BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

FINAL NOTICE

To:	**Barry Tootell**
Individual Reference Number:	**BXT01184**
Date:	**14 January 2016**

1. ACTION

1.1 For the reasons set out in this Notice, the PRA hereby:

(1) imposes on Mr Barry Tootell a financial penalty of £173,802, pursuant to section 66 of the Financial Services and Markets Act 2000 ("the Act") on the grounds that:

(a) during the period between 1 January 2009 and 10 May 2013 ("the Relevant Period") Mr Tootell breached Statement of Principle 6 of the Statements of Principle and Code of Practice for Approved Persons ("Statement of Principle 6")[1];

(b) during the period between 22 July 2009 and 10 May 2013 he was knowingly concerned in the contravention by The Co-operative Bank ("Co-op Bank" or "the Firm") of Principle 3 of the Principles for Businesses ("Principle 3")[2] during the Relevant Period; and

(2) makes an order, pursuant to section 56 of the Act, prohibiting Mr Tootell from performing any significant influence function in relation to a regulated activity carried on by a PRA-authorised person, or a person who is an exempt person in relation to a PRA-regulated activity carried on by the

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[1] The FSA Statements of Principle and Code of Practice for Approved Persons applied to Mr Tootell from 1 January 2009 to 31 March 2013 and the PRA's Statements of Principle and Code of Practice for Approved Persons applied from 1 April 2013 to 10 May 2013.

[2] Although the Principles for Businesses have now been replaced with effect from June 2014 by the PRA Fundamental Rules, the FSA Principles for Businesses applied to the Firm in the Relevant Period up to 31 March 2013 and the PRA's Principles for Businesses in the Relevant Period from 1 April 2013 to 10 May 2013.

person on the grounds that Mr Tootell is not a fit and proper person to perform such functions. This order takes effect from 15 January 2016.

1.2 Mr Tootell agreed to settle at an early stage of the PRA's investigation. Mr Tootell therefore qualified for a 30% (stage 1) discount under the PRA's Settlement Policy. Were it not for this discount, the PRA would have imposed a financial penalty of £248,289 on Mr Tootell.

2. SUMMARY OF REASONS FOR THE ACTION

Background

2.1 The PRA has decided to take this action as a result of Mr Tootell's performance of both Director (CF1) and Chief Executive Officer ("CEO") (CF3) controlled functions at Co-op Bank during the Relevant Period. Both of these functions are significant influence functions.

2.2 At the start of the Relevant Period until 22 July 2011, Mr Tootell was Chief Financial Officer ("CFO") of Co-op Bank and also responsible for the Banking Risk team at Co-op Bank. From 23 July 2011 until 5 September 2012, he was Acting CEO of Co-op Bank (having been asked to step-up with immediate effect on the departure of the previous CEO). From 5 September 2012 to 10 May 2013 he was CEO (these roles are both hereafter referred to as "CEO"). He held the Director controlled function (CF1) from 27 December 2007 until 10 May 2013 and the CEO controlled function (CF3) from 5 October 2011 until 10 May 2013.

2.3 Co-op Bank is a UK bank which provides high street and internet banking, current accounts, mortgages, savings accounts, credit cards and loans to individuals and businesses. The Firm is regulated by the PRA for prudential purposes and by the FCA for conduct matters.

2.4 Until 20 December 2013, Co-op Bank was a wholly owned subsidiary of the Co-operative Banking Group, which in turn was a wholly owned subsidiary of the Co-operative Group Limited ("Co-op Group"). Co-op Group is one of the UK's largest mutual businesses, owned by millions of UK consumers. It is a Registered Society within England and Wales and has interests across food, funerals, insurance and legal services.

2.5 Co-op Bank merged with Britannia Building Society ("Britannia"), a much larger organisation, on 1 August 2009, and acquired all the assets and liabilities previously held by Britannia. The acquired assets included portfolios of loans which had been made by Britannia to commercial borrowers, many of which were secured on commercial real estate ("CRE"). Among the accounting liabilities taken on by Co-op Bank were a series of securities known as Leek Notes which Britannia had sponsored to raise funding. The Leek Notes were secured on the cash inflows from residential mortgages.

