlement – bodily injury and legal	1/2 year	11.8	2.90%	11.8	3.10%
Rate of future inflation – bodily injury and legal	1%	8.2	2.00%	7.8	2.00%
Ogden discount rate – bodily injury	(1/4%)	3.4	0.70%	1.4	0.30%
Other classes					
Mean term to settlement (liability)	1/2 year	0.7	2.50%	0.7	2.50%
Mean term to settlement (non-liability)	1/2 year	0.7	1.20%	0.6	1.40%
Rate of future inflation (liability)	1%	1.9	6.90%	2	7.00%
Rate of future inflation (non-liability)	1%	0.7	1.30%	0.6	1.30%

c) Changes in General Insurance liabilities and reinsurance assets

i) Change in insurance contract liabilities (net of salvage and subrogation)

	Gross	Unexpired risk provision	Salvage & subrogation	Net
At the beginning of the financial period	682.9	6.7	(52.6)	637.0
Movement in the period	(43.4)	2.4	11.2	(29.8)
At the end of the financial period	**639.5**	**9.1**	**(41.4)**	**607.2**

ii) General Insurance – claims and loss adjustment expenses

	2009 Gross £m	Reinsurance £m	Net £m	2008 Gross £m	Reinsurance £m	Net £m
Notified outstanding claims	**434.7**	**(22.6)**	**412.1**	718.9	(27.4)	691.5
Claims incurred but not reported	**229.3**	**(14.5)**	**214.8**	33.7	(3.1)	30.6
Claims settlement expenses	**18.9**	**–**	**18.9**	22.3	–	22.3
At the beginning of the financial period	**682.9**	**(37.1)**	**645.8**	774.9	(30.5)	744.4
Claims paid during the period	**(359.0)**	**7.4**	**(351.6)**	(403.7)	4.5	(399.2)
Increase in liabilities:						
– arising from current and previous period claims	**315.6**	**(12.6)**	**303.0**	311.7	(11.1)	300.6
Total movement	**(43.4)**	**(5.2)**	**(48.6)**	(92.0)	(6.6)	(98.6)
Notified claims	**457.2**	**(20.5)**	**436.7**	434.7	(22.6)	412.1
Incurred but not reported	**165.0**	**(21.8)**	**143.2**	229.3	(14.5)	214.8
Claims settlement expenses	**17.3**	**–**	**17.3**	18.9	–	18.9
At the end of the financial period	**639.5**	**(42.3)**	**597.2**	682.9	(37.1)	645.8

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

iii) General Insurance – provisions for unearned premiums

	2009 Gross £m	2009 Reinsurance £m	2009 Net £m	2008 Gross £m	2008 Reinsurance £m	2008 Net £m
Unearned premium provision						
At the beginning of the financial period	**193.5**	**(3.5)**	**190.0**	200.4	(2.8)	197.6
Increase in the financial period	**424.3**	**(23.2)**	**401.1**	394.4	(19.2)	375.2
Release in the financial period	**(396.9)**	**21.5**	**(375.4)**	(401.3)	18.5	(382.8)
Movement in the financial period	**27.4**	**(1.7)**	**25.7**	(6.9)	(0.7)	(7.6)
At the end of the financial period	**220.9**	**(5.2)**	**215.7**	193.5	(3.5)	190.0

iv) General Insurance – provisions for unexpired risk

	2009 Gross £m	2009 Reinsurance £m	2009 Net £m	2008 Gross £m	2008 Reinsurance £m	2008 Net £m
Unexpired risk provision						
At the beginning of the financial period	**6.7**	**–**	**6.7**	5.7	–	5.7
Increase in the financial period	**9.1**	**–**	**9.1**	6.7	–	6.7
Release in the financial period	**(6.7)**	**–**	**(6.7)**	(5.7)	–	(5.7)
Movement in the financial period	**2.4**	**–**	**2.4**	1.0	–	1.0
At the end of the financial year	**9.1**	**–**	**9.1**	6.7	–	6.7

Additional provision is made for unexpired risks where the claims and expense likely to arise after the end of the financial period, in respect of contracts concluded before that date, are expected to exceed the unearned premiums at the end of the financial period. The provision primarily relates to the motor class of business.

v) Analysis of claims development – gross of reinsurance
Estimate for cumulative claims

	Accident year 2001 £m	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	Total £m
At end of accident year	507.1	591.8	572.0	550.5	480.1	419.3	384.5	347.3	325.9	4,178.5
– One year later	484.4	559.7	542.8	527.1	468.3	412.1	387.8	319.7	–	3,701.9
– Two years later	475.8	560.3	526.5	495.3	439.9	402.6	378.2	–	–	3,278.6
– Three years later	486.2	550.6	507.6	467.2	414.0	393.5	–	–	–	2,819.1
– Four years later	488.8	547.4	499.5	450.3	422.9	–	–	–	–	2,408.9
– Five years later	488.3	548.1	498.9	453.9	–	–	–	–	–	1,989.2
– Six years later	484.9	540.3	494.0	–	–	–	–	–	–	1,519.2
– Seven years later	481.5	546.5	–	–	–	–	–	–	–	1,028.0
–Eight years later	482.9	–	–	–	–	–	–	–	–	482.9
Estimate of cumulative claims	482.9	546.5	494.0	453.9	422.9	393.5	378.2	319.7	325.9	3,817.5
Cumulative payments to date	(463.8)	(521.3)	(469.3)	(429.3)	(360.5)	(323.4)	(297.6)	(226.4)	(134.4)	(3,226.0)
Provision before discounting	19.1	25.2	24.7	24.6	62.4	70.1	80.6	93.3	191.5	591.5
Provision for prior years before discounting										33.1
Discounting										(2.5)
Gross outstanding claims liabilities										**622.1**

	£m
Gross claims reported	457.1
Gross claims incurred but not reported	165.0
Gross outstanding claims liabilities	**622.1**

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

Analysis of claims development – net of reinsurance

Estimate for cumulative claims

					Accident year					
	2001 £m	**2002 £m**	**2003 £m**	**2004 £m**	**2005 £m**	**2006 £m**	**2007 £m**	**2008 £m**	**2009 £m**	**Total £m**
At end of accident year	504.0	585.6	569.6	547.2	477.6	461.6	372.6	334.6	313.1	4,165.9
– One year later	480.6	553.0	540.7	525.1	465.8	408.9	377.8	305.5	–	3,657.4
– Two years later	471.6	553.8	524.5	493.3	437.4	400.8	369.8	–	–	3,251.2
– Three years later	480.9	541.0	505.6	465.2	411.0	392.5	–	–	–	2,796.2
– Four years later	480.1	537.8	497.5	448.0	420.1	–	–	–	–	2,383.5
– Five years later	479.6	538.5	495.4	451.6	–	–	–	–	–	1,965.1
– Six years later	476.2	531.1	491.7	–	–	–	–	–	–	1,499.0
– Seven years later	471.5	533.6	–	–	–	–	–	–	–	1,005.1
– Eight years later	474.9	–	–	–	–	–	–	–	–	474.9
Estimate of cumulative claims	474.9	533.6	491.7	451.6	420.1	392.5	369.8	305.5	313.1	3,752.8
Cumulative payments to date	(461.1)	(515.2)	(467.9)	(427.1)	(359.4)	(323.3)	(292.8)	(221.2)	(131.5)	(3,199.5)
Provision before discounting	13.8	18.4	23.8	24.5	60.7	69.2	77.0	84.3	181.6	553.3
Provision for prior years before discounting										29.1
Discounting										(2.5)
Net outstanding claims liabilities										**579.9**

	£m
Net claims reported	436.7
Net claims incurred but not reported	143.2
Net outstanding claims liabilities	**579.9**

d) Capital position statement 2009

	Long-Term Business (excl. stakeholder) £m	**With-profits stakeholder fund £m**	**Shareholder funds £m**	**Total Long-Term Business £m**
Available capital resources				
Shareholders' funds held outside fund	**–**	**–**	**200.0**	**200.0**
Shareholders' funds held in fund	**–**	**–**	**–**	**–**
Total shareholders' funds	**–**	**–**	**200.0**	**200.0**
Adjustments onto regulatory basis:				
– UDS	**1,029.7**	**–**	**–**	**1,029.7**
– Adjustments to assets	**(22.1)**	**–**	**–**	**(22.1)**
Total available capital resources	**1,007.6**	**–**	**200.0**	**1,207.6**
With-profits liabilities on realistic basis:				
– Options and guarantees	**1,101.6**	**–**	**–**	**1,101.6**
– Other policyholder obligations	**10,877.7**	**198.2**	**–**	**11,075.9**
Total participating contract liabilities	**11,979.3**	**198.2**	**–**	**12,177.5**
– Non-participating life assurance	**603.7**	**–**	**–**	**603.7**
Insurance and participating contract liabilities per capital position statement	**12,583.0**	**198.2**	**–**	**12,781.2**

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

Capital position statement 2008

	Long-Term Business (excl. stakeholder) £m	With-profits stakeholder fund £m	Shareholder funds £m	Total Long-Term Business £m
Available capital resources				
Shareholders' funds held outside fund	–	–	200.0	200.0
Shareholders' funds held in fund	–	–	–	–
Total shareholders' funds	–	–	200.0	200.0
Adjustments onto regulatory basis:				
– UDS	598.8	–	–	598.8
– Adjustments to assets	(25.4)	–	–	(25.4)
Total available capital resources	573.4	–	200.0	773.4
With-profits liabilities on realistic basis:				
– Options and guarantees	1,819.0	–	–	1,819.0
– Other policyholder obligations	10,255.0	159.6	–	10,414.6
Total participating contract liabilities	12,074.0	159.6	–	12,233.6
– Non-participating life assurance	609.5	–	–	609.5
Insurance and participating contract liabilities per capital position statement	12,683.5	159.6	–	12,843.1

Reconciliation to insurance and participating contracts liability

	2009 £m	2008 £m
Insurance and participating contract liabilities as per capital position statement	**12,781.2**	12,843.1
Add back reinsurance	**2,971.5**	3,080.8
Outstanding claims reserves	**106.8**	115.5
General insurance gross contract liabilities	**209.6**	883.1
Less funeral bonds held by Trading Group	**(364.9)**	(224.7)
Insurance and participating contract liabilities	**15,704.2**	16,697.8

e) Long-term life insurance contracts – assumptions, changes in assumptions and sensitivity

i) Capital management policies and objectives

The liabilities of the long-term business fund shown in the capital position statement are calculated following FSA rules and guidance. CIS has a general reserve of £317m which is available to support both long-term business and general insurance business in run-off. The general reserve is shareholder capital and is held outside the long-term business fund. However, as at 2 January 2010, £200m of the general reserve was allocated to the long-term business fund.

The whole of the profits of the long-term business are applied for the sole benefit of the long-term business policyholders. This includes the making of reserves with the aim of preserving the strength of the fund for the benefit of current and future life assurance and pensions policyholders. Similarly, any losses incurred within the fund are borne by the policyholders, either through a reduction in the working capital of the fund or through a reduction in their benefits.

The working capital of the fund is the excess of assets within the fund over the amount needed to meet liabilities, including those arising from the regulatory requirement to treat customers fairly when setting discretionary benefits. The working capital is managed to ensure that the long-term business fund can meet its solvency requirements under a range of adverse conditions and to meet business plans.

Risks that may affect the long-term business fund are managed according to documented risk management policies, which require risks and capital to be monitored and reported regularly, and decisions made according to delegated authorities; details are provided in Note 54 Risk Management. Actions to control risk and manage the working capital of the fund include the use of reinsurance, the matching of assets and liabilities (including using derivatives) and the setting of discretionary benefits at appropriate levels, as described in the Principles and Practices of Financial Management (PPFM).

In exceptional circumstances, assets held outside the fund (share capital and general reserve), if available, may be used to help meet the long-term business fund's solvency requirements. In some circumstances, this may require a transfer of assets into the fund. In such cases the fund would be managed with the aim of repaying these assets (accumulated with interest at an appropriate level) over time from within the fund.

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

ii) Policy options and guarantees

Personal and free-standing pension scheme pure endowment contracts issued prior to March 1999 contain options guaranteeing a minimum annuity rate at vesting. The value of the options is calculated using a market-consistent stochastic approach. For a representative set of policies, the asset shares are projected to the date of vesting. If, based on projected market interest rates at the date of vesting, the annuity that would then be payable is less than the guaranteed annuity, additional provision is made with the additional costs being calculated on a market-consistent basis. Assumptions used in the calculation relating to expenses, mortality experience and the proportion of policies that reach vesting are best estimates based on experience investigations carried out during 2008. At 2 January 2010, provisions amounting to £512m (2008: £750.5m) have been made to cover the future cost of meeting guarantees of this type.

For accumulating with-profits business, provision has been made for the guarantee that no market value reduction will apply on death or on surrender of premiums paid prior to 1 April 2000 and 10 or more years prior to the date of surrender. The value of the guarantee is calculated using a market-consistent stochastic approach, and assuming that annual bonuses are at expected future levels. Provision has been made for the current value of the excess of the guaranteed payout on surrender over the projected asset share. Expense and mortality assumptions used in the calculation are best estimates based on experience investigations carried out during 2008. At 2 January 2010, provisions amounting to £65m (2008: £137.4m) have been made to cover the future cost of meeting guarantees of this type.

The cost of meeting maturity guarantees on life and pensions savings products is calculated stochastically using market-consistent interest rates. It is assumed that annual bonuses continue to be declared at the levels applicable following the bonus declaration arising out of the current valuation. Provision has been made for the present value of the excess of the guaranteed payout at maturity over the projected asset share. Expense and mortality assumptions used in the calculation are best estimates based on experience investigations carried out during 2008. At 2 January 2010, provisions amounting to £560m (2008: £964.6m) have been made to cover the future cost of meeting guarantees of this type.

iii) Basis of assessing liabilities

The long-term business provision is calculated twice a year having regard for the principles laid down in Chapters 1.2 and 1.3 of the Prudential Sourcebook for Insurers (INSPRU). In December 2006, FSA issued a policy statement (PS06/14) allowing insurers to move the capital and reserving requirements of non-profit business to a more realistic basis. CIS adopted the changes under this policy statement at 12 January 2008, and continues to do so at 2 January 2010.

iv) Participating business methodology

Provisions for participating business are calculated as the value of the with-profits benefits reserve plus the cost of options, guarantees and smoothing. Retrospective methods are used to calculate with-profits benefits reserves for all products apart from whole-of-life policies for which a prospective method is used.

Retrospective methods of calculation involve the accumulation of monthly cash flows in respect of premiums plus investment income (including unrealised gains/losses and allowances for allocations in respect of past miscellaneous surplus) less policy charges, expenses and tax.

Prospective methods are used to calculate with-profits benefits reserves for all Ordinary and Industrial Branch whole-of-life policies.

Prospective methods of calculation involve determining the present value of the future cash flows in respect of premiums plus investment return, less policy charges and expenses, benefits payable (including guaranteed benefits, bonuses declared and an element of potential future bonuses) and tax.

The cost of guarantees, options and smoothing is calculated using a market-consistent stochastic model. Policies are grouped by similar nature, term and size for each product. Stochastic projections are performed using grouped model points representing individual contracts. The market-consistent asset model has been used to calculate the costs of guarantees, options and smoothing.

The model is calibrated according to the rules within INSPRU and tests are performed to ensure that the model reproduces current market prices of traded instruments and is arbitrage-free.

v) Non-participating business methodology

Reserves for conventional non-participating business are valued prospectively, using a gross premium approach, by subtracting the actuarial value of the estimated future premium income from the value of the future benefit outgo. Prudent assumptions are used in these calculations but some allowance is made for expected future lapses.

The value of future profits that are expected to arise on non-participating contracts (being the present value of future cash flows under these contracts) is calculated using realistic assumptions and is deducted from the reserves to determine the realistic provision for conventional participating contract liabilities.

Provisions for unit-linked policies are determined by reference to the value of the units allocated to policies at the accounting date.

Although the gross insurance liabilities and the related reinsurance are fairly stated on the basis of the information currently available, the eventual liability may vary as a result of subsequent information and events.

The provisions, estimation techniques and assumptions are periodically reviewed with any changes in estimates reflected in the income statement as they occur.

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

vi) Assumptions used in valuing the realistic liabilities

In general, assumptions used in the valuation of realistic liabilities are based on the results of the most recent experience investigations and are considered to be best estimates of future experience. Where data is not significant enough to make firm conclusions, industry data is also considered.

vii) Interest rates used in valuing the realistic liabilities

A risk-free future interest rate of 4.45% (2008: 3.84%) is assumed when calculating prospective asset shares and the value of in-force business on non-participating contracts in compliance with the requirements of INSPRU.

Liabilities for non-participating contracts require a prudent assumption to be made regarding future interest rates and are determined by reference to recent investment returns on assets backing the contracts and consideration of the long-term view of these returns.

In calculating the value of in-force business on non-participating contracts, future profits are discounted using an interest rate that is 1% above the risk-free rate of return.

In determining the value of options and guarantees, the interest rate is stochastic with an average of the risk-free curve across all scenarios. The risk-free curve varies by duration.

viii) Future bonuses

Prospective asset share calculations and the valuation of options and guarantees use annual bonus rates proposed for the next calendar year, and assume they will continue at these levels.

ix) Expenses and expense inflation

Expense assumptions for prospective asset shares and value for the in-force business on non-participating contracts are determined based on the latest experience and are adjusted, where appropriate, to reflect any expected changes in patterns in the future.

Reserves for non-participating contracts require a prudent explicit allowance to be made for the future expenses of maintaining contracts in force.

The level of future expense inflation is determined with reference to historical trends and expectations of how future per policy expenses will change. The assumption used in determining the provisions is calendar year specific up to 2017 reverting to a long-term assumption of 5.1% pa (2008: 4.2% pa).

x) Mortality, morbidity and persistency

Wherever appropriate, mortality and persistency assumptions used are based on the results of the most recent experience investigations. Mortality assumptions are based on percentages of standard tables published by the Continuous Mortality Investigations Bureau (CMIB) and vary by product. Persistency assumptions (including early retirement rates on pension policies) vary by product and the number of years that a policy has been in force. Where data is not of a significant enough size to make firm conclusions, industry data is also considered. Critical illness assumptions are also based on percentages of standard tables published by CMIB.

In valuing guaranteed annuity options on personal pension policies, on retirement at the normal retirement age and after allowing for any tax-free cash sums, all guaranteed annuity options that are ‘in-the-money’ are assumed to be taken.

Mortality, morbidity and persistency assumptions have been updated to reflect the results of the 2009 experience investigations, but these changes have not had a major impact on the insurance contract liabilities.

Persistency assumptions have been updated to reflect the results of the 2009 investigations but these changes have not had a major impact on the insurance contract liabilities.

xi) Tax

It is assumed that the current tax legislation and associated tax rates remain unchanged. The tax rate assumption used for netting interest rates and expenses is 20% (2008: 20%).

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued

xii) Sensitivity analysis

The capital position of the long-term business fund is sensitive to a number of economic and insurance variances since the fund contains a number of different policyholder options and guarantees as described in section (ii) above. Some of the main sensitivities of the fund can be examined by applying the stress tests prescribed by the FSA in calculating the Risk Capital Margin (RCM). The tests carried out in calculating the RCM and the sensitivity of the working capital to each test are as follows:

Stress test

	Reduction in working capital £m
20% fall in equity values and 12.5% fall in property values	**88**
17.5% change in long-term gilt yields	**74**
32.5% improvement in persistency rates	**62**
Increase of 99 basis points in bond yields for credit risk test	**96**
Total RCM before management actions	**320**
Other stress tests:	
5% fall in assurance mortality rates	0
5% fall in annuitant longevity rates	33
10% increase in renewal expenses	48
1% increase in renewal expense inflation	91

In calculating the RCM, it has been assumed that no management action would be taken under the stressed conditions.

With these management actions, the RCM has been calculated to be £320m. (2008: £147m). The excess working capital of the fund after the RCM is therefore £688m (2008: £426m) or £888m (2008: £626m) if the additional capital available outside the long-term business fund is included. The RCM is covered 3.2 times (2008: 3.9 times) by working capital (excluding the £200m allocated from the general reserve).

f) Change in long-term insurance liabilities and reinsurance assets

		2009		
	Non-participating insurance contracts £m	**Participating insurance contracts £m**	**Reinsurance £m**	**Net £m**
At the beginning of the financial period	2,389.1	13,534.8	(3,080.8)	12,843.1
New liabilities	(7.2)	167.3	–	160.1
Changes in liabilities during the period	84.7	(978.1)	–	(893.4)
Effect of changes in non-economic assumptions	(26.1)	(78.8)	–	(104.9)
Effect of changes in asset shares	–	1,213.3	–	1,213.3
Effect of changes in economic conditions	(118.2)	(628.5)	–	(746.7)
Other	104.3	81.1	124.3	309.7
Insurance contract liabilities	**2,426.6**	**13,311.1**	**(2,956.5)**	**12,781.2**
Outstanding claims	–	121.8	(15.0)	106.8
At the end of the financial year	**2,426.6**	**13,432.9**	**(2,971.5)**	**12,888.0**

29 Insurance contracts liabilities and reinsurance assets – Financial Services continued
Movement in working capital of the long-term business fund

	2009 £m	2008 £m
At the beginning of the financial period	**573.4**	1,009.3
Opening adjustments	**(17.1)**	(23.2)
Changes to insurance assumptions	**71.4**	17.0
Economic variances	**335.1**	(504.6)
Insurance variances	**20.2**	11.1
Other factors	**24.6**	63.8
At the end of the financial period	**1,007.6**	573.4

Opening adjustments
Opening adjustments consist of:
- improvements to the actuarial models used to calculate the working capital;
- improvements in accounting reconciliations (2008 only).

Changes to insurance assumptions
Changes to insurance assumptions include:
- changes to expense, mortality and persistency assumptions to reflect the latest experience investigations.

Economic variances
Economic variances arise from the following:
- investment returns more than (2008: less than) the assumed risk-free rate helping to reduce (2008: increase) the cost of meeting policy guarantees;
- an increase (2008: decrease) in risk-free rates which has decreased (2008: increased) the cost of policy guarantees; and
- assumed equity and interest rate volatility which has decreased (2008: increased) the cost of policy guarantees.