2.6 In 2006, Co-op Bank initiated a project to replace its legacy banking IT systems with a new software platform (called Finacle), with a view to migrating its operations to this system. Following the merger with Britannia, the scope of the Finacle project was increased to cover the IT re-platforming of both the Co-op Bank and Britannia legacy businesses.

2.7 In 2011 and 2012, Co-op Bank was also engaged in a major efficiency project known as Project Unity to transfer certain Co-op Bank functions to Co-op Group in an effort to cut costs and to unify the Firm within the Co-op Group structure. The transfer of Co-op Bank functions included Internal Audit and certain Risk areas (but not the Banking Risk team). It also involved changes to reporting lines (including Mr Tootell's roles as CFO and CEO). Project Unity took up significant amounts of time and resource.

2.8 From 2011 until early 2013, Co-op Bank was involved in the consideration of, and negotiations and planning for, a proposed project to purchase 632 bank branches from Lloyds Banking Group, known as Project Verde. During this time, Project Verde was a major focus for Co-op Bank and engaged a considerable amount of time and resource. A further consequence of Project Verde was that a number of staff, including Mr Tootell, were unclear on their long-term future. In July 2012, the successful candidate for the CEO position of the prospective Verde business was publically announced and prior to this Mr Tootell was made aware that should the purchase go ahead he would not be CEO of the larger entity. However, the discussions around the feasibility of Project Verde took more time than anticipated and this uncertainty around Mr Tootell's position continued for longer than expected. It was decided, in April 2013, not to proceed with Project Verde.

2.9 Mr Tootell was placed on garden leave on 10 May 2013 and a new Acting CEO of Co-op Bank was appointed. Mr Tootell's employment with Co-op Bank ended on his resignation in December 2013.

2.10 On 17 June 2013, Co-op Bank publically announced that the Firm required an additional £1.5 billion of Common Equity Tier 1 capital. A significant part of the capital problems were as a result of large impairments to the Britannia CRE portfolio. Co-op Bank subsequently undertook a Liability Management Exercise to improve its capital position, which completed on 20 December 2013. As a consequence of this exercise, Co-op Bank ceased to be a wholly owned subsidiary of Co-op Group, although Co-op Group continues to hold more than 20% of voting rights in general meetings of Co-op Bank.

Breaches and failures

2.11 Co-op Bank breached Principle 3 between 22 July 2009 and 31 December 2013 as it failed to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. During this time:

(1) Co-op Bank's control framework was inadequate. Firms typically employ a three lines of defence model based on appropriate management oversight of the business (first line), risk and compliance (second line) and internal audit (third line). Co-op Bank sought to put in place such a three lines of defence model but this was flawed both in design and operation;

(2) Co-op Bank did not have adequate risk management framework policies or adequate policies and procedures in relation to corporate lending and capital management; and

(3) the management information produced by the Firm, including management information for its Board, was not adequate. It was not sufficiently forward-looking and did not sufficiently highlight the key issues. For example, until February 2013 no data was collected to allow the Firm to understand the number or pattern of Key Credit Criteria overrides. This meant that the Board was not appropriately apprised of key issues and information, which hampered its ability to deal with them in a timely manner.

2.12 The published PRA Final Notice dated 10 August 2015 explained these failings in more detail. They are also described in more detail in Annex A below.

2.13 In performing the CF1 (Director) and CF3 (CEO) significant influence functions at Co-op Bank during the Relevant Period, Mr Tootell breached Statement of Principle 6, which provides that an approved person performing an accountable function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his accountable function, and in addition, for all of the failings below apart from failing (3), was knowingly concerned in the Principle 3 breach by Co-op Bank (outlined above):

(1) from 1 August 2009 (the date of the merger with Britannia) until 1 October 2012 (the date that the Banking Risk structure was changed as a consequence of an initiative developed by Mr Tootell), Mr Tootell did not take adequate steps to ensure that the Banking Risk team was properly structured and organised to enable it to provide proper independent challenge and guidance to the first line business of the Firm. When Mr Tootell was CFO, he was directly responsible for the second line of defence Banking Risk team from 1 August 2009 until 22 July 2011. As CEO, from July 2011 onwards, Mr Tootell was responsible for the overall risk management framework at the Firm. The second line of defence was engaged in first line business and was not providing challenge in areas where it should;

(2) during the period when the conduct set out at (1) above was being carried out, Mr Tootell was amongst those at Co-op Bank who had been made aware that there was no independent and effective second line of defence function providing scrutiny and challenge to the decisions he and other Co-op Bank senior management were engaged in and of the significant shortcomings in the control framework more generally. Given these deficiencies, there was an even greater need for an appropriate culture within Co-op Bank in order to manage risk in a manner consistent with its risk appetite and prudent bank management more generally. However, between 22 July 2009 and 10 May 2013, Mr Tootell was centrally involved in a culture which encouraged prioritising the short-term financial position of the Firm at the cost of taking prudent and sustainable actions to secure the longer-term capital position of the Firm. Mr Tootell was centrally involved in the Firm managing its finances and capital position in a manner that was not in line with its stated cautious risk appetite and prudent bank management more generally. This included:

   (a) being the Co-op Bank senior executive overseeing the fair value adjustment ("FVA") exercise of Britannia's Corporate Loan Book (Britannia's corporate and commercial lending portfolios), which produced an FVA figure which was based on an exercise that was limited in time and scope (e.g. number of loans reviewed), which was not subsequently revised despite there being opportunity to do so, and which was at the lower end of the range of potential adjustments.

(b) being the Co-op Bank senior executive responsible for a change in the accounting/capital treatment of Leek Notes from July 2009. This change significantly boosted the Firm's short-term capital position at the expense of its medium and longer-term position and was taken in circumstances when Mr Tootell did not know if this approach would be followed in practice. When the accounting/capital assumption was not subsequently followed through, this created a negative variance to previous business plans because these costs had not been accounted for. This change in assumption also had significant implications for the Firm's market reputation;

(c) being the Co-op Bank senior executive responsible for the accounting/capital treatment of Co-op Bank's Finacle asset which artificially boosted Co-op Bank's Core Tier 1 capital position; and

(d) optimistic Corporate Loan Book (the Firm's combined corporate and commercial lending portfolio following the merger with Britannia) provisioning forecasts and impairment provision decisions and pressuring and instructing staff to amend impairment provision decisions to meet those forecasts;

(3) between 1 January 2009 and 31 July 2009, Mr Tootell did not oversee adequately the financial due diligence process on the Britannia Corporate Loan Book to ensure that it adequately identified and documented the risks inherent in the book and which may have impacted on the capital position of the Firm;

(4) between 23 July 2011 and 10 May 2013, when Mr Tootell was CEO, he was aware that the Corporate Loan Book had been identified as a significant risk to the capital position of the Firm (chiefly as a result of lending originating from the Britannia business) and that a new strategy was required for addressing this. Despite knowing this, as CEO Mr Tootell did not exercise adequate oversight in order to ensure that a clear, comprehensive and effective strategy for the Corporate Loan Book was adequately developed and implemented by the business; and

(5) between 1 January 2009 and 10 May 2013, Mr Tootell did not take adequate steps to ensure that the Board were fully and adequately briefed

about risks inherent to the business of the Firm of which he was aware and which had the potential to affect the capital position of the Firm. In particular he did not take adequate steps to inform the Board on a timely basis of the following:

(a) the extent of the limited financial due diligence that was carried out on the Britannia Corporate Loan Book prior to its merger with the Firm on 1 August 2009;

(b) how close Britannia was to potentially breaching the Material Adverse Change ("MAC") Clause of the Framework Agreement and of Britannia's deteriorating capital position during June and July 2009;

(c) the change in the capital planning assumption relating to Britannia's asset securitisation programme (the Leek Notes) in its business plan, the risks involved in this and the effect that this had on the capital position of the Firm in the short and medium-term between 22 July 2009 and May 2010;

(d) the limited nature of the FVA exercise of the Britannia Corporate Loan Book, carried out between August 2009 and March 2010; and

(e) the accounting and capital treatment of Co-op Bank's Finacle asset and the effect that this had on the capital position of the Firm in the short and medium-term.