Insurance variances
Insurance variances include:
- variances between actual and assumed experience during the financial year;
- changes to pension and endowment mis-selling compensation costs;
- new business profits or losses; and
- one-off expenses.

Other factors
Other factors include:
- the effect of asset sales to maintain the Equity Backing Ratio within the range specified in the Principles and Practices of Financial Management (PPFM); and
- a reduction in annual bonus rates for accumulating with-profits business.

30 Prepayments and other receivables – Financial Services

	2009 £m	2008 £m
Receivables arising from insurance:		
– arising from insurance operations	**119.1**	127.0
– salvage and subrogation recoveries	**41.4**	52.6
– reinsurance operations	**1.9**	1.4
Other receivables:		
– accrued interest and rent	**193.2**	218.1
– prepayments and accrued income	**147.4**	85.0
– outstanding income	**6.1**	7.8
– amounts receivable for investments sold	**18.8**	95.8
– other receivables	**10.6**	25.9
Trade receivables	**1.7**	2.8
Other assets	**20.4**	28.4
	560.6	644.8

31 Assets classified as held for sale – Financial Services

	2009 £m	2008 £m
Property, plant and equipment	–	43.1
Investment property	–	6.9
	–	50.0

32 Share capital

	Nominal and paid-up value Members' share capital 2009 £m	2008 £m
Representing:		
Corporate shares of £5 each	8.5	8.9
Individual shares of £1 and 10p each	63.4	59.0
	71.9	67.9

IFRIC 2 determines the features that allow shares to be classified as equity capital.

Members' share capital

Members' share capital comprises corporate and individual shares. The rights attached to shares are set out in the Society's rules. Shares held by corporate members (corporate shares) are not withdrawable and are transferable only between corporate members with the consent of the Society's Board. Shares held by individual members (individual shares) are withdrawable on such period of notice as the Society's Board may from time to time specify.

As the Board has an unconditional right to refuse redemption of both classes of shares, both corporate and individual shares are treated as equity shares.

Both classes of share maintain a fixed nominal value, attract a limited rate of interest and do not carry voting rights per se. Voting for corporate members is in proportion to trade with the Society. Each individual member has one vote in the appropriate region of the Society and each region has voting rights calculated on the same basis as a corporate member.

Corporate members receive a payment on trade transacted with the Society.

Distribution of reserves in the event of a winding-up

The Society's rules state that any surplus in the event of a winding-up shall be transferred to one or more societies registered under the Industrial and Provident Societies Acts 1965 to 2002. Such societies must be in membership of Co-operatives^{UK} Limited and have the same or similar rule provisions as regards surplus distribution on a dissolution or winding-up as the Society. If not so transferred, the surplus shall be paid or transferred to Co-operatives^{UK} Limited to be used and applied in accordance with co-operative principles.

33 Reserves

The nature and purpose of each reserve is described below. Refer to the Statement of Changes in Equity on pages 48 to 49 for a full reconciliation of changes in each reserve.

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the Tasly Sants Pharmaceutical Distributors Ltd investment (see Note 19).

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

Revaluation reserve – property, plant and equipment

The fair value comprises the cumulative net change in the fair value of available-for-sale financial assets until the investments are derecognised or impaired.

Available for sale investments reserve

CISGIL classifies the majority of holdings in debt securities as available for sale. Subsequent valuation is at fair value with differences between fair value and carrying value recognised in equity as they arise.

34 Movements in equity

	2009 £m	2008 £m
At beginning of period	**3,932.9**	3,797.4
Total comprehensive income for the period	**(224.0)**	86.4
Arising from transfer of engagements	**812.6**	51.9
Dividend paid by bank – minority interests	**(0.9)**	(0.9)
Dividend paid by Trading group – minority interests	**(1.0)**	(1.4)
Share interest	**(0.7)**	(1.2)
Movement in share capital	**4.0**	0.7
At end of period	**4,522.9**	3,932.9

35 Interest-bearing loans and borrowings – Trading and Corporate activities

This Note provides information about the contractual terms of the Group's interest-bearing loans and borrowings. For more information about the Group's exposure to interest rate and foreign currency risk, see Note 54.

	2009 £m	2008 £m
Non-current liabilities		
Secured bank loan	**193.1**	196.0
Unsecured bank loans	**1,360.0**	–
5⅞% Eurobond Issue 2013*	**206.2**	171.5
7⅝% First Mortgage Debenture Stock 2018*	**52.3**	54.2
Other loans	**5.9**	–
Non-current portion of finance lease liabilities	**12.2**	0.7
	1,829.7	422.4

	2009 £m	2008 £m
Current liabilities		
Current portion of secured bank loan	**2.9**	3.2
Corporate investor shares	**36.7**	47.6
Current portion of finance lease liabilities	**4.4**	0.7
Other unsecured loans	**3.5**	259.0
	47.5	310.5

* These drawndown loan commitments are designated as financial liabilities at fair value through the income statement. All of the other liabilities, except the finance lease liability, are classified as loans and receivables in accordance with IAS 32.

Corporate investor shares

Corporate investor debt may be issued to existing corporate members who hold fully paid corporate shares and are registered Industrial and Provident Societies. The terms and conditions under which such loans are withdrawn or repaid, and the rate of interest payable, is determined from time to time by the Society's Board.

Terms and repayment schedule

The 7⅝% First Mortgage Debenture Stock 2018, which is secured over freehold and leasehold properties with a carrying amount of £100m, has an original value of £50m to be paid to holders upon maturity.

The 5⅞% Eurobond Issue 2013 has an original value of £200m to be paid to holders upon maturity.

The unsecured bank loans consist of a £1,250m term loan which is fully drawn as at 2 January 2010, plus a £300m revolving credit facility of which £110m was drawn down as at 2 January 2010. Whilst both these facilities terminate in full on 15 July 2013 the term loan does have three intermediate repayment instalments of £100m on 27 February 2011, 2012 and 2013.

35 Interest-bearing loans and borrowings – Trading and Corporate activities continued

Finance lease liabilities

	2009 £m	2008 £m
Less than one year	**4.4**	0.7
Greater than one year but less than five years	**10.3**	0.7
Greater than five years	**1.9**	–
	16.6	1.4

Under the terms of the lease agreements, no contingent rents are payable.

36 Trade and other payables – Trading and Corporate activities

	2009 £m	2008 £m
Amounts falling due within one year:		
Trade payables	**888.5**	543.7
Value-added tax, PAYE and social security	**–**	19.1
Accruals and deferred income	**202.5**	158.4
Payments proposed to and on behalf of members	**36.8**	25.7
Funeral bonds	**1.2**	2.6
Other payables	**325.7**	315.6
	1,454.7	1,065.1

	2009 £m	2008 £m
Amounts falling due after more than one year:		
Funeral bonds	**475.0**	316.9
Other payables	**8.3**	–
	483.3	316.9

37 Provisions – Trading and Corporate activities

	Provision for claims £m	Onerous leases £m	Integration provision £m	Litigation £m	Other £m	2009 Total £m	2008 Total £m
At beginning of period	**47.7**	**70.9**	**47.3**	**26.5**	**31.1**	**223.5**	231.9
Arising on transfer of engagements (Note 49)	**–**	**17.4**	**9.7**	**–**	**–**	**27.1**	2.2
Credit to income statement	**–**	**–**	**–**	**–**	**(1.1)**	**(1.1)**	(11.3)
Arising from acquisitions (Note 50)	**14.0**	**136.0**	**5.0**	**8.2**	**21.1**	**184.3**	–
Charge to income statement	**38.1**	**0.1**	**41.1**	**21.7**	**21.1**	**122.1**	81.7
Disposal of business	**–**	**–**	**–**	**–**	**–**	**–**	(0.4)
Discounting	**–**	**6.8**	**–**	**–**	**–**	**6.8**	5.3
Payments	**(28.4)**	**(27.0)**	**(24.7)**	**(2.9)**	**(6.3)**	**(89.3)**	(84.5)
Transfer from payables	**–**	**–**	**–**	**–**	**(1.9)**	**(1.9)**	(1.4)
At end of period	**71.4**	**204.2**	**78.4**	**53.5**	**64.0**	**471.5**	223.5

	2009 £m	2008 £m
Non-current	**415.0**	209.5
Current	**56.5**	14.0
	471.5	223.5

37 Provisions – Trading and Corporate activities continued

The provision for claims relates to potential liabilities arising from past events. The provision includes an assessment, based on historical experience, of claims incurred but not reported at the period-end. The claims are expected to be settled substantially over the next three years. Discounting does not materially impact the level of the provision.

The provision for leases primarily relates to properties that are no longer used for trading. The provision is net of estimated rental income from sub-letting the properties. The provision is calculated on a property-by-property basis by reference to the headlease term and includes property holding costs such as rates. Rental streams are assumed to terminate at the next break point from sub-letting. The leases expire at dates ranging over many years and payments under lease commitments, net of amounts receivable under sub-lettings, will be approximately £56.4m payable in the next five years (2008: £24.0m). The costs have been discounted at rates ranging from 3.95% to 8%.

The integration provision relates principally to redundancies from recent mergers and acquisitions. The majority of these costs are expected to be incurred within the next year, but an unknown minority may be incurred within another two to three years.

The litigation provision represents management's prudent estimate of potential litigation. The actual cash outflow resulting from the provision will be dependent on the outcome of future negotiation and court settlements. The majority of these costs are expected to be incurred within the next one to three years.

Other provisions comprise numerous smaller individual provisions including potential asbestos in properties, contract terminations and the cost of exercising a potential option in a commercial contract. The expected timing of payment varies across these provisions, and an unknown amount may be incurred after two to three years.

38 Amounts owed to credit institutions – Financial Services

	2009 £m	2008 £m
Items in course of collection	**53.9**	5.3
Deposits from other banks	**6,028.5**	1,067.0
	6,082.4	1,072.3
Gilt repo liability	**1,071.2**	1,814.4
Other	**5.6**	7.1
	7,159.2	2,893.8

The amounts owed to credit institutions by CIS represents repurchase liabilities in respect of government-guaranteed securities that are the subject of repurchase contracts. The government-guaranteed securities are included within investments.

Other represents overnight borrowings and overdraft balances.

39 Customer accounts – Financial Services

	2009 £m	2008 £m
Retail	**24,915.1**	7,066.7
Corporate	**5,110.2**	3,346.2
Other	**795.9**	1,254.3
	30,821.2	11,667.2

The Group has entered into interest-rate swaps that protect it from changes in interest rates on the floating-rate assets that are funded by its fixed-rate customer accounts. Changes in the fair values of these swaps are offset by changes in the fair values of the fixed-rate customer accounts. Included within customer accounts are fixed-rate accounts with a total nominal value of £3,359.3m (2008: £nil) against which there are fair-value adjustments for hedged risk of £9.7m (2008: £nil), giving a total carrying value of £3,369.0m (2008: £nil).

40 Capital bonds

	2009 £m	2008 £m
Retail	**1,647.1**	**–**

The 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 profit and loss, and are carried at their fair value.

The fair values for the capital bonds are obtained on a monthly basis from third parties that issue these products. These external valuations are reviewed independently using valuation software to ensure the fair values are priced on a consistent basis.

The fair value for the capital bonds are obtained on a monthly basis from third parties that issue these products. 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 bond is attributable to changes in the liability's credit risk.

The maximum amount the Group would contractually be required to pay at maturity for all the capital bonds is £1,653.2m (2008: £nil).

The Group hedges all of its capital bonds with swaps. The gain on capital bonds in the income and expenditure account for the period is £41.8m (2008: £nil). However, taking into account changes in fair value of the associated swaps, the net impact to the income statement for the year is a loss of £0.2m (2008: £nil).

41 Debt securities in issue – Financial Services

	2009 £m	2008 £m
Certificates of deposits	**294.9**	526.2
Commercial papers	**71.5**	41.8
Fixed and floating notes	**2,967.9**	–
Debt securities in issue	**3,334.3**	568.0

The Group 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 offset by changes in the fair values of the debt securities in issue. The changes in fair value of the debt securities in issue are disclosed on the balance sheet as fair-value adjustments for hedged risk.

42 Investment contracts – Financial Services

All investment contracts are designated by CIS as at fair value through profit or loss on their initial recognition.

The maturity value of these financial liabilities is determined by the fair value of the underlying assets, at the maturity date. There will be no difference between the carrying amount and the maturity amount at maturity date.

Investment contract liabilities arising from unit-linked contracts are measured at fair value by reference to the fair value of the underlying portfolio of assets and are designated in this measurement category at inception. None of the change in liability is attributable to changes in the credit risk of the underlying assets. The maturity value of these financial liabilities is determined by the fair value of the linked assets at maturity date. There will be no difference between the carrying amount and the maturity amount at maturity date.

42 Investment contracts – Financial Services continued

The movement in the liability arising from investment contracts is summarised below:

	2009 £m	2008 £m
At the beginning of the financial period	**190.9**	220.1
Contributions	**34.1**	38.7
Account balance paid on surrender and other terminations in the financial year	**(12.2)**	(13.7)
Investment return credited and related benefits	**47.1**	(54.2)
At the end of the financial period	**259.9**	190.9

	2009 £m	2008 £m
Movement of fair value comprises:		
Investment return credited and related benefits	**46.5**	(54.9)
Management charges	**(2.2)**	(2.1)
Other income – management rebate	**2.8**	2.8
	47.1	(54.2)

43 Unallocated divisible surplus – Financial Services

	2009 £m	2008 £m
At the beginning of the financial period	**622.2**	1,045.6
Transfer from the income statement	**430.6**	(433.4)
Transfers (to)/from the statement of comprehensive income:		
Revaluation of owner-occupied property	**–**	(4.8)
Revaluation of owner-occupied property transferred to assets held for sale	**–**	14.8
At the end of the financial period	**1,052.8**	622.2

44 Other borrowed funds – Financial Services

	2009 £m	2008 £m
£150,000,000 Step-Up Callable Subordinated Notes 2019	**150.0**	150.0
60,000,000 9.25% non-cumulative irredeemable preferred shares of £1 each	**60.0**	60.0
Floating-rate subordinated Notes 2016	**102.9**	–
Subordinated Notes 2021	**150.0**	150.0
Fixed rate subordinated Notes 2024	**131.6**	–
Fixed-rate subordinated Notes 2033	**94.2**	–
Perpetual subordinated bonds issued 1 August 2009	**253.1**	–
Issue costs and discount	**4.7**	(1.6)
	946.5	358.4

The Co-operative Bank has not had any defaults of principal, interest or redemption amounts during the year on its borrowed funds (2008: nil).

All of the above Subordinated Notes are an unsecured obligation of the Banking activities and, in the event of the winding-up of The Co-operative Bank, the claims of note holders will be subordinated in right of payment to the claims of depositors and other creditors of The Co-operative Bank.

44 Other borrowed funds – Financial Services continued

Step-Up Callable Subordinated Notes 2019

The Notes were issued on 1 April 2004 at a discount of 0.946%. The Notes carry an annual 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.

No early repayment, which includes the purchase of the Notes or stock by the Group for cancellation, of any of the above subordinated liabilities can be made without the prior written agreement of the Financial Services Authority.

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 Co-operative Bank.

On a return of capital on a winding-up, the assets of The Co-operative 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 Co-operative 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 Co-operative 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 Co-operative Bank or other return of capital and then only on that resolution.

Subordinated Notes due November 2021

The Notes were issued on 16 November 2006 at a discount of 0.189%.

The Notes carry an interest rate of 5.625% per annum 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-month 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 Co-operative 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.

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 hedged with a cross-currency swap converting the exposure into sterling at a floating rate at three month libor with a margin on interest coupon of 0.34125%. The cross-currency swap maturess on 18 May 2011.

The Bank may redeem all, but not less than all, of the Notes at the principal amount on 18 May 2011, and on any quarterly interest payment date thereafter.

Fixed-rate subordinated Notes 2024

The Notes were issued on 17 March 2004 at a discount rate 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% per annum to maturity. The Notes are hedged with interest-rate swaps that convert the interest rate payable into floating rates at six month 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.

The Bank may redeem all, but not less than all, of the Notes at the principal amount on 2 December 2019, and on any quarterly interest payment date thereafter.

44 Other borrowed funds – Financial Services continued

Fixed-rate subordinated Notes 2033

The Notes were issued on 28 March 2002 at a discount rate 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 note holders 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% per annum 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 pay leg at six month libor payable in March and September. The fixed interest rate receivable leg on the swaps, are £25m at 5.405% and £75m at 5.225%. The annual interest receivable leg on the swap is matched to the dates on the Notes.

Perpetual subordinated bonds

Upon transfer of engagements, the Britannia Permanent Interest Bearing Shares (PIBS) were converted into perpetual subordinated debt of CFS (Perpetual Subordinated Bonds). The Co-operative Group are currently discussing with HM Treasury and the Financial Services Authority whether future legislation will allow for conversion into instruments which are similar to the PIBS but are not subordinated loans.

From 1 August 2009, The Bank assumed a liability to each PIBS Holder for a subordinated deposit equal to the principal amount of their PIBS. These deposits have automatically been applied in subscription to either perpetual subordinated bonds having an interest rate of 13% in respect of the First Perpetual Subordinated Bonds or perpetual subordinated bonds having an interest rate of 5.5555 per cent in respect of the Second Perpetual Subordinated Bonds for an amount corresponding to the principal amount of that holders PIBS.

The Trustee for the holders of the Perpetual Subordinated Bonds is The Law Debenture Trust Corporation plc whose registered office is Fifth Floor, 100 Wood Street, London EC2V 7EX.

The Financial Services Authority must give prior written consent to the early repayment, including the purchase of the Notes or stock by the Group for cancellation, of any subordinated bond.

45 Other liabilities and accruals – Financial Services

	2009 £m	2008 £m
Arising out of direct insurance operations	**3.5**	6.5
Accruals and deferred income	**338.9**	170.8
Other taxation and social security	**8.3**	7.6
Other payables	**57.9**	154.9
Amounts due for investments purchased	**4.7**	68.5
Trade creditors	**221.9**	91.7
Other reinsurance liabilities	**2,001.4**	2,274.4
Net asset value attributed to unit holders	**42.0**	–
	2,678.6	2,774.4

Liabilities arising from reinsurance operations include a financial liability of £1,992.4m (2008: £2,267.7m), which is valued at fair value through profit or loss. The liability is owed to a major reinsurer under a reinsurance arrangement to reinsure the majority of CIS's remaining obligations in respect of annuities in payment and a proportion of those in deferment. Under the reinsurance arrangement, CIS is contracted to pay premiums in accordance with a schedule of payments covering a period up to 2066. At inception of the contract, CIS recognised its premium obligation in full within the income statement by a charge representing the net present value of the contracted payments, and continues to recognise a financial liability to the extent that the premium has yet to fall due for payment. At inception of the contract, CIS also purchased a debt security, cash flows from which will fund the discharge of the financial liability as amounts fall due for payment.

45 Other liabilities and accruals – Financial Services continued

The value of the financial liability is linked to the value of the debt security and accordingly both the asset and liability were designated in the measurement category of fair value through profit or loss at inception. All of the change in the fair value of the liability is attributable to changes in the fair value of the debt security and does not reflect changes in the credit risk of the liability.

The maturity value will be determined by the fair value of the debt security at maturity date. There will be no difference between the carrying amount and the maturity value at maturity date. Of the discounted liability value, £53.9m (2008: £50.6m) is due to be settled within one year giving rise to a cash outflow of £54.2m (2008: £52.8m) (inclusive of interest). The amount to be settled after more than one year is £1,963.8m (2008: £2,218.3m).

Other payables in CFS include finance lease obligations as follows:

	Present value of lease payments		**Future minimum lease payments**	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Due within one year	**–**	–	**–**	–
Due between one year and five years	**0.1**	–	**0.1**	–
Due after five years	**1.2**	–	**1.8**	–
	1.3	–	**1.9**	–

The future minimum lease payments have been discounted at Libor over the term of the lease to give the present value of these payments.

46 Provisions – Financial Services

	Provisions for restructuring £m	**FSCS levy £m**	**Other provisions £m**	**2009 Total £m**	2008 Total £m
At beginning of year	**7.4**	**10.5**	**12.2**	**30.1**	28.1
Arising on transfer of engagements	**–**	**10.1**	**4.1**	**14.2**	–
Utilised	**(4.8)**	**(3.7)**	**(0.7)**	**(9.2)**	(13.8)
Charge to income statement	**13.9**	**10.1**	**16.6**	**40.6**	18.5
Provision released	**(2.5)**	**(6.4)**	**(4.6)**	**(13.5)**	(2.7)
At end of year	**14.0**	**20.6**	**27.6**	**62.2**	30.1

Restructuring provisions principally relate to the extensive restructuring and modernisation of the business, and the subsequent redundancy costs. Also included within this total are integration provisions relating principally to redundancies from the recent Britannia transfer of engagements. The majority of these costs are expected to be incurred within the next year.

Other provisions mainly comprise onerous contract provisions in respect of long-term business investment contracts, onerous lease provisions for vacant properties not in use, and an estimate of future payments to customers by The Co-operative Bank in compensation for loss suffered from past pension and investment advice.

Financial Services Compensation Scheme levy

In common with other financial institutions authorised by the Financial Services Authority (FSA), the Group contributes to the Financial Services Compensation Scheme (FSCS). The FSCS covers financial institutions authorised to do business in the United Kingdom. When an institution is unlikely, or likely to be unable, to pay claims against it, its customers may be able to claim compensation from the FSCS. The FSCS raises funds to meet the known compensation claims through levies on other FSA – authorised institutions. As a result of a number of institutions failing during 2008, the FSCS received funds from HM Treasury in order to meet its' obligations to depositors. These borrowings are anticipated to be repaid wholly or substantially from the realisation of the assets of the failed institutions. The FSCS raises annual levies from the banking industry in order to meet its management expenses and compensation costs. The annual levies are based upon the individual institutions proportion of protected deposits of the total market protected deposits at year end each year.