2.14 Annexes A and B set out the full particulars of Mr Tootell's breaches.

2.15 In making the above findings against Mr Tootell, the PRA accepts:

(1) a number of factors which gave rise to some of the issues Mr Tootell was seeking to address during the Relevant Period had their origins in the pre-merger Britannia business with which he had no involvement;

(2) as CFO and CEO of the Firm, Mr Tootell was operating within established Co-op Bank corporate governance structures and, as the CEO, he took a number of steps designed to improve the Firm's risk management and control framework;

(3) the assessment of forecasts, business performance, and the appropriate level of impairment provisioning requires the exercise of management judgement; and

(4) Mr Tootell did not deliberately or recklessly breach regulatory provisions.

2.16 Notwithstanding these matters, the PRA considers that Mr Tootell's conduct was not sufficient to discharge his regulatory obligations.

PRA powers

2.17 On 1 April 2013, a new "twin peaks" regulatory structure came into being, under which the FSA was replaced by the FCA and the PRA. The effective date of that change, 1 April 2013, is known as the date of Legal Cutover ("LCO").

2.18 Although the conduct to which this matter relates began prior to, and ended after, LCO, Part 2 of the Financial Services Act 2012 (Transitional Provisions) (Enforcement) Order 2013 ("the Transitional Provisions Order") permits the PRA and/or FCA to take action under section 66 of the Act in respect of misconduct occurring pre-LCO where: (a) the controlled function which the person was approved to perform is, on the LCO, a significant influence function in relation to the carrying on of a regulated activity by a PRA-authorised person; and (b) the FSA had not, before the LCO, given a warning notice in accordance with section 67(1) of the Act in respect of the misconduct. The PRA therefore has the power to take action in relation to this matter.

2.19 Pursuant to section 69(8) of the Act, the PRA must have regard to any statement published at the time when the contravention occurred when considering whether to impose a financial penalty (and if so, in what amount). Since the Relevant Period commenced before 1 April 2013, but continued after that date, pursuant to article 3(4)(b) of the Transitional Provisions Order, the PRA's Penalty Policy is the relevant policy to which the PRA must have regard.

PRA's rationale for taking action against Mr Tootell

2.20 The PRA considers that a good risk management culture and a strong control framework are of fundamental importance in ensuring a bank's safety and soundness.

2.21 Mr Tootell's breaches of Statement of Principle 6 during the Relevant Period and his being knowingly concerned in the Firm's breach of Principle 3 between 22 July 2009 and 10 May 2013 were serious. These breaches had the clear potential to affect the safety and soundness of the Firm. Due in part to these breaches themselves, it is not possible to determine whether the capital shortfall at Co-op Bank could have been avoided. Had Mr Tootell promoted a culture which was in line with Co-op Bank's own stated cautious risk appetite, structured and organised an effective Banking Risk team, overseen adequately the financial due diligence on the Britannia Corporate Loan Book, exercised adequate oversight of the development and implementation of the Corporate Loan Book strategy and brought key issues to the Board on a timely basis, this may have increased the prospects of the Firm dealing with the issues that it faced more effectively and in a more timely manner.

Sanction

2.22 Taking into account the above facts and matters and the relevant factors set out in the PRA's Penalty Policy, the PRA considers that Mr Tootell's breaches of Statement of Principle 6 and his being knowingly concerned in Co-op Bank's breach of Principle 3 warrant the imposition of a financial penalty of £248,289. That penalty was reduced by a 30% discount to £173,802 for settlement with Mr Tootell at Stage 1.