46 Provisions – Financial Services continued

The Co-operative Bank has provided for £20.3m (2008: £10.5m) for its share of levies that will be raised by the FSCS including the interest on the loan from the HM Treasury in respect of the levy years 31 March 2009 to 31 March 2011 respectively. The provision includes estimates for the interest FSCS will pay on the loan and of the Group's market participation in the relevant years.

At the date of these financial statements, it is not possible to estimate whether there will be ultimately additional levies on the industry, the level of The Co-operative Bank's market participation or other factors that may affect amounts or the timing of amounts that may ultimately become payable, nor the effect that such levies may have upon the operating results in any particular periods. The Financial Services Commission (FSC) in the Isle of Man operates a similar scheme. Britannia International Limited has provided £0.3m (2008: £nil) for the year ended 2 January 2010 in respect of this scheme.

Vacant Property

CFS 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 the discount rate applied in the goodwill calculations of 11%.

Regulatory

Provisions have been made in respect of various potential customer-compensation claims. Claims are investigated on an individual basis and, where appropriate, compensation payments are made.

47 Reconciliation of operating profit to net cash inflow from operating activities – Trading and Corporate activities

	2009 £m	2008 £m
Operating profit after significant items (continuing activities) (see Note 1)	**322.2**	234.4
Add: Losses on discontinued businesses before interest and tax	**(16.1)**	(6.4)
Less: Group operating costs	**(40.8)**	(30.0)
	265.3	198.0
Add back:		
– Depreciation and amortisation charges	**260.6**	179.1
– Goodwill and fixed-asset impairment	**13.2**	4.3
– Profit on disposal of fixed assets (including those in significant items)	**(98.5)**	(55.6)
– Change in value of investment properties and joint venture	**(3.5)**	62.3
Effect of non-cash pension costs	**(18.6)**	(11.5)
Movements in working capital:		
– Decrease/(Increase) in inventories	**50.4**	(32.7)
– Decrease/(Increase) in debtors	**69.4**	(88.3)
– Increase/(Decrease) in creditors and provisions	**(0.5)**	(5.9)
Tax paid	**(30.6)**	(9.2)
Net cash inflow from operating activities	**507.2**	240.5

48 Reconciliation of operating profit to net cash inflow from operating activities – Financial Services

	2009 £m	2008 £m
Operating profit after significant items (see Note 1)	**223.7**	70.7
Decrease in prepayments and accrued income	**305.3**	92.6
(Decrease)/increase in accruals and deferred income	**(66.1)**	7.1
Interest payable on subordinated liabilities	**17.1**	17.5
Effect of exchange rate movements	**(96.0)**	(10.9)
Impairment losses on loans and advances	**116.1**	96.8
Impairment losses on investments	**(4.0)**	50.7
Effect of non-cash pension costs	**0.2**	0.1
Depreciation and amortisation	**49.1**	51.2
Interest amortisation	**(12.6)**	(12.2)
Amortisation on investments	**(1.4)**	4.1
Profit on sale of investments	**–**	(3.1)
Decrease in intangible assets	**(5.6)**	–
Loss on disposal of fixed assets	**1.5**	4.3
Fair value amortisation	**(99.1)**	–
Preference dividend	**5.6**	5.6
Net cash flow from trading activities	**433.8**	374.5
(Decrease)/increase in deposits by banks	**(1,108.5)**	348.3
Increase in customer accounts	**872.0**	1,349.3
(Increase)/decrease in debt securities in issue	**(1,035.5)**	32.2
Decrease in loans and advances to bank	**(1,037.5)**	(297.0)
Increase in loans and advances to customers	**(1,005.2)**	(1,389.9)
Net movement of other assets and other liabilities	**(58.0)**	388.8
Fixed assets transferred to assets held for trading	**–**	42.1
Increase in property, plant and equipment	**(43.1)**	–
Investment property movement	**43.4**	493.8
Fair value through profit and loss movement	**638.6**	2,234.7
Derivative financial instruments movement	**452.3**	(156.6)
Assets available for sale movement	**(256.7)**	398.0
Assets held for sale	**–**	(50.0)
Movement in deferred acquisition costs	**(7.9)**	(3.0)
Reinsurance assets	**167.8**	181.7
Loan receivables at amortised cost	**2.5**	2.4
Insurance and other receivables	**(0.5)**	–
Insurance and participation contract provisions	**(258.9)**	(1,904.2)
Unallocated divisible surplus	**430.6**	(423.4)
Investment contracts	**69.0**	(29.2)
Amounts owed to credit institutions	**(743.2)**	(1,168.8)
Other provisions	**12.0**	(5.7)
Insurance and other payables	**(0.2)**	0.6
Other reinsurance liabilities	**2.5**	1.0
Net asset value attributable to unit holders	**42.0**	–
United Kingdom corporation tax paid	**(104.6)**	(125.3)
Net cash (outflow)/inflow from operating activities	**(2,493.3)**	294.3

49 Transfer of engagements

(i) Transfer of engagements of Britannia Building Society

On 1 August 2009, Britannia Building Society merged with The Co-operative Bank plc by a transfer of engagements between the building society and the mutual bank under the Building Societies (Funding) and Mutual Societies (Transfers) Act 2007.

Britannia was the UK's second largest building society, with nearly three million members countrywide, offering a range of mortgage, savings, investments and insurance products. The merger was undertaken to create the first ever super-mutual and combines the strengths of both organisations.

In the five months to 2 January 2010, including the impact of fair value adjustments, the former Britannia Group contributed total operating income of £225.2m, operating profit of £124.1m and profit before taxation of £124.0m.

The Britannia assets and liabilities were included in the Group accounts on the transfer of engagements at the following amounts:

	Pre-transfer of engagements carrying amounts £m	Fair value adjustments £m	Recognised values on transfer of engagements £m
Cash and balances at central banks	591.8	–	591.8
Loans and advances to banks	972.5	(16.4)	956.1
Loans and advances to customers (a)	23,752.9	(867.4)	22,885.5
Fair value adjustments for hedged risk (a)	370.2	(370.2)	–
Investment securities (b)	6,588.1	(443.9)	6,144.2
Derivative financial instruments	1,086.6	–	1,086.6
Investments in joint ventures	2.1	–	2.1
Goodwill (c)	194.8	(194.8)	–
Intangible fixed assets (d)	36.4	9.6	46.0
Investment properties (e)	131.1	(7.4)	123.7
Property, plant and equipment (f)	72.6	10.0	82.6
Other assets	18.0	(8.6)	9.4
Prepayments and accrued income	122.2	–	122.2
Deferred tax assets (g)	52.5	79.7	132.2
Deposits by banks	(6,117.6)	–	(6,117.6)
Customer accounts (h)	(18,309.5)	4.8	(18,304.7)
Capital bonds	(1,593.2)	–	(1,593.2)
Debt securities in issue (i)	(4,962.3)	1,295.0	(3,667.3)
Derivative financial instruments	(721.1)	–	(721.1)
Other liabilities	(54.0)	–	(54.0)
Accruals and deferred income (j)	(207.8)	(34.6)	(242.4)
Provision for liabilities	(14.2)	–	(14.2)
Current tax liabilities	(44.3)	(1.6)	(45.9)
Subordinated Liabilities (k)	(530.9)	221.4	(309.5)
Subscribed capital (k)	(318.7)	78.7	(240.0)
Available-for-sale reserve (l)	88.8	(88.8)	–
Cashflow hedging reserve (l)	12.7	(12.7)	–
Net identifiable assets	**1,219.7**	**(347.2)**	**872.5**
Goodwill			**0.6**
Deferred Consideration (m)			**49.6**
Imputed Consideration (n)			**811.2**
Acquisition costs			**12.3**

The value of assets, liabilities and contingent liabilities recognised are their estimated fair values based on applicable IFRSs.

a) The fair value adjustment to loans and advances to customers comprises:
   (i) an interest rate adjustment on a discounted cash flow basis to reflect the value inherent in fixed rate, base and tracker products compared to current market pricing;
   (ii) the inclusion of a credit risk adjustment to reflect future lifetime expected credit losses; and
   (iii) the write off of existing EIR balances and fair value adjustment for hedged risk.

49 Transfer of engagements continued

b) Floating-rate notes have been valued at their quoted market price at the date of transfer. The fair value of asset- and mortgage-backed securities have been calculated with reference to latest available third party prices.

c) Under IFRS, the goodwill on the balance sheet of the transferring entity is de-recognised. The book value of goodwill in the balance sheet at the date of transfer of £194.8m has therefore been written off.

d) (i) The Britannia software development costs and other intangible assets totalling £34.2m have been written off, as these were considered to have no market value at the date of transfer.

(ii) Intangible assets following the merger are identified and valued. The Britannia brand has been deemed to have a fair value of £2.0m and in respect of core deposits, the intrinsic value of the retail savings book has been valued at £44.0m. The brand intangible will be subject to an annual impairment review. The core deposit intangible asset will be amortised over the useful life of three years.

e) The investment properties in the former Britannia subsidiary company, Illius Properties Limited, have been revalued to their market value at the date of transfer.

f) The fair value adjustment to property, plant and equipment principally relates to the independent valuation of commercial properties at the date of transfer.

g) Deferred tax has been provided where subsequent tax benefits or charges will arise from the fair value adjustments.

h) The fair value adjustment to customer balances and other borrowed funds relates to an interest rate adjustment on a discounted cash flow basis.This reflects the inherent value of the primarily fixed rate business compared to current market pricing for retail deposits.

i) The debt securities in issue relating to the former Britannia Building Society have been valued using a discounted cash flow calculation, due to limited market data. The debt securities in issue relating to the securitised companies in the former Britannia Group have been valued at their market rate at the date of transfer. These liabilities were previously carried at amortised cost.

j) The fair value adjustment to accruals and deferred income relates to aligning the accounting policy treatment of capital bonds and maintenance of payments to the Britannia Foundation for three years.

k) The subordinated liabilities and subscribed capital have been restated using their quoted market price.

l) The available-for-sale and cashflow hedging reserves have been written off on the date of the transfer of engagements.

m) The deferred consideration consists of £1.8m relating to the payment of £1 joining fees for Britannia members to become members of CFS and £47.8m relating to the maintenance of Britannia Membership Reward (BMR) payments to former Britannia members for the next four years.

n) The business combination with Britannia Building Society did not involve the transfer of any cash consideration. The value of the imputed consideration has been calculated based on a discounted cash flow of the future profitability of the former Britannia business.

Goodwill recognised

Goodwill of £0.6m has been recognised on the transfer of engagements of Britannia Building Society. This has been calculated as the difference between the fair value of the net assets transferred and the imputed consideration. This goodwill relates to the expected efficiency and revenue benefits as a result of the merged organisation. For further details of the goodwill calculation and the assumptions behind the recoverable amount refer to Note 17.

Accumulated impairment losses relating to the goodwill at the 2 January 2010 are £nil.

The total amount of goodwill that is expected to be deductible for tax purposes is £nil.

49 Transfer of engagements continued

Acquired receivables

The Group expects to receive all gross contractual amounts receivable relating to the above financial assets with the exception of the following:

Class of receivable	Fair value £m	Gross contractual amounts receivable £m	Cash flows not expected to be collected £m
Loans and advances to banks	956.1	977.1	16.4
Loans and advances to customers	22,885.5	23,829.3	659.0
Investment securities	6,144.2	6,637.9	88.8
	29,985.8	**31,444.3**	**764.2**

The gross contractual amounts receivable relates to the cessation account balance before provisions and other fair value adjustments. Cash flows not expected to be collected are the undiscounted credit losses associated with the balance.

(ii) Transfer of engagements of Plymouth and South West Co-operative Society

On 6 September 2009, the Plymouth and South West Co-operative Society transferred its engagements to The Co-operative Group under section 51 (1) of the Industrial and Provident Societies Acts. The transfer of engagement took place to further consolidate the Co-operative Movement within the UK.

The Plymouth and South West Co-operative Society has contributed £2.4m to the Group's operating profit before significant items to the period since acquisition.

The transfer of engagements had the following effect on the Group's assets and liabilities on amalgamation date:

	Pre-transfer carrying amounts £m	IFRS and accounting policy adjustments £m	Fair value adjustments £m	Recognised values on transfer of engagement £m
Property, plant & equipment – Investment property (a)	13.2	–	(0.3)	12.9
Property, plant & equipment – Land and buildings (a)	39.0	–	10.8	49.8
Property, plant & equipment – Fixtures and fittings, plant & machinery and motor vehicles (b)	13.4	–	(1.0)	12.4
Goodwill (c)	6.3	(6.3)	–	–
Investments	0.4	–	–	0.4
Deferred tax asset (h)	–	–	3.7	3.7
Inventories	4.2	–	(0.1)	4.1
Receivables	6.9	–	(1.6)	5.3
Current investments	16.3	–	–	16.3
Cash	2.5	–	–	2.5
Payables (d)	(17.8)	–	(11.5)	(29.3)
Funeral bonds (e)	(10.7)	–	(1.4)	(12.1)
Provisions (f)	(2.3)	–	(15.2)	(17.5)
Pension deficit (g)	(17.2)	–	(25.3)	(42.5)
Net identifiable assets	**54.2**	**(6.3)**	**(41.9)**	**6.0**

The value of assets, liabilities and contingent liabilities recognised are their estimated fair values based on applicable IFRSs.

The fair value of assets and liabilities arising on the merger have been based on factors and circumstances available at the time of the business combination and at period end. While the fair values are considered accurate, IFRS 3 Business Combinations allows for hindsight adjustments to be made up to one year after the acquisition date, should additional facts or information regarding circumstances existing at the time of acquisition cause our assessment of the fair values on acquisition to change. The hindsight period comes to an end on 5 September 2010.

a) The property estate including investment properties has been valued at market value. Fixtures and fittings at leasehold sites have been written off to the extent they are reflected in the fair value of lease payments.

b) An impairment test at individual store level has resulted in the impairment of certain tangible fixed assets held at underperforming store/branches.

49 Transfer of engagements continued

c) Under IFRS, the goodwill on the balance sheet of the transferring entity is de-recognised. The book value of goodwill in the balance sheet at the date of transfer of £6.3m has therefore been de-recognised. Having reviewed all businesses for possible intangibles it was concluded that no intangibles should be recognised.

d) The adjustment to payables includes accruals for liabilities identified at the date of transfer.

e) The funeral bonds adjustment reflects an increase in the liability following assessment of the assumptions used to calculate this figure.

f) Provisions have been restated in accordance with the Group's policies with provisions made/ increased in respect of onerous leases and dilapidations.

g) The adjustment to the Plymouth and South West and Brixham pension schemes reflects the updating of the IAS 19 actuarial valuation from the start of the period to the date of the transfer.

h) Deferred tax adjustments arise from both accounting policy changes from moving to IFRS and deferred tax arising on the fair value adjustments. The key accounting policy adjustments arise because IAS 12 requires deferred tax to be provided on the revaluation of properties and rolled-over capital gains, rather than those expected to crystallise. The main deferred tax adjustment arising on the fair value adjustments is a result of the increase in the pension deficit.

(iii) Transfer of engagements of Lothian Borders & Angus Co-operative Society

On 14 December 2008 the Lothian Borders & Angus Co-operative Society transferred its engagements to The Co-operative Group under section 51 (1) of the Industrial and Provident Societies Acts.

At 10 January 2009, provisional values were included for some asset and liabilities acquired. A £0.5m reduction has been made to the value of property, plant and equipment in 2009.

50 Acquisitions

(i) Acquisition of the Somerfield group

On 27 February 2009, the Group completed its acquisition of a 100% equity interest in the Somerfield group. The acquisition took place to confirm the Co-operative Group as the nation's fifth largest food retailer and to create significant cost benefit synergies across the two businesses.

The Somerfield group has contributed £32.5m to the Group's operating profit before significant items to the period since acquisition.

The following summarises the major classes of consideration transferred:

	£m
Cash	20.0
Transaction costs and fees	50.0
	70.0

The cost of the acquisition on a cash free, debt free basis was £1.6bn including fees. This comprised net bank debt of £0.8bn, an acquisition price of £0.8bn comprising preference shares of £0.6bn, loan notes of £0.2bn and a net consideration of £20m for the equity share capital. Net consideration including fees was £70m.

50 Acquisitions continued

A summary of the acquired balance sheet is shown below:

	Pre-acquisition carrying amounts £m	Accounting IFRS adjustments £m	Fair value adjustments £m	Recognised values on acquisition £m
Property, plant & equipment (a)	1,515.1	(582.4)	(336.4)	596.3
Goodwill (b)	66.2	(66.2)	–	–
Inventories (c)	186.3	–	(9.8)	176.5
Trade Receivables (d)	84.8	–	–	84.8
Other Receivables	51.3	(4.6)	(1.1)	45.6
Cash and cash equivalents	48.1	–	–	48.1
Assets classified as held for sale (e)	–	582.4	(104.8)	477.6
Current trade payables	(275.5)	–	(1.2)	(276.7)
Current other payables (f)	(309.9)	(15.7)	(30.0)	(355.6)
Short term borrowings	(563.3)	–	–	(563.3)
Current tax payable	(11.6)	–	3.1	(8.5)
Non-current other long-term payables	(6.5)	–	–	(6.5)
Long term borrowings (g)	(843.6)	(87.2)	(26.8)	(957.6)
Deferred tax (h)	–	–	182.0	182.0
Provisions (i)	(138.7)	–	(39.6)	(178.3)
Pension liability (i)	(17.2)	–	(45.0)	(62.2)
Net identifiable liabilities	(214.5)	(173.7)	(409.6)	(797.8)
Goodwill				**867.8**
Purchase consideration				**70.0**

The Group incurred acquisition costs of £50m relating to external legal fees, due diligence costs and Somerfield debt break costs. In accordance with IFRS 3, directly attributable costs of acquisition have been included as part of the consideration.

The fair value of assets and liabilities arising on the acquisition have been based on factors and circumstances available at the time of the business combination and at period end. While the fair values are considered accurate, IFRS 3 Business Combinations allows for hindsight adjustments to be made up to one year after the acquisition date, should additional facts or information regarding circumstances existing at the time of acquisition cause our assessment of the fair values on acquisition to change. The hindsight period comes to an end on 26 February 2010.

a) Property fair values are based on external valuations in April 2009.

   The total reduction in the value of continuing stores also includes certain value in use impairments to reflect specific store issues. Fixtures and fittings at leasehold sites have been written off to the extent they are reflected in the fair value of lease payments.

b) Under IFRS, the goodwill on the balance sheet of the transferring entity is de-recognised. The book value of goodwill in the balance sheet at the date of transfer of £66.2m has therefore been de-recognised. Having performed a review for possible intangibles it was concluded that no intangibles should be recognised.

c) The reduction of £9.8m is a provision to allow for the alignment of stock valuation onto a line item method.

d) The key adjustments include recognition of two receivables where amounts received post acquisition related to a pre-acquisition period offset by write-offs where current value in use is lower than carrying value and an accounting policy alignment on the treatment of upfront lease payments.

e) Where stores have been disposed or are pending sale these are classified as held for sale in accordance with IFRS 5. All such stores have been valued at either actual or expected disposal values resulting in an increase from the external valuation. All plant and equipment in these stores has been written off.

f) This adjustment relates to the amortisation of future fixed rental uplifts, provision for above market utility contracts and a reassessment of supplier income due to the Society.

g) This adjustment relates to the write off of previously capitalised debt arrangement fees (£27m) and the recognition of the fair value of interest rate swaps (£87m).

50 Acquisitions continued

h) Prior to acquisition and accounting under UK GAAP, Somerfield had a deferred tax asset, which was not recognised on the balance sheet as the likelihood of utilising the benefit was not sufficiently certain. As a consequence of the significant store disposals and also forecast profitability, it is probable that future taxable profits will be available to enable the benefit to be utilised and, therefore, an asset of £182m has been recognised. The largest component of this deferred tax asset (£148.5m) is for tax relief available through future capital allowances claims on Somerfield fixed assets. Somerfield has deferred capital allowance claims in recent periods which has led to the build up of such a significant asset.

i) This relates mainly to additional property provisions made for rentals above market value, potential dilapidations and asbestos exposures and the alignment of accounting policies in the calculation of the onerous lease provision.

j) The Somerfield pension liability has increased by £45m to £62m reflecting the updating of the IAS 19 actuarial valuation from April 2008 to the acquisition date.

As a result of the acquisition, the Group was required to sell 133 Somerfield or Co-operative foodstores across the country in order to comply with Office of Fair Trading local competition laws.

The goodwill created is largely attributable to location, footfall and synergies on integration across the stores acquired. No other intangible assets have been identified as part of the fair value exercise.

If the mergers of Britannia and the Plymouth and South West Co-operative, plus the acquisition of Somerfield had occurred on 11 January 2009, then the estimated revenue of the whole Group would have been approximately £13.3bn and the operating profit before significant items would have been approximately £668m for the period.

(ii) Other 2009 acquisitions

A summary of other acquisitions in 2009 are disclosed below:

	2009 Total fair Value £m	2008 Total fair Value £m
Property, plant & equipment	**4.3**	5.6
Intangible assets	**–**	23.2
Inventories	**–**	0.1
Creditors	**(0.5)**	–
Cash	**0.1**	–
Net assets	**3.9**	28.9
Goodwill and intangibles	**3.0**	10.9
Purchase Consideration	**6.9**	39.8
Cash flow on acquisition:		
Cash consideration	**(6.9)**	(39.8)
Bank balances acquired	**0.1**	–
Cash outflow	**(6.8)**	(39.8)

There are no significant fair value adjustments included in the above. The preliminary adjustments made can only be determined on an estimated basis because of the uncertainty over the outcome of events that may impact on these fair values. As a consequence, further adjustments may arise in 2010. The amounts above relate to acquisitions principally in Pharmacy. Within Pharmacy, £1.4m has been capitalised as licences within intangible assets.