2.23 In addition, the PRA has decided to make a prohibition order pursuant to section 56 of the Act.

2.24 The basis and computation for this penalty and prohibition are set out in Annex C.

3. FAILINGS

3.1 The regulatory provisions relevant to this Final Notice are referred to in Appendix 2.

4. PROCEDURAL MATTERS

4.1 The procedural matters set out in Annex D are important.

Robert Dedman

Chief Counsel, Regulatory Action Division

for and on behalf of the PRA

Annex A

PARTICULARS OF BREACHES AND FAILINGS

<u>Facts and Matters relied on</u>

1. Background

<u>Co-op Bank</u>

1.1 Co-op Bank is a UK bank which provides high street and internet banking, current accounts, mortgages, savings accounts, credit cards and loans to individuals and businesses. The Firm is regulated by the PRA for prudential purposes and by the FCA for conduct matters.

1.2 Until 20 December 2013, Co-op Bank was a wholly owned subsidiary of the Co-operative Banking Group, which in turn was a wholly owned subsidiary of Co-op Group. Co-op Group is one of the UK's largest mutual businesses, owned by millions of UK consumers. It is a Registered Society within England and Wales and has interests across food, funerals, insurance and legal services. As an entity ultimately wholly owned by a mutual, Co-op Bank had limited options for raising capital, and a lack of access to the capital markets. It could retain profits or receive funds from Co-op Group, but, unlike publically-listed banks, it could not issue equity shares to the public from which it could raise capital without diluting the Co-operative Banking Group's stake in the Firm. This fact is relevant to a number of the issues referred to below.

1.3 Prior to August 2009, Co-op Bank had assets of around £15 billion. In January 2009, Co-op Bank announced plans to merge with Britannia, which was a larger organisation with assets of around £35 billion. From Co-op Bank's perspective, the key driver for the merger was to acquire Britannia's extensive branch network and savings and mortgage product strength.

1.4 However, as part of the merger, Co-op Bank acquired the Britannia Corporate Loan Book of around £3.7 billion. The Britannia Corporate Loan Book had a much higher risk profile than the Co-op Bank Corporate Loan Book. For example, the Britannia Corporate Loan Book had a higher degree of sector risk (with exposure to the CRE sector, which was experiencing a period of falling asset prices), high loan-to-values ("LTV"), connection risk (i.e., a number of loans extended to a single borrower or group of connected borrowers) and concentration risk (i.e. the extent to which multiple exposures related to a particular risk sector).

1.5 The terms of the merger were agreed in January 2009 and on 1 August 2009, Co-op Bank merged with Britannia and acquired all the assets and liabilities previously held by Britannia. Among the accounting liabilities taken on by Co-op Bank were a series of securities known as Leek Notes which Britannia had sponsored to raise funding. The Leek Notes were secured on the cash inflows from residential mortgages.

1.6 In the years following the merger, Co-op Bank sought to integrate the Britannia business into its own and a number of key Britannia executives and senior managers took up important roles within the Firm.

1.7 In 2006, Co-op Bank initiated a project to replace its legacy banking IT systems with Finacle, with a view to migrating its operations to this system. Following the merger with Britannia, the scope of the Finacle project was increased to cover the IT re-platforming of both the Co-op Bank and Britannia legacy businesses.

1.8 In 2011 and 2012, Co-op Bank was also engaged in a major efficiency project known as Project Unity to transfer certain Co-op Bank functions to Co-op Group in an effort to cut costs and to unify the Firm within the Co-op Group structure. The transfer of Co-op Bank functions included Internal Audit and certain Risk areas (but not the Banking Risk team). It also involved changes to reporting lines (including Mr Tootell's roles as CFO and CEO). Project Unity took up significant amounts of time and resource. In July 2011, on the departure of the previous CEO, Mr Tootell was asked by Co-op Group to step-up to the CEO position on an Acting basis with immediate effect.