51 Commitments and contingent liabilities

a) Capital expenditure committed by the Group at period end was £47.1m (2008: £243.3m)

b) Commitments under operating leases:

At 2 January 2010, the future minimum lease payments under non-cancellable operating leases were:

Group	2009 Land and buildings £m	2009 Other £m	2008 Land and buildings £m	2008 Other £m
Operating leases which expire:				
Within one year	**4.4**	**5.9**	2.7	2.4
In two to five years	**102.5**	**8.8**	66.0	6.5
In over five years	**3,425.6**	**0.4**	2,078.6	–
	3,532.5	**15.1**	2,147.3	8.9

The total of future minimum sublease payments expected to be received under non-cancellable subleases with less than 50 years remaining is £232.6m.

c) Banking activities

The table below gives the nominal principal amounts, credit equivalent amounts and risk-weighted amounts of contingent liabilities and commitments. The nominal principal amounts indicate the volume of business outstanding at the balance sheet date and do not represent amounts at risk. The credit equivalent and risk-weighted amounts have been calculated in accordance with the FSA guidelines implementing the Capital Requirements Directive (CRD).

	2009 Contract amount £m	2009 Credit equivalent amount (i) £m	2009 Average risk weight	2009 Risk-weighted amount £m	2008 Contract amount £m	2008 Risk-weighted amount £m
i) Contingent liabilities:						
Guarantees and irrevocable letters of credit	**118.9**	**98.2**	**91.1%**	**89.5**	94.9	74.5
	118.9	**98.2**	**91.1%**	**89.5**	94.9	74.5
ii) Other commitments:						
Documentary credits and short-term trade-related transactions	**2.1**	**1.0**	**40.0%**	**0.4**	3.4	0.6
Forward assets purchases and forward deposit placed	**164.5**	**164.5**	**47.5%**	**78.2**	200.0	29.2
Undrawn formal standby facilities, credit lines and other commitments to lend (includes revocable and irrevocable commitments)	**4,822.9**	**2,829.0**	**36.5%**	**1,032.9**	5,300.4	1,098.7
	4,989.5	**2,994.5**	**37.1%**	**1,111.5**	5,503.8	1,128.5

Notes

(i) Under the CRD, credit conversion factors are applied to exposures subject to the Standardised and Foundation IRB approach, primarily Corporate and Wholesale exposures as defined by BIPRU. Under the Retail IRB approach, the Credit Equivalent amount is defined as Exposure at Default (EAD).

(ii) Undrawn loan commitments include revocable commitments which are unused credit card limits of £2,261.9m (2008: £3,034.1m).

Assets pledged

Assets are pledged as collateral under repurchase agreements with other banks. Mandatory reserve deposits are also held with the Bank of England in accordance with statutory requirements. These deposits are not available to finance the Group's day-to-day operations.

	Asset 2009	Asset 2008	Related liability 2009	Related liability 2008
Balances with central banks	**34.0**	9.9	**–**	–

51 Commitments and contingent liabilities continued

Investment securities with a carrying value of £3,697.0m (2008: £nil) have been sold under sale and repurchase agreements. These assets have not been derecognised as the Bank has retained substantially all the risks and rewards of ownership. Included within deposits by banks are the related liabilities of £2,998.8m (2008: £nil).

The Group have loans and advances to banks of £nil (2008: £497.0m) under reverse sale and repurchase agreements and against which it holds gilts with a fair value of £nil (2008: £530.9m). These transactions are conducted under terms that are usual and customary to standard stock lending, securities borrowing and reverse purchase agreements. The Group is permitted to sell or repledge the assets received as collateral in the absence of their default. The Group is obliged to return equivalent securities. At 2 January 2010, the fair value of collateral repledged amounted to £nil (2008: £nil). The Group does not adjust for the fair value of securities received under reverse sale and repurchase agreements.

Unauthorised overdraft charges

In July 2007 the Office of Fair Trading (OFT) agreed with eight financial institutions to commence proceedings in the High Court of England and Wales in a test case regarding informal overdraft charges. The Co-operative Bank is not part of the proceedings but will be bound by the outcome. In April 2008, the High Court issued its judgement in respect of the first stages of the test case process. The Court's judgement was that informal overdrafts are an essential, real and identifiable service provided by banks for their personal current account customers, that the institutions' current overdraft charges are not unenforceable penalties, but are assessable for fairness under the Unfair Terms in Consumer Contracts Regulations 1999 and most of the litigant banks' current terms and conditions (including charges) are in plain and intelligible language. The financial institutions appealed the fairness ruling.

In February 2009 the Court of Appeal decided that the OFT can assess whether the litigant banks' terms and conditions, allowing them to impose informal overdraft bank charges, are fair. However, the litigant banks appealed against this judgement to the House of Lords.

On 26 November 2009 the Supreme Court (formerly the House of Lords) announced its decision in the test case regarding these informal overdraft charges. It found in favour of the banks and ruled against the original judgement that would have allowed the OFT to assess whether bank charges were fair. Subsequent to this decision, the OFT has decided not to take the matter further.

Therefore the Group has made no provision and no contingent liability exists. However, the Group has proactively implemented changes to current account tariffs to provide greater clarity for customers.

Payment protection insurance

There has been extensive regulatory scrutiny of the payment protection insurance (PPI) market over recent years, and, as a result of this, following a request by the FSA to a number of institutions in the market, the Bank stopped selling its single premium PPI product in January 2009. Additionally at the FSA's request, the Bank agreed to conduct a voluntary review of its past sales made, from July 2007, in its branch network. The commencement of this review has been deferred pending the provision by the FSA of further guidance on how it should be conducted. The regulator has also signalled its intention to require PPI providers, including the Bank, to carry out a review of all PPI sales-related complaints rejected since January 2005.

52 Related party transactions and balances

a) Trading and Corporate activities

The nature of the relationship of related parties and the extent of material transactions and balances with them are set out below or are disclosed elsewhere within the financial statements.

	Relationship	**2009 £m**	2008 £m
Sales to associated undertakings and joint ventures on normal trading terms	(i)	–	–
Subscription to Co-operatives[UK] Limited	(ii)	0.9	0.5

i) Details of the Society's principal associates are set out in Note 53.

ii) The Society is a member of Co-operatives Limited.

The Society's corporate members include consumer co-operative societies, which, in aggregate, own the majority of the corporate shares with rights attaching as described in Note 32. The sales to corporate members, on normal trading terms, were £1,271.5m (2008: £1,296.7m) and the amount due from corporate members in respect of such sales was £56.6m at 2 January 2010 (2008: £52.7m).

52 Related Party transactions and balances continued

Transactions with directors and key management personnel

Disclosure of key management compensation is set out in the Remuneration Report. A number of trading transactions are entered into with related parties in the normal course of business. Key management are considered to be Board Executive members and directors of The Co-operative Group. The average value of all transactions greater than £1,000 with the Trading Group was £7,011 (2008: £7,699).

b) Banking activities

A number of banking transactions are entered into with related parties in the normal course of business. These include loans and deposits. Key management are considered to be Board Executive members of the Group. The volume of related party transactions, outstanding balances at the year-end and related income and expense for the year are as follows:

	Directors and key management personnel	
	2009 £m	2008 £m
Loans outstanding at 10 January 2009 and 2 January 2010	**1.0**	0.1
Deposits at beginning of year	**1.5**	1.5
Interest and fee expense	**–**	0.1
Net movement	**(0.8)**	(0.1)
Deposits at end of year	**0.7**	1.5

c) Insurance activities

The Society enters into transactions with key management personnel in the normal course of business. Details of the transactions carried out during the year and balances are as follows:

	2009 £	2008 £
At beginning of period	**39,151**	70,514
Net movement	**94,269**	(31,363)
At end of year	**133,420**	39,151

53 Principal subsidiary and associated undertakings

The principal subsidiary and associated undertakings of the Society, which are registered in England except where stated, are:

	Society's holding %	Nature of business
Co-operative Financial Services Ltd:	100	Holding society
CIS General Insurance Ltd	100	General insurance
CFS Management Services Ltd	100	Service company
CFS Services Ltd	100	Financial services
Co-operative Insurance Society Ltd (v):	100	Life assurance
Hornby Road Investments Ltd (v)	100	Investment holding
CIS Unit Managers Ltd (v)	100	Investment holding and management
CIS Policyholder Services Ltd (v)	100	Provision of financial services
The Co-operative Bank plc (v):	100	Banking
Britannia Treasury Services Ltd	100	Holding company
Britannia Development and Management Company Ltd	100	Property investment
Britannia Asset Management Ltd	100	Holding company
Illius Properties Ltd	100	Property investment
Britannia Covered Bond LLP	100	Mortgage acquisition and guarantor of covered bonds
Unity Trust Bank plc (iv) (v)	27	Banking
Co-operative Bank Financial Advisers Ltd (v)	100	Financial advisers
The Covered Bond LLP	100	Financial services
Trading:		
Alldays Finance Ltd	100	Holds investments
Alldays Stores Ltd	100	Food retailing
Balfour Convenience Stores Ltd	100	Food retailing
Convenience Stores West Ltd	100	Food and general retailing
Co-operative Group Healthcare Ltd	100	Pharmaceutical retailing
Co-operative Brands Ltd	100	Holds intellectual property
Co-operative Legal Services Ltd	75	Legal services
Co-operative Ventures Ltd		Investment holding
CRS (Properties) Ltd (iii)	100	Property management
Farmcare Ltd	100	Farming
Funeral Services Ltd	100	Funeral directors
Millgate Insurance Brokers Ltd	100	Insurance broking
National Co-operative Chemists Ltd	99	Pharmaceutical retailing
Rochpion Properties (4) LLP	100	Holds property
The Fairways Partnership Ltd (vi)	87	Funeral directors
The Fairways Funeral Partnership Ltd (vi)	87	Funeral directors
The Co-operative Trust Corporation Ltd	75	Charity
The Co-operative Pharmacy National Distribution Centre Ltd	100	Pharmacy distribution
Donald Wardle & Son Ltd	100	Pharmacy
Somerfield Ltd	100	Investment holding
Somerfield Stores Ltd	100	Food retailing
The Co-operative Motor Group Ltd	100	Motors retailing
Co-operative Group Food Ltd	100	Food retailing
Co-operative Group Estates Ltd (iii)	100	Property management
Co-operative Group Travel Holdings Ltd	100	Travel agents
Co-operative Group Travel Ltd	100	Travel agents

For information on the Group's principal associated undertakings, refer to Note 19.

Notes

i) All the principal subsidiaries have been audited by KPMG Audit Plc or its associate.

ii) All of the Group's financial services subsidiaries have a year end of 31 December. For more details on this, refer to the Group's accounting policies on page 53.

iii) All the other principal trading subsidiaries have year-ends that are co-terminus with the Society, with the exception of CRS (Properties) Ltd and Co-operative Group Estates Ltd (both 31 January).

iv) Unity Trust Bank plc is a subsidiary of the Group because The Co-operative Bank plc elects a majority of directors and appoints the chair and managing director of Unity Trust Bank plc.

v) Indirectly held subsidiaries.

vi) The minority shareholdings of these subsidiaries were acquired on 16 February 2010.

54 Risk management

The Board is responsible for approving the Group's strategy, its principal markets and the level of acceptable risks. The Group operates a risk management process that identifies the key risks facing each business. Each business and division has a risk register that identifies the likelihood and impact of those risks occurring and the actions being taken to manage those risks. For further information regarding the Group's approach to risk management please refer to the 'Principal risks and uncertainties' section from pages 27 to 29.

The principal risks facing the Group are set out below in the context of: Trading Group risk; Banking risk; and Insurance risk.

Trading Group risk

Credit risk

Credit risk arises from the possibility of customers and counterparties failing to meet their obligations to the Trading Group. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. Credit evaluations are performed on all customers requiring credit over a certain amount. The Trading Group does not require collateral in respect of financial assets. The majority of businesses in the Trading Group have cash-based rather than credit-based sales hence customer credit risk is relatively small.

Investments are allowed only in liquid securities and only with counterparties that have a credit rating equal to or better than the Trading Group. Transactions involving derivative financial instruments are with counterparties with whom the Trading Group has a signed netting agreement as well as sound credit ratings. Given their high credit ratings, management has no current reason to expect that any counterparty will fail to meet its obligations.

At the balance sheet date there were no significant concentrations of credit risk. Further information regarding the age profile of trade receivables is shown in Note 24. The carrying value of all balances that attract a credit risk, which represents the maximum exposure, is set out below:

	Carrying amount 2009 £m	Carrying amount 2008 £m
Trade and other receivables (excluding prepayments and accrued income)	**405.9**	442.5
Interest rate swaps	**10.5**	16.6
Forward exchange contracts	**0.1**	0.5
Cash deposits	**346.9**	8.6

Interest rate risk

Hedging

Interest rate risk arises from movements in interest rates that impact on the fair value of the assets and liabilities and related finance flows. The Trading Group adopts a policy of ensuring that between 30-80% of its exposure to changes in interest rates on borrowings is on a fixed-rate basis. The fixed proportion as at 2 January 2010 was 57%. Interest rate swaps, denominated exclusively in sterling, have been entered into to achieve an appropriate mix of fixed and floating rate exposure within the Trading Group's policy. The swaps mature over the next eight years following the maturity of the related loans (see the following table) and have fixed swap rates ranging from 1.98–5.68%. At 2 January 2010, the Trading Group had interest rate swaps with a notional contract amount of £1,146.3m (2008: £669.7m), the increase arising from the acquisition of Somerfield.

The Trading Group does not designate interest rate swaps or forward foreign exchange contracts as hedging instruments. Derivative financial instruments that are not hedging instruments are classified as held for trading by default and thus fall into the category of financial assets at fair value through income statement. Derivatives are subsequently stated at fair value, with any gains and losses being recognised in the income statement.

The net fair value of swaps at 2 January 2010 was a net liability of £85.5m (2008: £19.4m) comprising assets of £10.5m (2008: £16.6m) and liabilities of £96.0m (2008: £36.0m). These amounts are recognised as fair value derivatives.

54 Risk management continued

Effective interest rates and repricing analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the periods in which they reprice.

2009	Effective interest rate	Total £m	6 months or less £m	6–12 months £m	1–2 years £m	2–5 years £m	More than 5 years £m
Cash and cash equivalents	0.490%	346.9	346.9	–	–	–	–
Secured debt:							
First mortgage debenture 2018	7.625%	(50.0)		–	–	–	(50.0)
Investment Properties Loan	0.612%	(196.0)	(1.4)	(1.5)	(3.5)	(10.6)	(179.0)
Effect of interest rate swap	4.633%	–	–	–	–	–	–
Unsecured bond issued:							
% Fixed-rate sterling eurobond	5.875%	(200.0)	–	–	–	(200.0)	–
% Effect of interest rate swaps	-3.600%	200.0	–	–	–	200.0	–
Other unsecured loans	0.591%	(1,366.4)	(1,360.0)	–	–	(6.4)	–
Effect of interest rate swaps	2.347%	–	750.3	–	(6.3)	(176.0)	(568.0)
Corporate investor shares	1.360%	(36.7)	(31.8)	(4.9)	–	–	–
Finance lease liabilities		(16.6)	(2.0)	(2.4)	(2.6)	(7.7)	(1.9)
		(1,318.8)	(298)	(8.8)	(12.4)	(200.7)	(798.9)

2008	Effective interest rate	Total £m	6 months or less £m	6–12 months £m	1–2 years £m	2–5 years £m	More than 5 years £m
Cash and cash equivalents	1.25%	167.5	167.5	–	–	–	–
Secured debt:							
First mortgage debenture 2018	7.625%	(50.0)	–	–	–	–	(50.0)
Investment Properties Loan	2.384%	(199.2)	(1.9)	(1.3)	(2.9)	(9.9)	(183.2)
Effect of interest rate swap	2.861%	–	–				
Unsecured bond issued:							
% Fixed-rate sterling eurobond	5.875%	(200.0)	–	–	–	(200.0)	–
Effect of interest rate swaps	1.26%	–	(200.0)	–	–	200.0	–
Yen floating rate loan (1)	0.92%	(38.6)	(38.6)	–	–	–	–
Yen floating rate loan (2)	0.92%	(94.0)	(94.0)	–	–	–	–
Effect of interest rate swap	0.47%						
Other unsecured loans	2.384%	(126.4)	(86.3)	(12.9)	(6.8)	(20.4)	–
Effect of interest rate swaps	2.803%	(29.9)	86.3	(93.4)	6.8	(29.6)	–
Corporate investor shares	3.50%	(47.6)	(45.0)	(2.6)			
Finance lease liabilities		(1.4)	(0.7)	–	(0.7)	–	–
		(619.6)	(212.7)	(110.2)	(3.6)	(59.9)	(233.2)

Foreign currency risk

The Trading Group is exposed to foreign currency risk on purchases and borrowing that are denominated in a currency other than sterling. The currencies giving rise to this risk are primarily Euro and US Dollars.

The Trading Group hedges at least 90% of all trade payables denominated in a foreign currency. At any point in time the Trading Group also hedges 90% of its estimated foreign currency exposure in respect of orders placed and not invoiced over the following four months. The Trading Group uses forward exchange contracts to hedge its foreign currency risk. The forward exchange contracts have maturities of less than one year after the balance sheet date. Where necessary, the forward exchange contracts are rolled over at maturity.

In respect of other monetary assets and liabilities held in currencies other than sterling, the Trading Group ensures that the net exposure is kept to an acceptable level, by buying or selling foreign currencies at spot rates where necessary to address short-term imbalances.

At 2 January 2010, the Trading Group had forward currency transactions, primarily in Euro and US Dollars and Japanese Yen, with a notional contract amount of £16.0m (2008: £117.3m).

54 Risk management continued

Liquidity risk

As at 2 January 2010, the Trading Group had available borrowing facilities totalling £2,036m (2008: £999m), which comprised committed facilities of £40m and uncommitted facilities of £1,996m (2008: £944m). These are detailed below:

Bank Facilities as at 2 January 2010

	Expiry	£m
Uncommitted facilities	**July 2010/August 2010**	**40.0**
Syndicate Term Loan	**July 2013**	**1,250.0**
Syndicate Revolving Credit Facility	**July 2013**	**300.0**
Secured Investment Property Bilateral	**September 2015**	**196.0**
		1,786.0
Debenture	**December 2018**	**50.0**
Eurobond Issue	**December 2013**	**200.0**
		2,036.0

The following are the maturities of financial liabilities as at 2 January 2010:

	Carrying amount £m	Contractual cash flows £m	6 months or less £m	6–12 months £m	1–2 yrs £m	2–5 yrs £m	5 yrs or more £m
Non-Derivative Financial liabilities							
Secured bank loans	**(196.0)**	**(196.0)**	**(1.4)**	**(1.5)**	**(3.5)**	**(10.6)**	**(179.0)**
Secured debenture	**(52.3)**	**(50.0)**	**–**	**–**	**–**	**–**	**(50.0)**
Unsecured bank facility	**(1,366.4)**	**(1,366.4)**	**–**	**–**	**(100.0)**	**(1,266.4)**	**–**
Sterling Eurobond	**(206.2)**	**(200.0)**	**–**	**–**	**–**	**(200.0)**	**–**
Finance lease liabilities	**(16.6)**	**(16.6)**	**(2.0)**	**(2.4)**	**(2.6)**	**(7.7)**	**(1.9)**
Trade and other payables	**(1,959.1)**	**(1,959.1)**	**(702.3)**	**(733.4)**		**(10.3)**	**(513.1)**
Derivative Financial liabilities							
Interest rate swaps used for hedging	**(96.0)**	**(96.0)**	**–**	**–**	**(0.9)**	**(4.1)**	**(91.0)**

Sensitivity analysis

Interest rate risk

At 2 January 2010, if sterling (GBP) market interest rates had been 1% higher/lower with all other variables held constant, post-tax profit for the year would have been GBP £17.9m (2008: GBP £16.1m) higher and GBP £5m (2008: GBP £9.8m) lower respectively, mainly arising from the revaluation of the Society's £250m quoted debt marked to market through the consolidated income statement. Profit is relatively less sensitive to movements in GBP interest rates due to the level of borrowings' fixed-interest cover in place as disclosed under 'hedging'.

Foreign exchange risk

At 2 January 2010, if the Euro, US dollar, Australian dollar and New Zealand dollar had all strengthened by 10% against sterling (GBP) with all variables held constant, post-tax profit for the year would have been £1.2m (2008: £0.5m) lower, mainly as a result of foreign exchange losses on translation of EUR-denominated trade payables. Conversely, if the Euro, US dollar, Australian dollar and New Zealand dollar had all weakened by 10% against sterling (GBP) with all variables held constant, post-tax profit for the year would have been £1.1m (2008: £0.4m) higher.

Guarantees

In the course of conducting its operations, the Trading Group is required to issue bank guarantees and bonds in favour of various counterparties. These facilities are provided by the Trading Group's banking syndicate and as at 2 January 2010 the total amount of guarantees/bonds outstanding is £70.9m (2008: £68.8m).

54 Risk management continued

Fair values of the trading group

The fair value of financial assets and liabilities together with the carrying amounts shown in the balance sheet at 2 January 2010 are as follows:

	Carrying amount 2009 £m	**Fair value 2009 £m**	Carrying amount 2008 £m	Fair value 2008 £m
Financial assets				
Trade and other receivables	**527.2**	**527.2**	442.5	442.5
Cash and cash equivalents	**346.9**	**346.9**	167.5	167.5
Derivative financial assets and liabilities				
Interest rate swaps:				
Assets	**10.5**	**10.5**	16.6	16.6
Liabilities	**(96.0)**	**(96.0)**	(36.0)	(36.0)
Non-derivative financial liabilities				
Forward exchange contracts:				
Assets	**0.1**	**0.1**	0.5	0.5
Liabilities	**(0.1)**	**(0.1)**	(1.1)	(1.1)
Secured debt				
First mortgage debenture 2018	**(52.3)**	**(52.3)**	(54.2)	(54.2)
Other secured loans	**(196.0)**	**(196.0)**	(199.2)	(199.2)
Unsecured bond issue:				
Fixed-rate sterling eurobond	**(206.2)**	**(206.2)**	(171.5)	(171.5)
Funeral bonds	**(476.2)**	**(476.2)**	(319.5)	(319.5)
Unsecured bank facilities				
Yen floating rate loan (1)	**–**	**–**	(38.6)	(38.6)
Yen floating rate loan (2)	**–**	**–**	(94.0)	(94.0)
Other unsecured loans	**(1,366.4)**	**(1,366.4)**	(126.4)	(126.4)
Corporate investor shares	**(36.8)**	**(36.8)**	(47.6)	(47.6)
Finance lease liabilities	**(16.6)**	**(16.6)**	(1.4)	(1.4)
Trade and other payables (excluding accruals, deferred income and funeral bonds)	**(1,251.0)**	**(1,251.0)**	(904.1)	(904.1)

Estimation of fair values

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the table.