1.9 From 2011 until early 2013, Co-op Bank was involved in the consideration of, and negotiations and planning for, Project Verde. However, in April 2013 it was decided not to proceed with it. During this time, Project Verde was a major focus for Co-op Bank and engaged a considerable amount of time and resource.

1.10 On 17 June 2013, Co-op Bank publically announced that the Firm required an additional £1.5 billion of Common Equity Tier 1 capital. A significant part of the capital problems were as a result of huge impairments to the Britannia CRE portfolio. Co-op Bank subsequently undertook a Liability Management Exercise to improve its capital position which completed on 20 December 2013. As a consequence of this exercise, Co-op Bank ceased to be a wholly owned subsidiary of Co-op Group, although Co-op Group continues to hold more than 20% of the voting rights in general meetings of Co-op Bank.

1.11 During the Relevant Period, Co-op Bank sought to employ a three lines of defence model. In theory, this meant that:

(1) the first line of defence had primary responsibility for the management of risks;

(2) the second line of defence, including Compliance and Risk functions, provided independent challenge and guidance to the first line; and

(3) the third line of defence, comprising Internal Audit, provided independent assurance that appropriate procedures were in place and were being followed.

1.12 However, the design and operation of Co-op Bank's three lines of defence model was flawed. On 11 August 2015, the PRA published a Final Notice in respect of Co-op Bank, censuring the Firm for failing to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems, in breach of Principle 3. The Firm was also censured for failing to deal with its regulators in an open and cooperative way, in breach of Principle 11.

Mr Tootell's role

1.13 Mr Tootell joined the Firm in December 2007 as acting CFO, and was appointed to the role on a permanent basis in April 2008. He remained CFO until 22 July 2011. He held the CF1 (Director) controlled function from 27 December 2007 until 10 May 2013. As CFO, Mr Tootell was responsible for all aspects of financial and management accounting and financial and capital planning. Mr Tootell was also responsible for all aspects of banking risk across the Firm. Banking risk includes risks associated with matters such as credit, markets, interest rates, liquidity, treasury and capital management.

1.14 On 23 July 2011, Mr Tootell was appointed Acting CEO of the Firm. This appointment was made permanent on 5 September 2012. At this time it was known to Mr Tootell and publically that he would not remain CEO on the completion of Project Verde (the announcement of the CEO of the prospective Verde business having been made public on 19 July 2012).[3] From 5 October

[3] These roles are both referred to as "CEO" in this Final Notice.

2011 until 10 May 2013, Mr Tootell held the CF3 (CEO) function in addition to the CF1 (Director) function. As CEO from 23 July 2011, Mr Tootell was responsible for developing an overall business strategy and planning, directing and controlling the operations of Co-op Bank and leading and motivating the business in order to achieve the strategic objectives and the agreed business targets.

1.15 Mr Tootell was placed on garden leave on 10 May 2013 and a new Acting CEO was appointed. Mr Tootell's employment with Co-op Bank ended on his resignation in December 2013.

2. Inadequate Banking Risk structure

Background

2.1 Co-op Bank had an inadequate control framework in place during the Relevant Period.

2.2 Co-op Bank's three lines of defence model was flawed both in design and operation. The Firm's failure to put in place an adequate control framework during the Relevant Period resulted in a failure to organise and control its affairs responsibly and effectively with adequate risk management systems, in breach of Principle 3.

Banking Risk team

2.3 Whilst Mr Tootell was CFO, he was also responsible for all aspects of banking risk across the Firm. The Banking Risk team oversaw risks associated with matters such as credit, markets, interest rates, liquidity, treasury and capital management. As CFO, Mr Tootell was not responsible for the overall risk management framework at Co-op Bank. However, as CEO, from July 2011 until the end of the Relevant Period, Mr Tootell was responsible for this.

2.4 Second line functions should support and challenge the management of risks firm-wide, by expressing views within a firm on the appropriateness of the level of risk being accepted. In order to achieve this, these functions should be independent of a firm's revenue-generating functions and should possess sufficient authority and resource to offer robust challenge to the business.