Securities

Fair value is based on quoted market prices at the balance sheet date without any deduction for transaction costs.

Derivatives

Forward exchange contracts are either marked to market using listed market prices or by discounting the contractual forward price and deducting the current spot rate. For interest rate swaps, broker quotes are used. Those quotes are back-tested using pricing models or discounted cash flow techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate for a similar instrument at the balance sheet date. Where other pricing models are used, inputs are based on market-related data at the balance sheet date.

Interest-bearing loans and borrowings

These are shown at amortised cost.

Trade and other receivables/payables

For receivables/payables, the notional amount is deemed to reflect the fair value.

Determination of fair values

The fixed rate sterling eurobond and the first mortgage debenture values are determined in whole by using quoted market prices. The interest rate swap values are determined in whole by counterparties who use discounted cashflow calculated valuations. The forward exchange contracts are valued using an internal valuation technique. All other assets and liabilities stated in the table above are held at par value.

54 Risk management continued

Interest rates used for determining fair value

The Trading Group uses the government yield curve as of 2 January 2010 plus an adequate constant credit spread to discount financial instruments.

The interest rates used are as follows:

	2009	2008
Derivatives	**0.95–3.99%**	0.78–3.23%
Loans and borrowings	**4.95–8.02%**	4.77–6.49%

Banking risk

Credit risk

Credit risk is the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the bank or its failure to perform as agreed. Credit risk is an integral part of many of our business activities and is inherent in 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 and securities borrowing and lending transactions).

The Credit Risk Management Policies are approved by the CFS Risk Management Committee (RMC) annually and are the responsibility of the Director of Banking Risk and Capital Management. The policies determine the criteria for the management of retail, corporate and wholesale market exposures and credit management standards including country, sector and counterparty limits along with delegated authorities. Larger corporate facilities are sanctioned by the Board's Exposures Committee who also review, each month, facilities granted within the CFS Chief Executive's discretion.

All authority to take credit risk derives from the CFS Board. This is delegated through authorities to individuals or committees via the Chief Executive. The level of credit risk authority delegated to holders depends upon their seniority and experience, varying according to the quality of the counterparty and any associated security or collateral.

The Co-operative Bank's Personal Lending Policy is to establish credit criteria that determine the optimum balance between volume growth (generating higher income) and higher bad debts, so as to maximise overall profitability. The quality of the portfolio and individual customers is monitored, using risk rating systems and score cards calibrated to risk of default and expected loss, and the Board receives an update on bad debt bi-annually. The Risk Management Committee receives regular reports on the performance of the portfolio.

The Co-operative Bank's Corporate Sector Policy is to maintain a broad sectoral spread of exposures that reflect the bank's areas of expertise. Credit exposures to corporate and business banking customers are assessed individually. The quality of the overall portfolio is monitored, using a credit grading system calibrated to expected loss. All aspects of credit management are controlled centrally. The RMC receives regular reports on the performance of the portfolio.The Exposures Committee receives regular reports on new facilities and changes in facilities, sector exposures, bad debt provisions and the realisation of problem loans.

The Co-operative Bank's Wholesale markets credit risk framework takes a holistic approach to risk management with, at its centre, a credit risk policy that governs the types of exposure the business can take and sets concentration parameters. To complement this, individual authority is delegated in terms of Internal Rating Grade (IRG) and associated Probability of Default (PD) to approve limits to individual counterparties within the parameters established by the credit risk policy. The RMC receives regular reports on the performance of the portfolio. The Exposures Committee receives regular reports on changes in exposure limits, watchlist and problem counterparty information.

Cash and balances at central banks are considered to be risk-free and have been excluded from the following analysis of credit exposure.

54 Risk management continued

Credit exposure	Gross balance £m	2009 Credit commitments £m	Credit risk exposure £m	2008 Credit risk exposure £m
Loans and advances to banks	**1,781.5**	**113.8**	**1,895.3**	1,725.5
Loans and advances to customers	**34,240.7**	**5,021.3**	**39,262.0**	15,759.0
Investment securities	**2,500.7**	**–**	**2,500.7**	145.9
Investment securities – available for sale	**4,529.1**	**–**	**4,529.1**	2,191.5
Derivative financial instruments	**1,023.0**	**–**	**1,023.0**	228.7
	44,075.0	**5,135.1**	**49,210.1**	20,050.6
Allowance for impairment losses on loans and advances			**(194.0)**	(187.9)
Impairment losses on investments securities			**(86.4)**	(92.3)
Carrying amount			**48,929.7**	19,770.4

Credit risk analysis

	Loans and advances to banks £m	Loans and advances to customers £m	Investment Securities Loans and receivables £m	Investment Securities Available for sale £m	Derivative financial instruments £m	2009 Total £m	2008 Total £m
Individually impaired							
90 days past due or evidence of impairment	**–**	**2,100.3**	**25.0**	**71.9**	**–**	**2,197.2**	238.1
Impairment recognised	**–**	**(53.6)**	**(8.5)**	**(71.9)**	**–**	**(134.0)**	(129.4)
Carrying amount	**–**	**2,046.7**	**16.5**	**–**	**–**	**2,063.2**	108.7
Collectively impaired							
Less than 90 days past due	**–**	**212.1**	**124.3**	**–**	**–**	**336.4**	163.6
90–179 days past due	**–**	**22.6**	**–**	**–**	**–**	**22.6**	27.6
180 days plus past due	**4.6**	**143.0**	**–**	**–**	**–**	**147.6**	127.1
Impairment recognised	**–**	**(140.4)**	**(6.0)**	**–**	**–**	**(146.4)**	(150.8)
Carrying amount	**4.6**	**237.3**	**118.3**	**–**	**–**	**360.2**	167.5
Past due but not impaired							
0–29 days past due	**–**	**287.0**	**–**	**–**	**–**	**287.0**	11.5
30–59 days past due	**–**	**125.0**	**–**	**–**	**–**	**125.0**	2.2
60–89 days past due	**–**	**52.1**	**–**	**–**	**–**	**52.1**	1.3
Carrying amount	**–**	**464.1**	**–**	**–**	**–**	**464.1**	15.0
Neither past due nor impaired							
Low to medium risk	**1,890.7**	**28,669.4**	**2,351.4**	**4,457.2**	**1,023.0**	**38,391.7**	17,102.8
Medium to high risk	**–**	**7,650.5**	**–**	**–**	**–**	**7,650.5**	2,376.4
Carrying amount	**1,890.7**	**36,319.9**	**2,351.4**	**4,457.2**	**1,023.0**	**46,042.2**	19,479.2
Total carrying amount	**1,895.3**	**39,068.0**	**2,486.2**	**4,457.2**	**1,023.0**	**48,929.7**	19,770.4

Analysis of impaired assets and associated collateral

Impaired assets

Loans and 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. For available-for-sale investment securities, particular consideration is given to evidence of any significant financial difficulty of the issuer or measurable decrease in the estimated cash flows from the investments.

The loan portfolios are reviewed on a continuous basis to assess impairment. In determining whether a bad debt provision should be recorded, judgements 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 prior to the balance sheet date.

54 Risk management continued

Corporate loans and Retail Mortgage lending with evidence of impairment including 90 days past due are individually assessed for impairment. Collectively impaired assets include unsecured retail lending balances. Provisions are applied to credit card balances at 30 days past due and at 45 days past due on all other unsecured retail lending balances.

At the balance sheet date, the bank assesses its debt securities for objective evidence that an impairment loss has now occurred. For a debt security this may be the disappearance of an active market. Impairment has been assessed from evidence that a loss event has occurred and whether the loss event has a negative effect on future cash flows.

Past due

Loans and securities are considered past due where the contractual interest or principal payment are in arrears, but the bank believes that impairment is not appropriate as a trigger point for impairments has not been reached; this could be the stage of collection of amounts owed to the bank. In the table, past due but not impaired represents mortgage and unsecured retail lending balances past due but not considered impaired. This includes credit card exposures less than 30 days and 45 days for other retail unsecured lending.

Within the credit risk analysis table, low to medium risk has been defined as exposures where probability of default (PD) is 1% or below over a one-year time horizon for exposures on IRB Approach under Basel II and slotting category strong/good/satisfactory for specialised lending exposures under the slotting approach. Medium to high risk has been defined as a probability of default of greater than 1% over a one-year time horizon for exposure on IRB Approach under Basel II and slotting category weak for specialised lending exposures under the slotting approach.

Loans with renegotiated terms are loans that have been renegotiated due to the deterioration in the borrower's financial position but where the Group has agreed concessions that remain commercial. These renegotiated loans are considered as continuing to be impaired, and as such these are disclosed as impaired.

Within the Treasury debt security portfolio, over 82% of exposures have an external credit rating equivalent to Fitch A or above.

The factors considered in determining if financial assets are individually impaired are stated above and within critical judgements on pages 51 to 52.

Fair value adjustments and provisions held against impaired exposures

When Britannia Building Society merged with the Co-operative Bank, the heritage Britannia lending portfolios were carried into the newly merged entity at their fair value, taking account of future lifetime expected loss on the lending portfolios at 31 July 2009. The lifetime expected loss adjustment is offset against the heritage Britannia gross lending balances in the combined entity's accounts. For 2009 the balance sheet impairment provision and income statement charge in the Bank financial statements relates solely to heritage Bank lending portfolios. In future years this will also incorporate any loss provisions on new business generated by the merged entity and any additional loss provisions not covered by the lifetime expected loss calculation on the heritage Britannia lending portfolios.

Description of collateral

The Co-operative Bank uses collateral and guarantees to mitigate credit risk. Collateral is regularly revalued and guarantees reviewed to ensure continuing effectiveness. The majority of collateral held is not eligible financial collateral, but is real estate collateral either as retail mortgages or real estate collateral held against corporate lending.

When calculating the value of collateral for regulatory capital risk mitigation purposes, the appropriate valuation criteria contained within BIPRU is applied. Robust policies are in place to manage collateral and valuation.

Where exposures are agreed on a secured basis, security cover is taken into account 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.

Eligible financial collateral includes gilts held as part of reverse repo agreements, and cash as part of collaterised swaps or against corporate lending. The guarantees include parental guarantees held against subsidiary exposures.

At the reporting date, the fair value of collateral as security against financial assets that are past due but not impaired was £966.9m (2008: £20.4m).
At the reporting date, the fair value of collateral as security against individually impaired financial assets was £2,037.3m (2008: £61.3m).
At the reporting date, the carrying value of assets obtained by taking possession of collateral or by calling on guarantees was £229.0m (2008: £1.4m).

54 Risk management continued

Market risk

Market risk arises from the effect of changes in market prices of financial instruments, on income derived from the structure of the balance sheet, execution of customer and inter-bank business and proprietary trading. The majority of the risk arises from changes in interest rates as The Co-operative Bank does not trade in equities or commodities and has limited foreign currency activities.

Interest Rate Risk Policy Statements, approved by the CFS Risk Management Committee on behalf of the Board, specify the scope of The Co-operative Bank's wholesale market activity, market risk limits and delegated authorities. The policy is executed by The Co-operative Bank's Asset and Liability Committee (ALCO). ALCO meets monthly and its prime task is to assess the interest rate risk inherent in the maturity and repricing characteristics of The Co-operative Bank's assets and liabilities. It sets limits within which Treasury and the CFS's Corporate Finance department manage the effect of interest rate changes on The Co-operative Bank's overall net interest income. Treasury are responsible for interest rate risk management for Treasury, and CFS' Corporate Finance department manages interest rate risk within the rest of the Co-operative 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 quarterly reports on the management of balance sheet risk and, each month, ALCO reviews the balance sheet risk position and the utilisation of wholesale market risk limits.

Non-Treasury interest rate risk

The bank (excluding Wholesale) uses a gap report and earnings approach to manage interest rate risk, focusing in detail on the sensitivity of assumed changes in interest rates on net interest income for one year. Higher level analysis is performed for subsequent years. The bank does not consider economic value an appropriate measure for interest rate risk in the non-trading book (excluding Treasury).

ALCO, the Board sub-committee responsible for monitoring compliance with interest rate risk limits, meets on a monthly basis. ALCO monitors the non-trading interest rate risk which is split between certain Treasury portfolios, banking and investment books, and the rest of the Bank. The Bank non-trading portfolios excluding these certain Treasury portfolios, are managed by Corporate Finance. All interest rate risk is centralised into Corporate Finance using appropriate transfer pricing rates.

The management of interest rate risk is supplemented by the use of gap reports, which 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) is no more than a set limit.

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. Drawdown risk, in particular for fixed-rate mortgages, is managed through weekly balance sheet meetings. Corporate Finance undertake hedges for interest rate risk using derivative instruments and investment securities, which are executed via Treasury to wholesale markets, and loans and deposits which are executed internally with Treasury.

The table below illustrates the sensitivity analysis relating to The Co-operative Bank's non-trading book (excluding Treasury) prepared by Corporate Finance, a primary measure in the approach to managing interest rate risk.

The table illustrates the estimated change in net income over the 12-month periods shown based on a 1% shock in interest rates at the beginning of the year across the yield curve on the Bank's balances excluding Wholesale Treasury and customer currency balances, which are managed within the Treasury Risk framework. The percentage change in forecast net interest income (NII) as a proportion of cumulative net interest income for the 12 months is shown overleaf. The shock results are driven by product pricing and product mix. The extent of rate movements and low rate environment have impacted the repricing of liability products resulting in larger exposure to rate shocks.

54 Risk management continued

Change in net interest income over the 12 months based on 100bp shock in interest rates at the beginning of the year (£m)

	100bp parallel increase	100bp parallel decrease
2009		
At the period-end	(0.2)	1.9
Average for the period	(4.4)	5.7
Maximum for the period	3.4	25.6
Minimum for the period	(23.3)	(3.7)
2008		
At the year-end	(5.6)	(6.4)
Average for the period	(5.8)	(6.4)
Maximum for the period	(2.8)	(9.5)
Minimum for the period	(8.8)	(3.5)

Treasury interest rate risk

Treasury executes short-term funding and hedging transactions with the wholesale markets on behalf of the Bank and its customers. It also generates incremental income from proprietary trading within strict risk limits. There are two prime measures of risk supplemented by additional controls such as maturity and stop loss limits. Risk units express the various re-pricing and maturity mismatches as a common unit of measurement. PV100 shows the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates. Value at Risk (VaR) measures the daily maximum potential gain or loss due to recent market volatility within a statistical confidence level of 95% and a one day holding period. Simulation is being developed to provide Value at Risk calculations to cover the combined Core Banking Book positions. 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 by the Bank as the sole measure of risk.

PV100

This illustrates the change in valuation on a fixed income portfolio experienced given a 1% increase and decrease in interest rates for Treasury, representing Treasury Banking Book and Trading Book combined. PV100 is the effect on the net present value (NPV) of the Treasury portfolio to a parallel shift of 100 basis points upon the base yield curve. The effects of a 1% increase in interest rates are £0.4m (2008: £3.1m) and a 1% decrease (£0.2m) (2008: £3.1m)

Currency risk

The Bank's Treasury foreign exchange activities are primarily:

- 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 intra-day trading and overnight positioning in major currencies to generate incremental income.

54 Risk management continued

The table below provides an analysis of The Co-operative Bank's assets and liabilities by currency at 2 January 2010.

	Sterling £m	US Dollars £m	Euro £m	Other £m	2009 Total £m	2008 Total £m
Assets						
Cash and balances at central banks	**1,706.8**	**–**	**–**	**–**	**1,706.8**	535.8
Loans and advances to banks	**1,377.9**	**101.5**	**293.8**	**8.3**	**1,781.5**	1,524.2
Loans and advances to customers	**33,697.9**	**72.2**	**261.0**	**15.6**	**34,046.7**	10,173.0
Fair value adjustments for hedged risks	**66.1**	**–**	**–**	**–**	**66.1**	–
Investment securities-loans and receivables	**1,862.7**	**137.3**	**426.6**	**59.6**	**2,486.2**	123.4
Investment securities-available for sale	**2,441.0**	**613.3**	**1,042.4**	**360.6**	**4,457.3**	2,121.7
Derivative financial instruments	**1,022.7**	**–**	**0.3**	**–**	**1,023.0**	228.7
Equity shares	**7.2**	**–**	**–**	**–**	**7.2**	13.0
Investments in joint ventures	**1.8**	**–**	**–**	**–**	**1.8**	–
Goodwill	**0.6**	**–**	**–**	**–**	**0.6**	–
Intangible fixed assets	**46.1**	**–**	**–**	**–**	**46.1**	2.3
Investment properties	**137.7**	**–**	**–**	**–**	**137.7**	–
Property, plant and equipment	**121.5**	**–**	**–**	**–**	**121.5**	59.6
Amounts owed by group undertakings	**91.0**	**–**	**–**	**–**	**91.0**	137.9
Other assets	**20.9**	**0.3**	**0.8**	**0.1**	**22.1**	31.2
Prepayments and accrued income	**30.1**	**–**	**–**	**–**	**30.1**	13.0
Deferred tax assets	**93.7**	**–**	**–**	**–**	**93.7**	–
Total assets	**42,725.7**	**924.6**	**2,024.9**	**444.2**	**46,119.4**	14,963.8
Liabilities						
Deposits by banks	**4,056.5**	**488.0**	**1,397.5**	**140.4**	**6,082.4**	1,073.3
Customer accounts	**30,755.6**	**22.4**	**46.3**	**3.9**	**30,828.2**	11,690.0
Capital bonds	**1,647.1**	**–**	**–**	**–**	**1,647.1**	–
Debt securities in issue	**3,201.0**	**123.8**	**9.5**	**–**	**3,334.3**	571.5
Derivative financial instruments	**580.3**	**4.2**	**6.8**	**–**	**591.3**	119.7
Other borrowed funds	**946.5**	**–**	**–**	**–**	**946.5**	366.5
Amounts owed to group undertaking	**329.2**	**–**	**–**	**–**	**329.2**	225.5
Other liabilities	**220.2**	**0.9**	**0.8**	**–**	**221.9**	91.7
Accruals and deferred income	**158.0**	**–**	**–**	**–**	**158.0**	1.6
Provisions	**33.4**	**–**	**–**	**–**	**33.4**	15.8
Current tax liabilities	**71.0**	**–**	**–**	**–**	**71.0**	1.2
Deferred tax liabilities	**–**	**–**	**–**	**–**	**–**	27.0
Total liabilities	**41,998.8**	**639.3**	**1,460.9**	**144.3**	**44,243.3**	14,183.8
Net on cash required balance sheet position	**726.9**	**285.3**	**564.0**	**299.9**	**1,876.1**	780.0

At 2 January 2010 the Group's open position was £0.7m (2008: £0.7m) representing a potential loss of £nil given a 3% depreciation in sterling (2008: £nil). The Group's open position is monitored against limits in addition to limits in place on individual currencies. All figures are in £ sterling equivalent.

Liquidity risk

Liquidity risk arises from the timing of cash flows generated from the Group's assets, liabilities and off-balance sheet instruments. The Group's liquidity management policies are reviewed and approved annually by the Risk Management Committee and compliance reviewed monthly by ALCO.

54 Risk management continued

Liquidity risk arising from the structure of the balance sheet (structural liquidity) is managed to policies developed by ALCO. Liquidity risk is defined as the Board approved survival period under stress scenarios. The Bank undertakes the following stress tests on a weekly basis:

- A moderate firm specific stress which assumes a credit rating notch downgrade and consequential outflows
- A severe firm specific stress which assumes a two notch credit rating downgrade and consequential outflows
- An idiosyncratic stress scenario which assumes a two notch credit rating downgrade and a 'run' on the bank defined as twice the worst gross outflows experienced over the last 10 years
- A moderate market wide stress which assumes a restriction in the operation of wholesale markets
- A severe market wide stress which assumes a total restriction in the operation of wholesale markets.

The Bank's liquidity management framework is designed in line with industry guidelines, including IIF (Institute of International Finance) and BIS (Bank for International Settlements) recommendations, and is being developed in response to emerging FSA requirements.

The Bank manages liquidity risk by applying:

- A rigorous control process embedded in the bank's operations;
- Robust liquidity management with:
  - Net outflows monitored to ensure they are within FSA limits;
  - Maintenance of a well-diversified deposit base;
  - Management of stocks: high-quality primary liquidity including cash, and secondary liquidity including certificates of deposit;
  - Target funding ratio and funding ratios translated into Retail and Corporate targets.

Day-to-day cash flow (tactical liquidity) is managed by Treasury within guidelines laid down by ALCO and in accordance with the standards established for all banks by banking regulators.

The Bank has a high proportion of retail assets funded by retail deposits, ensuring there is no over reliance on wholesale funding. There is a target funding ratio set in line with the Board approved strategic plan, which is being met. The Group's structural liquidity risk management is therefore retail based and is dependent on behavioural analysis of both customer demand and deposit and loan drawdown profiles by product category based on experience over the last 10 years. The behaviour of retail products is reviewed by ALCO on a quarterly basis. In addition the Group has maturity mismatch limits to control the exposure to longer-term mismatches.

The Bank's liquidity position is monitored on a daily basis and reported to ALCO each month. Treasury holds a pool of liquid assets of £2.5bn on behalf of the Bank, and actionable management actions are in place to provide an additional £1.5bn of liquidity. These sources of liquidity totalling £4.0bn are held in order to be available to meet unexpected liquidity requirements.

Marketable assets are maintained as a liquidity pool against potential retail outflows; the asset quality of these is controlled via credit limits. Concentration limits are set by issuer name and holding per bond to ensure diversity of assets.The Bank has access to a variety of medium-term wholesale funding sources: securitisation, covered bond and EMTN. The Bank will issue from the programmes as funding requirements and market conditions permit.

The Bank has access to a variety of medium term wholesale funding sources: securitisation, covered bond and EMTN. The Bank will issue from the programmes a funding requirements and market conditions permit.

Liquidity gap

The following table analyses assets and liabilities into relevant maturity groupings based on the remaining period of the balance sheet date to the contractual maturity date.

The bank manages liquidity on a behavioural rather than contractual basis of reflecting where actual behaviour differs from contractual maturity:

- Retail and Corporate deposit bases are very stable with deposits being attracted to the bank by good customer service on its ethical policy. As a result, the deposit base remains stable whereas the contractual maturity is immediate for instant access deposits.
- Personal loan and Visa balances are repaid earlier than their contractual maturity date.

These behavioural adjustments are based on historical experience of customer behaviour over a period of up to 10 years.

As the bank manages liquidity on a behavioural basis, both the liquidity gap analysis and cash flow maturity analysis have been disclosed on a contractual and behavioural basis.

	Repayable on demand £m	3 months or less but not repayable on demand £m	1 year or less but over 3 months £m	5 years or less but over 1 year £m	Over 5 years £m	Non-cash items £m	2009 Total £m	2008 Total £m
Assets								
Loans and advances to banks	**272.9**	**1,492.6**	**–**	**32.4**	**–**	**(16.4)**	**1,781.5**	1,524.0
Loans and advances to customers	**1,024.6**	**2,667.2**	**1,584.6**	**7,048.6**	**22,553.0**	**(765.2)**	**34,112.8**	10,173.0
Investment securities – loans and receivables	**–**	**105.7**	**391.3**	**1,808.5**	**524.7**	**(344.0)**	**2,486.2**	123.4
Investment securities – available-for-sale	**–**	**1,076.4**	**874.7**	**1,705.0**	**801.6**	**(0.4)**	**4,457.3**	2,121.7
Debt securities	**1.5**	**89.5**	**–**	**–**	**–**	**–**	**91.0**	137.9
Other assets	**1,881.0**	**135.1**	**149.3**	**490.3**	**74.2**	**460.7**	**3,190.6**	883.6
	3,180.0	**5,566.5**	**2,999.9**	**11,084.8**	**23,953.5**	**(665.3)**	**46,119.4**	14,963.6
Liabilities								
Deposits by banks	**420.8**	**4,421.1**	**701.3**	**537.9**	**1.3**	**–**	**6,082.4**	1,073.3
Customer accounts	**19,137.6**	**3,216.5**	**6,246.8**	**2,213.7**	**–**	**13.6**	**30,828.2**	11,690.0
Customer accounts – capital bonds	**–**	**57.5**	**356.7**	**1,173.6**	**59.3**	**–**	**1,647.1**	–
Debt securities in issue	**–**	**944.4**	**436.5**	**2,590.6**	**551.6**	**(1,188.8)**	**3,334.3**	571.5
Other borrowed funds	**–**	**7.6**	**–**	**–**	**1,232.0**	**(293.1)**	**946.5**	358.4
Amounts owed by other Co-operative Group undertakings	**58.2**	**271.0**	**–**	**–**	**–**	**–**	**329.2**	225.5
Other liabilities	**95.8**	**17.8**	**62.7**	**326.5**	**99.0**	**473.8**	**1,075.6**	265.1
	19,712.4	**8,935.9**	**7,804.0**	**6,842.3**	**1,943.2**	**(994.5)**	**44,243.3**	14,183.8
Net liquidity gap – Contractual basis	**(16,532.4)**	**(3,369.4)**	**(4,804.1)**	**4,242.5**	**22,010.3**	**329.2**	**1,876.1**	780.7
Behavioural adjustments:								
Loans and advances to customers	**–**	**(235.3)**	**(598.9)**	**(2,137.8)**	**2,972.0**	**–**	**–**	–
Customers' accounts	**17,556.9**	**(44.3)**	**2,328.8**	**(19,841.4)**	**–**	**–**	**–**	–
Net liquidity gap – Behavioural basis	**1,024.5**	**(3,649.0)**	**(3,074.2)**	**(17,736.7)**	**24,982.3**	**329.2**	**1,876.1**	780.7

Gross contractual cash flow maturity analysis

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

2009	Carrying value £m	Gross nominal outflow £m	Less than 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m
Non-derivative liabilities							
Deposits by banks	**6,082.4**	**6,812.9**	**531.4**	**4,309.4**	**710.3**	**540.5**	**1.2**
Customer accounts	**30,828.2**	**30,894.6**	**21,020.5**	**1,173.6**	**6,330.9**	**2,369.6**	**–**
Capital bonds	**1,647.1**	**1,594.3**	**11.6**	**42.8**	**343.8**	**1,139.9**	**56.2**
Debt securities	**3,334.3**	**4,256.5**	**570.0**	**232.6**	**898.0**	**2,515.7**	**40.2**
Other borrowed funds	**946.5**	**2,119.8**	**115.4**	**64.2**	**82.0**	**438.1**	**1,420.1**
Amounts owed by group undertakings	**329.2**	**329.2**	**92.6**	**236.6**	**–**	**–**	**–**
	43,167.7	**46,007.3**	**22,341.5**	**6,059.2**	**8,365.0**	**7,003.8**	**1,517.7**
Derivative liabilities							
Net outflow	**591.3**	**773.1**	**89.1**	**34.8**	**217.7**	**377.6**	**53.9**
	43,769.0	**46,780.4**	**22,430.6**	**6,094.0**	**8,582.7**	**7,381.4**	**1,571.6**
Other liabilities	**484.3**	**–**	**–**	**–**	**–**	**–**	**–**
Total recognised liabilities	**44,243.3**	**46,780.4**	**22,430.6**	**6,094.0**	**8,582.7**	**7,381.4**	**1,571.6**
Unrecognised loan commitments	**4,642.3**	**4,642.3**	**4,517.8**	**60.7**	**–**	**63.8**	**–**
Total	**48,885.6**	**51,422.7**	**26,948.4**	**6,154.7**	**8,582.7**	**7,445.2**	**1,571.6**

54 Risk management continued

2008	Carrying value £m	Gross nominal outflow £m	Less than 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m
Non-derivative liabilities							
Deposits by banks	1,073.3	1,074.5	980.6	91.4	2.5	–	–
Customer accounts	11,690.0	11,741.7	9,549.3	925.3	942.2	324.9	–
Customer accounts – capital bonds	–	–	–	–	–	–	–
Debt securities	571.5	575.3	205.1	274.0	96.2	–	–
Other borrowed funds	366.5	516.2	–	8.8	14.0	91.2	402.2
Amounts owned by group undertaking	225.5	225.5	225.5	–	–	–	–
	13,926.8	**14,133.2**	**10,960.5**	**1,299.5**	**1,054.9**	**416.1**	**402.2**
Derivative liabilities							
Net outflow	119.7	119.7	119.7	–	–	–	–
	14,046.5	**14,252.9**	**11,080.2**	**1,299.5**	**1,054.9**	**416.1**	**402.2**
Other liabilities	137.3	–	–	–	–	–	–
Total recognised liabilities	**14,183.8**	**14,252.9**	**11,080.2**	**1,299.5**	**1,054.9**	**416.1**	**402.2**
Unrecognised loan commitments	5,503.8	5,503.8	5,480.8	7.0	15.6	0.4	–
Total	**19,687.6**	**19,756.7**	**16,561.0**	**1,306.5**	**1,070.5**	**416.5**	**402.2**

Gross expected cashflow maturity analysis – behavioural

The following is an analysis of gross expected cash flow maturity for financial liabilities at the balance sheet date.

Behavioural cash flow analysis

2009	Carrying value £m	Gross nominal outflow £m	Less than 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m
Non-derivative liabilities							
Deposits by banks	**6,082.4**	**6,092.7**	**531.4**	**4,309.3**	**710.3**	**540.5**	**1.2**
Customer accountss	**30,828.2**	**30,880.9**	**1,954.3**	**2,339.6**	**4,638.9**	**21,948.1**	**–**
Capital bonds	**1,647.1**	**1,594.3**	**11.6**	**42.8**	**343.8**	**1,139.9**	**56.2**
Debt securities in issue	**3,334.3**	**4,256.4**	**570.0**	**232.6**	**898.0**	**2,515.6**	**40.2**
Other borrowed funds	**946.5**	**2,119.9**	**115.4**	**64.2**	**82.0**	**438.1**	**1,420.2**
Amounts owned by group undertakings	**329.2**	**329.2**	**92.6**	**236.6**	**–**	**–**	**–**
	43,167.7	**45,273.4**	**3,275.3**	**7,225.1**	**6,673.0**	**26,582.2**	**1,517.8**
Derivative liabilities							
Net outflow	**591.3**	**773.1**	**89.1**	**34.8**	**217.7**	**377.6**	**53.9**
	43,759.0	**46,046.5**	**3,364.4**	**7,259.9**	**6,890.7**	**26,959.8**	**1,571.7**
Other liabilities	**484.3**						
Total recognised liabilities	**44,243.3**	**46,046.5**	**3,364.4**	**7,259.9**	**6,890.7**	**26,959.8**	**1,571.7**
Unrecognised loan commitments	**5,016.2**	**5,016.2**	**4,891.7**	**60.7**		**63.8**	**–**
Total liabilities	**49,259.5**	**51,062.7**	**8,256.1**	**7,320.6**	**6,890.7**	**27,023.6**	**1,571.7**

54 Risk management continued

2008	Carrying value £m	Gross nominal outflow £m	Less than 1 month £m	1–3 months £m	3–12 months £m	1–5 years £m	Over 5 years £m
Non-derivative liabilities							
Deposits by banks	1,073.3	1,074.5	980.6	91.4	2.5	–	–
Customer accounts	11,690.0	11,741.7	1,705.8	1,163.6	2,054.6	6,817.7	–
Customer accounts – capital bonds	–	–	–	–	–	–	–
Debt securities in issue	571.5	575.3	201.6	277.5	96.2	–	–
Other borrowed funds	366.5	516.2	–	8.8	14.0	91.2	402.2
Amounts owned by group undertakings	225.5	225.5	225.5	–	–	–	–
	13,926.8	**14,133.2**	**3,113.5**	**1,541.3**	**2,167.3**	**6,908.9**	**402.2**
Derivative liabilities							
Net outflow	119.7	119.7	119.7	–	–	–	–
	14,046.5	**14,252.9**	**3,233.2**	**1,541.3**	**2,167.3**	**6,908.9**	**402.2**
Other liabilities	137.3	–	–	–	–	–	–
Total recognised liabilities	**14,183.8**	**14,252.9**	**3,233.2**	**1,541.3**	**2,167.3**	**6,908.9**	**402.2**
Unrecognised loan commitments	5,503.8	5,503.8	5,480.8	7.0	15.6	0.4	–
Total liabilities	**19,687.6**	**19,756.7**	**8,714.0**	**1,548.3**	**2,182.9**	**6,909.3**	**402.2**

Fair values of financial assets and liabilities

The table below sets out a comparison of the book value and the fair value at 2 January 2010 of all of the Group's financial instruments, where there is no significant difference between book value and carrying value.

	2009		2008	
	Carrying value £m	**Fair value £m**	Carrying value £m	Fair value £m
Financial assets				
Loans and advances to banks	**1,781.5**	**1,780.5**	1,524.2	1,522.8
Loans and advances to customers	**34,112.8**	**34,731.0**	10,173.7	10,173.4
Investment securities	**2,486.2**	**2,489.4**	123.4	112.3
Financial liabilities				
Financial liabilities at amortised cost				
Deposits by banks	**6,082.4**	**6,804.7**	1,073.3	1,073.3
Deposits from customers	**30,828.2**	**30,919.6**	11,690.0	11,951.9
Other deposits	**–**	**–**	–	–
Debt securities in issue	**3,334.3**	**2,475.2**	571.5	572.6
Other borrowed funds	**946.5**	**787.0**	366.5	332.7

Key considerations in the calculation of fair values are as follows:

a) Loans and advances to banks/deposits by banks

Loans and advances to banks include inter-bank placements and items in the course of collection.The fair value of floating rate placements and overnight deposits is their carrying amount. 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. A credit loss adjustment has been applied based-on expected loss amounts derived from the Bank's regulatory capital calculations.

b) Loans and advances to customers

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 the zero coupon rate. Forecast principal repayments are based on redemption at the earlier of maturity or repricing date with some overlay for historic 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. A credit loss adjustment has been applied based on expected loss amounts derived from the Bank's regulatory capital calculations.

54 Risk management continued

c) 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 price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

d) 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.

e) 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, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

f) Investment securities

Fair value is based on 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.

g) Derivatives

Futures and options are marked to market using listed market prices. For interest rate swaps, the estimated fair value is based on discounted cash flows using prevailing money market interest rates for instruments with similar remaining maturity.

Use of financial instruments

The use of financial instruments is essential to The Co-operative Bank's business activities and financial instruments constitute a significant proportion of the Co-operative Bank's assets and liabilities. Risk management procedures are described earlier in this report, and analysis of the financial instruments is provided in the notes to the financial statements.

The table below analyses financial instruments by measurement basis as detailed by IAS 39.

Balance sheet categories 2009	Trading £m	Designated at fair value £m	Loans and receivables £m	Available-for-sale £m	Other amortised cost £m	Cash flow hedges £m	Total £m
Assets							
Cash and balances at central banks	–	–	1,706.8	–	–	–	1,706.8
Loans and advances to banks	–	–	1,781.5	–	–	–	1,781.5
Loans and advances to customers	–	48.2	34,064.6	–	–	–	34,112.8
Investment securities	–	–	2,486.2	4,457.3	–	–	6,943.5
Derivative financial instruments	48.9	855.5	–	–	–	118.6	1,023.0
Equity shares	–	–	–	7.2	–	–	7.2
Amounts owed by group undertakings	–	–	91.0	–	–	–	91.0
Total financial assets	48.9	903.7	40,130.1	4,464.5	–	118.6	45,665.8
Non-financial assets							453.6
Total assets							46,119.4
Liabilities							
Deposits by banks	–	103.8	–	–	5,978.6	–	6,082.4
Customers accounts	–	–	–	–	30,828.2	–	30,828.2
Capital bonds	–	1,647.1	–	–	–	–	1,647.1
Debt securities in issue	–	–	–	–	3,334.3	–	3,334.3
Derivative financial instruments	40.2	480.6	–	–	–	70.5	591.3
Other borrowed funds	–	–	–	–	946.5	–	946.5
Amounts owned to group undertakings	–	–	–	–	329.2	–	329.2
Total financial liabilities	40.2	2,231.5	–	–	41,416.8	70.5	43,759.0
Non-financial liabilities							484.3
Total liabilities							44,243.3
Capital and reserves							1,876.1
Total liabilities and equity							46,119.4

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Balance sheet categories **2008**	Trading £m	Designated at fair value £m	Loans and receivables £m	Available-for-sale £m	Other amortised cost £m	Cash flow hedges £m	Total £m
Assets							
Cash and balances at central banks	–	–	535.8	–	–	–	535.8
Loans and advances to banks	–	–	1,524.2	–	–	–	1,524.2
Loans and advances to customers	–	35.8	10,137.9	–	–	–	10,173.7
Debt securities	–	–	123.4	2,121.7	–	–	2,245.1
Derivative financial instruments	71.3	19.7	–	–	–	137.7	228.7
Equity shares	–	–	–	13.0	–	–	13.0
Amounts owned by group undertakings	–	–	137.9	–	–	–	137.9
Total financial assets	**71.3**	**55.5**	**12,459.2**	**2,134.7**	**–**	**137.7**	**14,858.4**
Non-financial assets							106.1
Total assets							**14,964.5**
Liabilities							
Deposits by banks	–	–	–	–	1,073.3	–	1,073.3
Customers accounts	–	–	–	–	11,690.0	–	11,690.0
Guaranteed equity bonds	–	–	–	–	–	–	–
Debt securities in issue	–	–	–	–	571.5	–	571.5
Derivative financial instruments	62.5	24.4	–	–	–	32.8	119.7
Other borrowed funds	–	–	–	–	366.5	–	366.5
Amounts owed to group undertakings	–	–	–	–	225.5	–	225.5
Total financial liabilities	**62.5**	**24.4**	**–**	**–**	**13,926.8**	**32.8**	**14,046.5**
Non-financial liabilities							137.3
Total liabilities							**14,183.8**
Capital and reserves							780.7
Total liabilities and equity							**14,964.5**

54 Risk management continued

Valuation of financial instruments

The following table analyses financial assets at fair value by the three-tier valuation appearance as defined within IAS 39.

Category (as defined by IAS 39) 2009	Fair value measurement at end of the reporting period using: Quoted market prices in active markets Level 1 £m	Valuation techniques using observable inputs Level 2 £m	Valuation techniques using significant unobservable inputs Level 3 £m	Total £m
Financial assets				
Loans and receivables designated at fair value				
Loans and advances to customers	–	36.4	11.8	48.2
At end of the year	–	36.4	11.8	48.2
Available-for-sale financial assets				
Investment securities – available-for-sale				
– listed	486.5	–	–	486.5
– unlisted	3,121.6	849.2	–	3,970.8
– Equity shares	–	–	7.2	7.2
Total available-for-sale financial assets	3,608.1	849.2	7.2	4,464.5
Derivative financial instruments				
Interest rate swaps				
– designated as fair value hedges	–	0.5	–	0.5
– designated as cash flow hedges	–	118.1	–	118.1
– at fair value through income & expense	–	170.1	–	170.1
Cross currency interest rate swaps				
– designated as fair value hedges	–	635.5	–	635.5
Other	–	98.8	–	98.8
Total derivative financial instruments	–	1,023.0	–	1,023.0
Total assets	3,608.1	1,908.6	19.0	5,535.7
Financial liabilities designed at fair value				
Deposits from banks	–	103.8	–	103.8
Capital bonds		1,647.1	–	1,647.1
Total financial liabilities	–	1,750.9	–	1,750.9
Derivative financial instruments				
Interest rate swaps				
– designated as cash flow hedges	–	70.5	–	70.5
– at fair value through income and expense	–	479.1	–	479.1
Cross currency interest rate swaps				
– designated as fair value hedges	–	–	–	–
Other	–	41.7	–	41.7
Total derivative financial instruments	–	591.3	–	591.3
Total liabilities carried at fair value	–	2,342.2	–	2,342.2

54 Risk management continued

Category (as defined by IAS 39) 2008	Fair value measurement at end of the reporting period using: Quoted market prices in active markets Level 1 £m	Valuation techniques using observable inputs Level 2 £m	Valuation techniques using significant unobservable inputs Level 3 £m	Total £m
Financial assets				
Loans and advances to customers	–	22.0	13.8	35.8
	–	**22.0**	**13.8**	**35.8**
Available-for-sale financial assets				
Investment securities – available-for-sale				
– listed	2,119.0	2.7	–	2,121.7
– unlisted	4.2	–	8.8	13.0
Total available-for-sale financial assets	**2,123.2**	**2.7**	**8.8**	**2,134.7**
Derivative financial instruments				
Interest rate swaps				
– designated as cash flow hedges	–	137.7	–	137.7
– at fair value through income & expense	–	69.7	–	69.7
Other	–	21.3	–	21.3
Total derivative financial instruments	**–**	**228.7**	**–**	**228.7**
Total assets	**2,123.2**	**253.4**	**22.6**	**2,399.2**
Financial liabilities				
Derivative financial instruments				
Interest rate swaps				
– designated as fair value hedges	–	1.5	–	1.5
– designated as cash flow hedges	–	29.5	–	29.5
– at fair value through income & expense	–	73.6	–	73.6
Other	–	15.1	–	15.1
Total derivative financial instruments	**–**	**119.7**	**–**	**119.7**
Total liabilities	**–**	**119.7**	**–**	**119.7**

54 Risk management continued

Movements in fair values of instruments with significant unobservable inputs were:

	Fair value 10 January 2009 £m	Purchases £m	Sales £m	Transfers of engagements £m	Profit or loss including impairment £m	Other comprehensive income, net of impairment £m	Fair value 2 January 2010 £m
Group							
Loans and advances to customers	13.8	(0.5)	–	–	(1.5)	–	11.8
Equity shares	8.8	–	–	1.5	(3.1)	–	7.2
	22.6	**(0.5)**	**–**	**1.5**	**(4.6)**	**–**	**19.0**
Bank							
Loans and advance to customers	13.8	(0.5)	–	–	(1.5)	–	11.8
Debts securities	29.9	–	–	–	9.3	–	39.2
Equity shares	8.8	–	–	1.5	(3.1)	–	7.2
Amounts owed to other Co-operative Group undertakings	(1,996.3)	(250.7)	648.9	(1,799.5)		–	(3,397.6)
	(1,943.8)	**(251.2)**	**648.9**	**(1,798.0)**	**4.7**	**–**	**(3,339.4)**

	Fair value 10 January 2009 £m	Purchases £m	Sales £m	Transfers of engagements £m	Profit or loss including impairment £m	Other comprehensive income, net of impairment £m	Fair value 2 January 2010 £m
Group							
Loan and advances to customers	3.5	8.8	–	–	–	1.5	13.8
Equity shares	8.8	–	–	–	–	–	8.8
	12.3	**8.8**	**–**	**–**	**–**	**1.5**	**22.6**
Bank							
Loans and advance to customers	3.5	8.8	–	–	–	1.5	13.8
Debts securities	–	–	–	–	–	29.9	29.9
Equity shares	8.8	–	–	–	–	–	8.8
Amounts owed to other Co-operative Group undertakings	–	(2,289.4)	263.4	–	–	29.7	(1,996.3)
	12.3	**(2,280.6)**	**263.4**	**–**	**–**	**61.1**	**(1,943.8)**

Valuation techniques

Fair values are determined according to the following hierarchy:

a) Quoted market price

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, and a significant proportion of the Bank's financial assets fall into this category.

b) Valuation technique 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:

Loans and advances to customers

Loans and advances to customers include Corporate loans £36.4m (2008: £22.0m) which are fair valued through P&L 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.

Debt securities

Debt securities classified under valuation techniques using observable inputs are described in the accounting policies section on page 56.

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 FX 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.

54 Risk management continued

c) Valuation technique with significant unobservable inputs

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 £11.8m (2008: £13.8m) which are fair valued through P&L 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 and has increased the valuation by £0.2m in 2009 (2008: reduced the valuation by £0.4m).

Derivative financial instruments

Derivative financial instruments including internal interest rate swaps have been entered into during the year between the Bank and The Covered Bond LLP (LLP).

The purpose of the covered bond swap is to convert the fixed and base rate linked revenue receipts of the covered bond pool of assets to the same LIBOR linked basis as the intercompany loan. Under this swap arrangement the LLP pays to the swap counterparty, in this case The Co-operative Bank plc, the monthly mortgage revenue receipts of the coverpool 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 swap is valued based on an assumed amortisation profile of the covered bond pool 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.

The FV of the swap is based on a valuation model that reflects the mortgage cash flows over a three-year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Equity shares

Primarily, equity shares relate to investments held in Vocalink Limited which are unquoted shares. The valuation of such shares is based on our % shareholding of the most recent public information valuation issued by the company.

Deposits from customers

Deposits from customers includes a deposit by the LLP subsidiary relating to the legal transfer of loans and advances on issue of the Bank's covered bond. The deposit is fair valued to eliminate an accounting mismatch of the swap derivative as discussed above.

Revaluation of the £3.4bn (2008: £2.0bn) mortgage coverpool from book to fair value is based on assumed timing of future mortgage capital and revenue receipts, discounted to present value using a credit adjusted discount rate.

The amortisation profile is as per the swaps valuation methodology, assuming some annual prepayment, but is extended beyond any bond maturity, until all the mortgages themselves mature, which is circa 25 years. Similarly, the revenue receipts are calculated as per the swap valuation methodology, but extended until all the mortgages mature. For fixed rate mortgages revenue receipts are based on fixed customer rates within the assumed amortisation profile. For tracker, SVR and discount products revenue receipts are assumed to be based on forward LIBOR rates plus the product margins. Fixed and tracker mortgages are assumed to revert to SVR at end of any offer period. All mortgages in the covered bond pool were originated pre 31 December 2007.

The FV of the swap is based on a valuation model that reflects the mortgage cash flows over a three-year period using a discount rate based on LIBOR spreads. This derivative eliminates on consolidation.

Primary financial instruments used by the Co-operative Bank

The main financial instruments used by the Bank, and the purposes for which they are held, are outlined below:

Customer loans and deposits

The provision of banking facilities to customers is the prime activity of the Bank and customer loans and deposits are major constituents of the balance sheet. Customer loans include retail mortgages, corporate loans, credit cards, unsecured retail lending and overdrafts. Customer deposits include retail and corporate current and saving accounts. The Bank has detailed policies and procedures to manage risks. In addition to mortgage lending, much of the lending to corporate and business banking customers is secured.

54 Risk management continued

Debt securities, wholesale market loans and deposits

Debt securities include structured investments and credit trading funds. Debt securities also underpin the Bank's liquidity requirements and generate incremental net interest and trading income.

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 wholesale market loans are invested in marketable, investment grade debt securities, short-term wholesale market placements and used to fund customer loans.

Capital funds – Subordinated Note issues and preference shares

The Bank has a policy of maintaining prudent capital ratios and utilises a broad spread of capital funds. In addition to ordinary share capital and retained earnings, the Bank has issued £60m preference shares and, when appropriate, also issues perpetual and fixed term Subordinated Notes.

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 approved by the Board.

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, forward rate agreements, 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.

Insurance risk

CIS and CISGIL issue contracts that transfer insurance risk or financial risk or both. This section summarises these risks and the way CIS and CISGIL manages them.

Our approach to risk management

CISGIL and CIS operate in regulated markets and are subject to significant government regulation.

The CFS group of companies including Co-operative Financial Services Limited, Co-operative Insurance Society Limited (Life and Savings business), CIS General Insurance Limited and The Co-operative Bank plc have a common Board composition.

CFS has developed and implemented a common governance and organisation structure, with the same committee structure supporting each Board within the CFS group.The CFS Board has ultimate responsibility for the management of all risks across CFS.

The Board is responsible for approving the CFS strategy, its principal markets and the level of acceptable risks articulated through its statement of risk appetite. It is also responsible for overall corporate governance, which includes ensuring that there is an adequate system of risk management and that the level of capital held is consistent with the risk profile of the business.

The Board has established Board Committees and Senior Management Committees to administer, oversee and challenge the risk management process, identifying the key risks facing the business and assessing the effectiveness of planned management actions.

Specific Board authority has been delegated to Board Committees and the Chief Executive who may, in turn, delegate elements of his discretions to appropriate Executive Directors and their senior line managers.

Insurance risk

The risk under any insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

The principal risk that CISGIL and CIS face under their insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual number and amounts of claims and benefits will vary from year to year from the estimates established.

54 Risk management continued

a) General insurance risk

Principal risks covered

The major classes of general insurance business written are motor and property, together with some liability, pecuniary loss and personal accident risks. Almost all risks under general insurance policies cover a 12-month duration and all risks directly underwritten are confined to the UK market.

Motor cover provided is principally in respect of private vehicles or to small businesses, with limited underwriting of fleet business. Principal risks under motor policies are bodily injury to third parties, accidental damage to property including policyholders' and third parties' vehicles and theft of, or from, policyholders' vehicles. Property cover is predominantly household with some commercial property business. Principal risks under property policies are damage to domestic and commercial properties from storm or flood, fire, escape of water, subsidence and theft or accident damage to contents.

CISGIL has entered into an Indemnification Agreement with CIS, a fellow subsidiary within the CFS group, to assume financial responsibility for the run-off of general insurance business formerly written by CIS. In return CISGIL has received a premium, settled by transfer of assets, equivalent to the net technical liabilities of this business included in CIS's financial statements at the 2005 year-end. This exposes CISGIL to the risk of these assets being insufficient to cover the claims arising from this business.

Frequency and severity of claims

The frequency and severity of property claims can be affected by several factors, the most significant being weather events. In addition, there is a possibility of a very large individual commercial property claim arising from fire and/or consequential loss. The most significant factors affecting the frequency and severity of motor claims are judicial, legislative and inflationary changes and the frequency and severity of large bodily injury claims.

Risk management objectives and strategy

CISGIL's objective in managing general insurance risk is to ensure that insurance risks are understood and accepted in accordance with its documented underwriting policy and that policy pricing appropriately reflects the underlying risk. General insurance risk is managed through the underwriting strategy, reinsurance arrangements, proactive claims handling and the claims provisioning process.

The underwriting strategy attempts to ensure that the underwritten risks are well diversified in terms of type and amount of risk, industry/demographic profile and geography and only those risks that conform with underwriting criteria are accepted. Exposure mix and the frequency and average costs of claims are monitored throughout the year and where significant deviations from expectation are identified, remedial action is taken. A programme of reinsurance is in place that sets retention levels in accordance with the risk appetite of the business.

The overriding objective in claims handling is to ensure all claims are properly scrutinised and paid where they fall within the terms and conditions of the policy. The proper scrutiny of claims is facilitated by the use of various technical aids such as a pricing database, weather validation and fraud databases and the use of claims specialists. The basis for assessing claims provisions is set out in Note 29 (b).

Concentration of risk

The bias of the portfolio towards personal contracts reduces the risk of large single losses and there is no significant concentration of risk in any geographical area of the UK. Excess of loss and surplus reinsurance cover is used to mitigate losses from individual large claims, particularly large bodily injury and commercial losses.

Statistical modelling with specialised software is produced to assess CISGIL's exposure to natural hazards such as windstorm and flood events, including a large east coast flood, which would significantly affect the property portfolio. Weather event catastrophe reinsurance cover is the most important component of the reinsurance programme and is set to restrict losses from a single event.

Sources of uncertainty in the estimation of future claim payments and premium receipts

The nature of insurance contracts is that the obligations of the insurer are uncertain as to the timing or quantum of liabilities arising from contracts. CISGIL takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

Uncertainty over the timing of claims relates to liabilities that have occurred but are not yet reported (IBNR) and the interval between claim notification and settlement. Recognised statistical methods are used to assess the payment of claims, both in respect of claims already notified and those yet to be notified. Bodily injury claims and associated legal costs, which are a significant element of outstanding claims on the motor and liability accounts, have a longer period to settlement, potentially several years. There is a higher degree of uncertainty associated with these long-tail claims than property damage claims, which are settled more quickly. By their nature, the statistical methods used to assess the timing of future payments rely, to some extent, on past patterns of claims being repeated in future.

In terms of monetary values placed on claims liabilities, uncertainty arises from a number of sources. Inflation assumptions, to which long-tail claims are sensitive, are set with regard to current conditions and expectations for economic influences relevant to the claim type but future experience may diverge. Bodily injury claims in particular are sensitive to changes in the legislative and regulatory environments where court decisions, guidance from the Lord Chancellor or statutory changes can affect unsettled liabilities.

54 Risk management continued

In addition to cost inflation and other external factors referred to above, the amount and timing of claim payments will be affected by changes in the organisation's claims handling processes. The claims handling function has recently undergone significant change in terms of the service proposition and the claims processes, leading to greater uncertainty in interpreting the development of costs and the average period to settlement. Estimations are also made in respect of pipeline premiums, non-recoverable premium debts and doubtful reinsurance recoveries. In calculating the pipeline premiums, projections are based on past patterns of premium processing. Changes in processing cycles and in attrition rates could alter these past trends.

b) Long-term insurance risk

Principal risks covered

The majority of the long-term business consists of participating savings business, including deferred pensions. In addition, cover is provided in respect of mortality risk (both term insurance and whole-of-life) and critical illness.

Principal risks associated with these policies arise from policyholder mortality or longevity, morbidity and persistency.Improvements in pensioner longevity pose a potential risk of increases in the cost of annuities in payment, guaranteed benefits under deferred annuity contracts and cost of guaranteed annuity options (GAOs) on personal pension contracts. Persistency risk arises where more policies than expected reach their investment guarantee dates, resulting in a potential increase in the cost of guarantees.

This is particularly significant in relation to personal pension contracts where the risk is that more policyholders than expected reach their retirement date, which is the date on which GAOs become available.

Frequency and severity of claims

Factors that could increase the overall frequency of claims include epidemics (such as AIDS and SARS) for term assurance products, increased healthcare screening (such as cancer screening) resulting in earlier or more claims than expected for critical illness products, and more rapid improvements in longevity than expected for in-payment and deferred annuity business (for example from developments in medical science).

For participating policies, a significant amount of the insurance risk is shared with the participating contract holders. Insurance risk is also shared on critical illness and waiver of premium policies, both of which allow for premium rate reviews to enable changes in actual experience from expectation to be reflected in future premiums. For all other policies, there are no mitigating terms and conditions that reduce the insurance risk accepted.

Insurance risk is affected by the policyholders' rights to terminate the policy, pay reduced or no future premiums or to take up a guaranteed annuity option. Consequently, the amount of insurance risk is subject to policyholder behaviour.

Risk management objectives and strategy

CIS's objective in managing long-term business insurance risk is to ensure that insurance risks are understood and accepted in accordance with its documented underwriting policy and that policy pricing appropriately reflects the underlying risk. CIS manages long-term business insurance risk through the use of appropriate underwriting, product design and pricing and the use of reinsurance arrangements. Risk is managed and monitored across the portfolio.

The majority of term assurance and critical illness policies are reinsured on a quota share basis. A significant proportion of in-payment annuity business and deferred annuity business is also reinsured.

Sources of uncertainty in the estimation of future benefit payments and premium receipts

Uncertainty in the estimation of future benefit payments and premium receipts arises from the uncertainty regarding long-term changes in mortality levels and variability in policyholder behaviour regarding termination and alteration of policies.

The amount of insurance risk under contracts with guaranteed annuity options depends upon the number of policyholders who exercise their option. The lower the current market interest rate is in relation to the rates implicit in the guaranteed annuity option, the greater the likelihood that policyholders will choose to exercise the option.

Concentration of insurance risk

The existence of guaranteed annuity options on personal pension products gives rise to a significant concentration of insurance risk.

54 Risk management continued

c) Financial risk

CISGIL and CIS are exposed to financial risk through their financial assets, financial liabilities (including investment contracts, borrowings and derivatives), reinsurance assets and insurance liabilities. In particular a key financial risk is that the proceeds from financial assets and property are insufficient to fund the obligations arising under general or long-term insurance and investment contracts. CISGIL and CIS manage financial risk under the segmentations of general insurance, other than long-term business funds and long-term business and then according to the sub-categories of market, credit and liquidity risk.

Financial risk management objective and strategy

The principal objective of CISGIL and CIS financial risk management strategies are to optimise the return on investments commensurate with an acceptable level of financial and insurance risk. Financial risk is managed within an asset and liability management (ALM) framework to ensure that this objective is achieved. An overriding constraint on the Long-term Fund's investment strategy is to ensure that at all times the fund has sufficient assets to meet its solvency and capital requirements.

The whole of the profits of the long-term business must be applied for the sole benefit of the long-term business policyholders. This includes the creation of reserves with the aim of preserving the strength of the fund for the benefit of the current and future long-term business policyholders. Similarly, any losses incurred within the fund are borne by the long-term business policyholders, either through a reduction in the working capital of the fund or through a reduction in their benefits. The working capital of the fund is the excess of assets within the fund over the amount needed to meet liabilities, including those arising from the regulatory requirement to treat customers fairly when setting discretionary benefits. The working capital is managed to ensure that the long-term business fund can meet its solvency requirements under a range of adverse conditions and to meet business plans. In exceptional circumstances, assets held outside the fund (share capital and general reserve) may, if available, be used to help meet the long-term business fund's solvency requirements.

Risks that may affect the long-term business fund are managed according to documented risk management policies, which require risks and capital to be regularly monitored and reported, and decisions made according to delegated authorities. Actions to control risk and manage the working capital of the fund include the use of reinsurance, matching assets and liabilities (including using derivatives) and setting discretionary benefits at appropriate levels, as described in the Principles and Practices of Financial Management (PPFM).

The RMC specifically monitors ALM exposures and controls the effectiveness of the market and credit policies. Exposures to financial risk are managed through diversifying investments across asset classes, issuers and markets.

CIS Shareholder funds reflect assets backing reserves and are principally invested in equities. CIS has reduced the exposure to the volatility of equity prices experienced in recent years by selling equity futures whilst retaining the underlying equity holdings.

The principal ALM technique used in CISGIL is to invest in assets that are predominantly fixed-interest securities with a similar duration profile to the liabilities under the general insurance contracts.

The principal ALM technique of CIS's long-term business fund is to match the assets to the insurance and investment contract liabilities with reference to the type of benefits payable to contract holders. Separate asset portfolios and funds are maintained for linked liabilities and each participating investment sub-fund. Linked liabilities are directly linked to the performance of specific asset portfolios and no significant market or credit risk to CIS arises from these contracts.

As part of its ALM framework, CISGIL and CIS set a strategic asset allocation range with reference to a suitable benchmark for each asset class taking account, separately, of the short-term insurance and investment liabilities, shareholder and long-term insurance and investment liabilities, long-term investment performance and the financial risks. Controls and limits are set for each risk and sub-risk type and managed within the risk management procedures accordingly. CISGIL and CIS consider the capital adequacy and solvency of each insurance fund when establishing and controlling the assets and risk limits.

Principal financial risks affecting CISGIL and CIS

Market risk includes the risks that arise from fluctuations in values of, or income from, assets or in interest rates or exchange rates to the extent that there is a mismatch between assets and liabilities. Market risk is particularly relevant in the long-term business fund where a significant proportion of assets is held in equities, property and alternative investments such as hedge funds. Market risk is managed separately in respect of the long-term fund and the other than long-term fund and the particular risks and mitigants adopted by each fund are set out below.

i) Financial risk within the long-term business fund is managed as follows:
- Long-term insurance liabilities in respect of non-participating policies are closely matched with fixed-interest securities. This close matching is achieved by holding assets whose cash flows correspond to the expected aggregate cash flow on the non-participating business
- Interest rate swaptions are held to meet the expected guaranteed annuity option liabilities
- For unit-linked investment contracts, assets are matched with liabilities
- Equity-put options are held to reduce a proportion of the equity price risk arising from backing guaranteed benefits on participating contracts with equities
- Financial assets held to meet expected participating policy guarantee costs (other than equity-put options), and the working capital of the fund, are invested in fixed-interest securities to reduce interest-rate risk.

54 Risk management continued

ii) Borrowings at variable interest rates expose CIS to cash flow interest-rate risk, whereas borrowings at fixed rates create an exposure to fair value risk. CIS's policy is to maintain the majority of borrowings in instruments of duration less than three years. CIS manages its cash flow interest rate risk by using interest rate swaps and deposits. CIS enters into interest rate swaps and gilt repurchasing arrangements to manage borrowing requirements.

iii) CISGIL has matched the insurance liabilities arising under its short-term general insurance contracts with a portfolio of fixed-interest debt securities of a similar average duration to the liabilities arising under those contracts. To enhance certainty over the investment return generated from these assets, management practice is generally to maintain holdings to maturity. Short-term insurance liabilities are not directly sensitive to the level of money market rates, as they are contractually non-interest-bearing. However, interest rate risk arises because of the time value of money and the potential duration to settlement of claims. The value of assets held is subject to volatility from changes in short-term money-market interest rates and proceeds from maturing investments are subject to risk over the future return on reinvestment.

CISGIL matches cash flows of assets and liabilities in this portfolio by estimating their mean duration. The mean duration of liabilities is calculated using historical claims data to determine the expected settlement pattern for claims arising from insurance contracts in force at the balance sheet date (both incurred claims and future claims arising from the unexpired risks at the balance sheet date). Mean durations are:

	2009	2008
Net insurance liabilities	**2.34 years**	2.30 years
Financial assets	**3.34 years**	1.42 years

Sensitivity analysis

The only significant aspect of market risk to which the other than long-term fund is exposed is equity price risk. The market value of the assets in this fund fluctuate in accordance with underlying equity market values. However, this risk has been significantly reduced by selling equity futures. An increase of 10% in equity values would increase the balance sheet carrying value of equities in the other than long-term business fund at the end of the financial year by £48.5m (2008: £43.7m). This would be largely offset by an increase in the value of financial liability in respect of financial futures contracts. However, the futures do not provide a perfect hedge against changes in value of the equities portfolio, and the change in the liability would be expected to lie within the range £41m to £56m (2008: £31m to £57m) giving a net profit impact, pre-tax, of between +/– £7.5m (2008: +/– £13m). A 10% reduction in equity values would produce the same impact on pre-tax profit. This sensitivity analysis is based upon a change in one assumption while holding all other assumptions constant.

Fluctuations in asset values within long-term business participating investment sub-funds will be met by an equivalent change to policyholder benefits subject to any guarantees provided under such policies. Where policy guarantees mean that such fluctuations cannot be met by a change to policyholder benefits, changes to asset values will be met by the working capital of the long-term business fund. In addition, fluctuations in financial assets backing non-participating policies and participating policy guarantees will also impact the working capital of the fund. Examples of how particular market risk scenarios impact the working capital of the fund are illustrated in Note 29 (e) (xii).

Credit risk

CISGIL's and CIS's principal credit-risk exposure arises in connection with default of debt securities and reinsurance counterparties, either failing to meet financial obligations when due or entering into restructuring arrangements that may adversely affect the market value of the debt security or reinsurance recoverable.

CISGIL and CIS have established a credit policy and exposure framework to monitor counterparty and credit-risk exposures, on an ongoing basis through the establishment of appropriate risk limits. CISGIL and CIS structure the levels of counterparty risk and asset concentration risk that they accept by placing limits and controls over the exposure to a single debt instrument and counterparty, or counterparty group, and seek to actively diversify investment holdings and counterparty exposures across markets and economic segments. Counterparty exposures are subject to review at least annually and, where concern exists over counterparty credit quality, watchlists are maintained and actively managed.

Where reinsurance is used to manage insurance risk, a risk is created that the reinsurer fails to meet its obligations in the event of a claim. Creditworthiness of reinsurers is considered regularly, together with reinsurer exposures. Additionally, in respect of the reinsurance of in-payment and deferred annuity business, CIS has taken a charge over assets to safeguard expected future reinsurance recoveries.

Financial responsibility for the benefits and burdens of the general insurance business of CIS in run-off has been passed to CISGIL via an indemnification agreement. If CISGIL were unable to fulfil its contractual obligations, financial responsibility for these claims would revert to CIS.

Other risk-mitigation techniques employed to manage exposure to counterparty default include transacting only through a diversified range of authorised counterparties/brokers and the requirement for derivative transactions (including investment and trading in futures, swaptions, stock lending and gilt repo transactions) to be fully collateralised regularly for CIS and on a daily basis for CISGIL.

54 Risk management continued

At the balance sheet date there were no significant concentrations of credit risk. The table below provides an analysis at the balance sheet date of the credit rating of those assets subject to credit risk.

	AAA £m	AA £m	A £m	BBB and below £m	Not rated £m	2009 Total £m	2008 Total £m
Reinsurance assets	**9.8**	**2,008.8**	**989.8**	**–**	**10.6**	**3,019.0**	3,121.4
Financial assets at FV through profit and loss (held for trading purposes)							
Listed equities	**–**	**–**	**–**	**–**	**4,803.3**	**4,803.3**	4,528.9
Unlisted equities	**–**	**–**	**–**	**–**	**820.8**	**820.8**	298.0
Listed debt (fixed rate)	**3,020.1**	**1,029.0**	**1,919.0**	**730.4**	**69.2**	**6,767.7**	6,773.5
Listed debt (floating rate)	**–**	**–**	**–**	**–**	**–**	**–**	–
Unlisted debt (fixed rate)	**3.0**	**–**	**–**	**–**	**2.5**	**5.5**	6.5
Unlisted debt (floating rate)	**–**	**–**	**–**	**–**	**–**	**–**	2,267.7
Deposits with approved credit institutions (fixed rate)	**–**	**577.7**	**937.3**	**–**	**4.8**	**1,519.8**	2,920.0
Derivatives	**–**	**252.6**	**428.6**	**–**	**–**	**681.2**	1,027.4
Financial assets designated at FV through profit and loss							
Listed equities	**–**	**–**	**–**	**–**	**244.0**	**244.0**	
Unlisted equities	**–**	**–**	**–**	**–**	**–**	**–**	
Listed debt (fixed rate)	**12.0**	**–**	**–**	**–**	**–**	**12.0**	7.2
Unlisted debt (fixed rate)	**–**	**–**	**–**	**–**	**–**	**–**	
Unlisted debt (floating rate)	**–**	**1,992.4**	**–**	**–**	**–**	**1,992.4**	
Fixed assets – available for sale							
Listed debt (fixed rate)	**37.4**	**213.6**	**516.3**	**235.2**	**–**	**1,002.5**	657.1
Unlisted debt (fixed rate)	**–**	**–**	**–**	**4.9**	**–**	**4.9**	
Deposits with approved credit institutions (fixed rate)	**–**	**–**	**–**	**–**	**–**	**–**	4.9
Derivatives	**–**	**–**	**–**	**–**	**–**	**–**	2.4
Loans and receivables at amortised cost							
Loans	**–**	**–**	**–**	**–**	**7.8**	**7.8**	10.3
Insurance receivables and other assets	**38.5**	**48.6**	**85.7**	**23.5**	**237.4**	**433.7**	551.4
Cash and cash equivalents	**9.2**	**11.2**	**35.5**	**–**	**–**	**55.9**	50.8
Total assets bearing credit risk	**3,130.0**	**6,133.9**	**4,912.2**	**994.0**	**6,200.4**	**21,370.5**	22,227.5

The maximum exposure to credit risk is represented by the carrying value of each financial asset and reinsurance balance in the table.

CIS makes provision for the possible impairment of policyholder debts where these are more than one month overdue.

CISGIL makes provisions for the possible impairment of financial assets where there is objective evidence that an impairment loss has been incurred.

Liquidity risk

CISGIL and CIS are exposed to calls on their available cash resources mainly from claims arising and collateral arrangements on derivatives and reinsurance contracts. Liquidity risk is the risk that cash may not be available at a reasonable cost to pay obligations when due.

The following table indicates the time profile of undiscounted cash flows arising from financial liabilities (based upon contractual maturity) and insurance liabilities (based upon estimated timing of outflow of amounts recognised in the balance sheet).

CISGIL liquidity risk

CISGIL is exposed to calls on its available cash resources mainly from claims arising. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of borrowing facilities in place to cover claims at unexpected levels of demand.

A liquidity risk policy has been established and risk is managed through the requirement to hold a proportion of financial assets in cash and liquid fixed interest stocks to pay claims for a specified time period in stressed conditions, where liquid assets are considered to be:

54 Risk management continued

Asset Type	Value included as liquid asset
Gilts	100%
Cash	100%
Corporate bonds:	
AAA	80%
AA	70%
A	60%
BBB	50%
All other investments	0%

The stressed condition which is assessed is 20% of the one in 100 year windstorm loss before reinsurance recoveries, and this is calculated by GI Capital and Risk at least every year, based on the ICA models. It is considered that 20% is reasonable for liquidity, as there is always a delay before claims are paid and CISGIL is to some extent in control of the period to payment. Based on the latest catastrophe model the one in 100 year windstorm loss is £91m, giving a liquidity requirement of £18.2m against actual liquid assets of £645m.

CISGIL has access to overnight borrowing facilities with the Co-operative Bank plc a fellow subsidiary. Overnight borrowings are subject to the Co-operative Bank's regulatory related counterparty exposure limits. These borrowings are on normal commercial terms and represent an unsecured, uncollateralised obligation of CISGIL. CISGIL is active in the gilt repo market to facilitate liquidity risk management and maintains short-term borrowing facilities to enable settlement.

Sensitivity analysis

The only significant aspect of market risk to which CISGIL is exposed to is interest rate risk. The market value of CISGIL's assets is subject to volatility from changes in short-term money market interest rates; furthermore proceeds from maturing investments are subject to risk over the future return on reinvestment. An increase of 100 basis points in interest yields would reduce the carrying value of CISGIL's assets at the end of the financial year by £34.1m (2008: £11.8m). CISGIL invests predominantly in fixed rate securities and has adopted a policy of recognising investment assets on an 'available for sale' basis, therefore the impact upon profit during the period would not be material and would instead be recognised directly in other comprehensive income as a reduction of £24.6m net of tax (2008: £8.5m). Conversely the impact of a decrease of 100 basis points in interest yields would be recognised directly in other comprehensive income as an increase of £26.6m net of tax (2008: £8.9m).

CISGIL has issued £105m of subordinated debt at varying margins above three-month LIBOR. The effect on profit of a 1% movement in three-month LIBOR would be £0.76m per annum net of tax (2008: £0.75m).

The sensitivity analysis above assumes a reasonably possible movement in one variable with all other variables held constant. Furthermore the calculation assumes that a change in base rate would have an immediate and equal impact at all points on the yield curve.

CISL liquidity risk

Liquidity risk is the risk that cash may not be available at a reasonable cost to pay obligations when due. CISL is exposed to calls on its available cash resources mainly from claims arising and collateral arrangements on derivatives and reinsurance contracts.

A liquidity risk policy has been established and risk is managed through the requirement to hold a proportion of financial assets in cash and liquid stocks to pay claims and other cash flows for a specified time period in stressed conditions, where liquid assets are considered to be:

Asset Type	Value included as liquid asset
Gilts	100%
Cash	100%
Corporate bonds:	
AAA	80%
AA	70%
A	60%
BBB	50%
Equity	60%
All other investments	0%

54 Risk management continued

The minimum financial assets proportion is determined using the Society's internal economic capital assessment and is regularly reviewed considering the nature, cause, effect and probability of extreme case scenarios in the light of changing natural, social and economic conditions. The current extreme scenario assumes:

- increase in claims and surrenders by 50%;
- increase in expenses by 10%;
- reduction in asset values by 10%, with no investment income;
- no new business premiums income received; and
- no reinsurance recoveries received.

In addition, a minimum of £700m of gilts are held to meet extreme collateral payments on derivative contracts.

Based on the latest internal assessment, the liquidity requirement is £1.6bn against actual available liquid assets of £8.0bn.

CIS is active in the gilt repo market as part of its cash management activities and maintains short-term borrowing facilities to enable settlement and also maintains a borrowing from its parent.

The following table indicates the time profile of undiscounted cash flows arising from financial liabilities (based upon contractual maturity) and insurance liabilities (based upon estimated timing of outflow of amounts recognised in the balance sheet) for both CISL and CISGIL.

2009	Carrying value £m	Gross nominal outflow £m	Up to 1 year £m	1–5 years £m	5–10 years £m	10–15 years £m	Over 15 years £m
Insurance and participating contract liabilities	**16,729.0**	**16,729.0**	**2,218.7**	**4,716.7**	**3,600.7**	**2,528.7**	**3,664.2**
Financial liabilities at FV through profit and loss (held for trading)							
Derivatives	**502.9**	**502.9**	**502.9**	**–**	**–**	**–**	**–**
Financial liabilities designated at FV through profit and loss							
Investment contract liabilities	**259.9**	**259.9**	**259.9**	**–**	**–**	**–**	**–**
Other financial liabilities	**1,992.4**	**4,454.2**	**54.2**	**262.4**	**446.4**	**606.4**	**3,084.8**
Financial liabilities at amortised cost							
Loans and borrowings	**172.0**	**172.1**	**172.1**	**–**	**–**	**–**	**–**
Amounts owed to credit institutions (fixed rate)	**1,071.2**	**1,071.8**	**1,071.8**	**–**	**–**	**–**	**–**
Insurance and other payables	**184.1**	**184.1**	**174.8**	**9.3**	**–**	**–**	**–**
Other reinsurance liabilities	**9.0**	**9.0**	**9.0**	**–**	**–**	**–**	**–**
Subordinated debt	**105.0**	**113.8**	**1.8**	**35.8**	**76.2**	**–**	**–**
Cash and cash equivalents	**5.6**	**5.6**	**5.6**	**–**	**–**	**–**	**–**
	21,031.1	**23,502.4**	**4,470.8**	**5,024.2**	**4,123.3**	**3,135.1**	**6,749.0**
Other liabilities	**1,195.2**						
Net asset value attributable to unit holders	**42.1**						
Total recognised liabilities	**22,268.4**						

54 Risk management continued

2008	Carrying value £m	Gross nominal outflow £m	Up to 1 year £m	1–5 years £m	5–10 years £m	10–15 years £m	Over 15 years £m
Insurance and participating contract liabilities	16,697.8	16,697.8	2,179.8	4,310.3	3,535.7	2,516.6	4,155.4
Financial liabilities at FV through profit and loss (held for trading)							
Derivatives	396.8	396.8	396.8	–	–	–	–
Financial liabilities designated at FV through profit and loss							
Investment contract liabilities	190.9	190.9	190.9	–	–	–	–
Other financial liabilities	2,267.7	4,528.3	52.8	253.7	430.6	576.6	3,214.6
Financial liabilities at amortised cost							
Loans and borrowings	277.0	277.1	277.1	–	–	–	–
Amounts owed to credit institutions (fixed rate)	1,814.4	1,817.8	1,817.8	–	–	–	–
Insurance and other payables	334.8	334.8	319.0	15.8	–	–	–
Other reinsurance liabilities	6.7	6.7	6.7	–	–	–	–
Subordinated debt	105.0	126.8	3.7	43.1	80.0	–	–
Cash and cash equivalents	7.1	7.1	7.1	–	–	–	–
	22,098.2	24,384.1	5,251.7	4,622.9	4,046.3	3,093.2	7,370.0
Other liabilities	828.0						
Total recognised liabilities	22,926.2						

Currency risk

Currency risk is the risk that cash flows fluctuate as a result of changes in foreign exchange rates. CIS writes contracts of insurance in the United Kingdom and insurance and investment liabilities are denominated in sterling. The Other Than Long-Term Fund is invested solely in assets denominated in sterling. The long-term business fund invests in an internationally diversified range of assets. Currency futures are used to ensure that the currency risk to the fund is not significant.

Fair values

The following summarises the major methods and assumptions used in estimating the fair values of financial instruments reflected in the financial statements:

(a) Securities

Fair value for listed debt and equity securities is based on clean bid prices at the balance sheet date without any deduction for transaction costs.

Fair values in respect of unlisted equity securities, participation in collective investment pools and partnerships are determined using a range of valuation techniques. These include reference to other recent arm's-length transactions, reference to other transactions that are substantially the same, and discounted cash flow techniques.

Fair value of unlisted debt securities represents the discounted expected principal and interest cash flows.

(b) Derivatives

Interest rate swap options are valued at broker quotes, which are validated using pricing models or discounting techniques. Index futures are valued at clean bid prices at the balance sheet date without any deduction for transaction costs.

(c) Convertible loan notes

Fair value is based on clean bid prices, if available. Otherwise, a valuation technique is used.

(d) Interest-bearing loan receivables

Fair value is calculated based on discounted expected future principal and interest cash flows.

(e) Trade and other receivables and payables

For receivables and payables with a remaining life of less than one year, the nominal amount is deemed to reflect the fair value. All other receivables and payables are discounted to determine the fair value.

54 Risk management continued

(f) Interest rates used for determining fair values

Interest rate assumptions used in the valuation of unlisted debt and loan receivables are based upon gilt yields of appropriate maturity.

In all instances fair values equate to carrying values.

Balance sheet categories

2009	Designated at fair value £m	Loans and receivables £m	Available for sale £m	Other amortised cost £m	Total £m
Assets					
Financial assets at fair value through profit or loss	**16,165.6**	**–**	**–**	**–**	**16,165.6**
Available for sale financial assets	**–**	**7.8**	**1,007.4**	**–**	**1,015.2**
Loans and advances to customers	**–**	**–**	**–**	**–**	**–**
Derivative financial instruments	**681.2**	**–**	**–**	**–**	**681.2**
Insurance receivables and other assets	**–**	**247.6**	**–**	**–**	**247.6**
Cash and cash equivalents	**–**	**55.9**	**–**	**–**	**55.9**
Other assets	**–**	**147.3**	**–**	**–**	**147.3**
Total financial assets	**16,846.8**	**458.6**	**1,007.4**	**–**	**18,312.8**
Non-financial assets					**4,816.2**
Total assets					**23,129.0**
Liabilities					
Investment contract liabilities	**259.9**	**–**	**–**	**–**	**259.9**
Derivative financial instruments	**502.9**	**–**	**–**	**–**	**502.9**
Loans and borrowings	**–**	**–**	**–**	**172.0**	**172.0**
Amounts owed to credit institutions	**1,071.2**	**–**	**–**	**–**	**1,071.2**
Insurance and other payables	–	**–**	**–**	**156.7**	**156.7**
Other reinsurance liabilities	**1,992.5**	**–**	**–**	**–**	**1,992.5**
Other borrowed funds	**–**	**–**	**–**	**105.0**	**105.0**
Overdrafts	**–**	**–**	**–**	**5.6**	**5.6**
Other liabilities	**–**	**–**	**–**	**30.0**	**30.0**
Total financial liabilities	**3,826.5**	**–**	**–**	**469.3**	**4,295.8**
Non-financial liabilities					**18,166.0**
Total liabilities					**22,461.8**
Capital and reserves					**667.2**
Total liabilities and equity					**23,129.0**

54 Risk management continued

2008	Designated at fair value £m	Loans and receivables £m	Available for sale £m	Other amortised cost £m	Total £m
Assets					
Financial assets at fair value through profit or loss	16,804.2	–	–	–	16,804.2
Available for sale financial assets	–	–	662.0	–	662.0
Loans and advances to customers	–	9.7	–	0.6	10.3
Derivative financial instruments	1,027.4	–	–	–	1,027.4
Insurance receivables and other assets	–	365.8	–	–	365.8
Cash and cash equivalents	–	50.8	–	–	50.8
Other assets	–	133.0	–	–	133.0
Total financial assets	17,831.6	559.3	662.0	0.6	19,053.5
Non-financial assets					5,026.4
Total assets	17,831.6	559.3	662.0	0.6	24,079.9
Liabilities					
Investment contract liabilities	190.9	–	–	–	190.9
Derivative financial instruments	396.8	–	–	–	396.8
Loans and borrowings	–	–	–	277.0	277.0
Amounts owed to credit institutions	1,814.4	–	–	–	1,814.4
Insurance and other payables	–	–	–	291.8	291.8
Other reinsurance liabilities	2,267.7	–	–	–	2,267.7
Other borrowed funds	–	–	–	105.0	105.0
Overdrafts	–	–	–	7.1	7.1
Other liabilities	–	–	–	50.6	50.6
Total financial liabilities	4,669.8	–	–	731.5	5,401.3
Non-financial liabilities					18,005.7
Total liabilities					23,407.0
Capital and reserves					672.9
Total liabilities and equity					24,079.9

54 Risk management continued

Valuation of financial instruments

The following table details financial assets held by the Group and Society which are measured at fair value. As per IFRS 7 March 2009, an entity is required to provide a breakdown of such assets and detailing the basis on which the fair value has been determined. The valuations are categorised into a three-level hierarchy:

- Level 1 – fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 – fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices).
- Level 3 – fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

2009	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Financial investments at fair value through profit or loss	**5,273.6**	**431.8**	**185.0**	**5,890.4**
Listed debt – fixed rate	**7,752.5**	**29.7**	**–**	**7,782.2**
Unlisted debt – fixed rate	**4.9**	**5.5**	**–**	**10.4**
Unlisted debt – floating rate	**–**	**1,992.4**	**–**	**1,992.4**
Deposits with credit institutions	**1,497.6**	**–**	**–**	**1,497.6**
Total financial instruments at fair value through profit or loss	**14,528.6**	**2,459.4**	**185.0**	**17,173.0**
Derivative financial instruments	**13.0**	**668.2**	**–**	**681.2**
Total financial assets at fair value	**14,541.6**	**3,127.6**	**185.0**	**17,854.2**
Financial liabilities				
Investment contract liabilities – unit linked	**–**	**259.9**	**–**	**259.9**
Derivative financial instruments	**30.2**	**472.7**	**–**	**502.9**
Other financial liabilities	**–**	**–**	**–**	**–**
– Gift repos	**1,071.2**	**–**	**–**	**1,071.2**
– Debt securities	**–**	**1,992.4**	**–**	**1,992.4**
Total financial liabilities at fair value	**1,101.4**	**2,725.0**	**–**	**3,826.4**

2008	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Financial investments at fair value through profit or loss	13,750.8	2,846.9	206.5	16,804.2
Derivative financial instruments	1.8	1,025.6	–	1,027.4
Available-for-sale financial assets	565.6	96.4	–	662.0
Total financial assets at fair value	14,318.2	3,968.9	206.5	18,493.6
Financial liabilities				
Investment contract liabilities	–	190.9	–	190.9
Derivative financial instruments	68.4	328.4	–	396.8
Other financial liabilities	1,814.4	2,267.7	–	4,082.1
Total financial assets at fair value	1,882.8	2,787.0	–	4,669.8

55 Capital resources

	Trading Group		CFS	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Share capital	**71.9**	67.9	**64.9**	64.9
General reserve	–	–	**317.0**	317.0
Retained earnings and other reserves	**1,524.9**	1,821.7	**2,387.4**	1,500.1
	1,596.8	1,889.6	**2,769.3**	1,882.0
Perpetual non-cumulative preference share	–	–	**60.0**	60.0
Subordinated debt	–	–	**869.0**	298.4
Total capital resources	**1,596.8**	1,889.6	**3,698.3**	2,240.4

Capital management
The Group's policy is to maintain a strong base and to be more prudent than industry norms as it is not able to raise equity externally. The Group still recognises the need to maintain a balance between the potential higher returns that might be achieved with greater gearing and the advantages and security afforded by a sound capital position.

Co-operative Trading Group is not a regulated entity and manages capital to ensure an appropriate balance between investing in the future growth of the Society whilst paying distributions to stakeholders.

The Co-operative Bank plc, CIS General Insurance Limited and Co-operative Insurance Society Limited are regulated entities. Their submissions to the FSA in the period have shown that these individually regulated operations have complied with all externally imposed solvency requirements throughout the period.

Retained earnings exclude cumulative gains on cash flow hedges of £70m (2008: gain of £104.3m), cumulative gains on available-for-sale assets of £13.2m (2008: loss of £32.9m), cumulative gains on revaluation of property, plant and equipment of £94.4m (2008: gain of £94.4m) and a translation reserve gain of £1.0m (2008: gain of £0.8m).

Retained earnings include a General Reserve of £317m, which is currently held within Co-operative Insurance Society Limited outside the long-term business fund. £200m of the reserve has been hypothecated to support the long-term insurance business and the remainder is available to meet the obligations of both the long-term and general insurance business as it runs off within this legal entity.

The following are also included in the calculation of total CFS capital resources:
- Co-operative Bank plc preference shares which carry the right to a fixed non-cumulative preference dividend at a rate of 9.25%, payable 31 May and 30 November
- Subordinated debt which consists of two debt issues by The Co-operative Bank plc, £150m Step up Callable Subordinated Notes 2019 and £150m Callable Subordinated Notes 2021 fixed rate until 2016, then moving to floating rate
- Floating–rate subordinated notes 2016 which were acquired on the transfer of engagements of Britannia Building Society, were issued on 18 May 2006 at a discount of 0.14%. The bank may redeem all, but not less than all, of the notes at the principal amount on 18 May 2011, and on any quarterly interest payment date thereafter
- Fixed-rate subordinated notes 2024, acquired on the transfer of engagements of Britannia Building Society, were issued on 17 March 2004 at a discount of 1.148%. The bank may redeem all, but not less than all, of the notes at the principal amount on 2 December 2019, and on any quarterly interest payment date thereafter
- Fixed-rate subordinated notes 2033, acquired on the transfer of engagements of Britannia Building Society, 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 of the claims of depositors and other creditors of the Bank
- Upon transfer of engagements, the Britannia Permanent Interest Bearing Shares (PIBS) were converted into perpetual subordinated debt of CFS (Perpetual Subordinated Bonds). The Co-operative Group are currently discussing with HM Treasury and the Financial Services Authority whether future legislation will allow for conversion into instruments which are similar to the PIBS but are not subordinated loans.

From 1 August 2009, the Bank assumed a liability to each PIBS holder for a subordinated deposit equal to the principal amount of their PIBS. These deposits have automatically been applied in subscription to either perpetual subordinated bonds having an interest rate of 13% in respect of the First Perpetual Subordinated Bonds or perpetual subordinated bonds having an interest rate of 5.5555% in respect of the Second Perpetual Subordinated Bonds for an amount corresponding to the principal amount of that holders PIBS.

Subordinated debt is stated net of issue costs.

56 Events after the reporting period
There were no events after the reporting period.

Analysis of profits from regional business activities (unaudited)

	2009 Sales £m	2009 Profit £m	2008 Sales £m	2008 Profit £m
Central and Eastern	**812**	**70.5**	809	55.9
North	**1,355**	**94.2**	1,358	82.2
North West and North Midlands	**991**	**88.3**	975	64.5
Scotland and Northern Ireland	**892**	**75.8**	874	70.0
South East	**739**	**64.4**	704	48.4
South West	**723**	**67.4**	692	57.3
Wales/Cymru	**402**	**38.8**	402	34.6
Sales and contribution from regional business activities	**5,914**	**499.4**	5,814	412.9
Sales and profit from non-regional businesses and regional business overhead	**4,572**	**(121.9)**	1,669	(139.1)
Co-operative Financial Services	**2,020**	**277.5**	1,908	148.7
Intercompany eliminations and group operating costs	**(17)**	**(42.6)**	(30)	(29.7)
Net revenue and operating profit before significant items	**12,489**	**612.4**	9,361	392.8

Regional businesses are The Co-operative Food, The Co-operative Funeralcare, The Co-operative Travel, The Co-operative Pharmacy and Motors. The regional profits represent store contribution and are before central administration costs, significant items, profits of associated undertakings and after central charges in respect of internal rents, which are designed to reflect the use of Trading Group property by the businesses at a commercial rate.

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