2.5 From 1 August 2009 until 1 October 2012 (the date that the Banking Risk structure was changed as a consequence of an initiative developed by Mr Tootell), Mr Tootell did not take adequate steps to ensure that the Banking Risk team was properly structured and organised to enable it to provide proper independent challenge and guidance to the first line business of the Firm. This was recognised as an issue which a large project was intended to remedy. While not responsible for this large project, Mr Tootell did not take adequate steps to seek to ensure the area under his control functioned properly while the large project was ongoing.

2.6 In some cases, the first and second line roles were blurred, in particular within the corporate lending, capital management and treasury functions, where the second line risk teams were actively involved in the day-to-day business management and decisions. For example, the second line risk team not only managed corporate lending exceeding £0.5 million that was considered to be at risk, and hence on the Watchlist (assets showing signs of distress), but also played an instrumental role in making recommendations to the business on proposed level of impairments and collective provisions. Such direct involvement in the process prevented the second line function from providing independent challenge to provisioning levels determined by the first line.

2.7 Further, in the case of the treasury function, the Banking Risk team was inadequate. This deficiency had been identified within the Firm in early-2010, and Mr Tootell was aware of it.

2.8 The issues were raised repeatedly by Internal Audit, external consultants and the FSA. For example, an FSA 'Dear CEO' letter to the Firm, dated 8 April 2011, included the statement: "*Our review also highlighted a number of areas where the ability of the 2nd line to provide truly independent challenge to the business is limited by virtue of overlapping responsibilities. For example, we found that retail credit risk teams had responsibility for creating and challenging risk scorecards, and that the technical review of credit analytics was also performed by the same team that created the MI*". Mr Tootell was provided with a copy of this Dear CEO letter as a member of Co-op Bank's executive team and attended Co-op Bank senior management meetings in which it was discussed.

2.9 When Mr Tootell became Acting CEO in July 2011, he took some positive steps to change the organisation of the second line of defence at the Firm (including implementing in mid-2011 the Walker Review recommendation that responsibility for credit and treasury risk be transferred from the CFO to the Chief Risk Officer, bringing in additional senior staff, and bringing in external consultants to assist). However, it was not until October 2012 that the second line of defence was adequately reorganised and the delineation between first and second line roles was clarified.

3. Culture of managing imprudently, outside Co-op Bank's stated cautious risk appetite

3.1 Co-op Bank's stated risk appetite was cautious, as set out in papers produced for Co-op Bank's Risk Management Committee in November 2010 and in communications with the regulators during the Relevant Period.

3.2 Despite Co-op Bank's statement of a cautious risk appetite, during the Relevant Period Mr Tootell made decisions and relied on applications of accounting standards[4] and regulatory capital requirements which were not, on a number of occasions, in line with that stated risk appetite and thereby exposed Co-op Bank to increased risks without proper consideration of their implications or of appropriate strategies for managing them.

3.3 Firms should have a culture that supports their prudent management and individuals, whatever their position in a firm, should take responsibility for acting in a manner consistent with its safety and soundness. A culture in which historical practices and accepted orthodoxies are challenged, action is taken to address risks on a timely basis and risk and control functions carry real weight, is likely to support prudent management.

3.4 Given the significant shortcomings in Co-op Bank's control framework, there was an even greater need for an appropriate risk-focused culture within Co-op Bank. As CFO and CEO, Mr Tootell had an important role not only in managing the business but also in setting its culture.

3.5 However, Mr Tootell made a series of decisions which were designed to improve the short-term financial position of Co-op Bank, pushing problems into the future. As a result, Mr Tootell contributed to a culture in Co-op Bank which focused on improving the short-term financial position of the Firm at the cost of

[4] Requirements which apply to firms under accountancy standards may entail a degree of subjectivity and often a range of approaches are capable of meeting the strict requirements of the relevant standard. Such approaches may range from the most conservative or prudent application to one which is more optimistic. The Co-op Bank's external auditors maintained an indicative scale of 1 (most prudent) to 7 (most optimistic) to provide guidance to the Firm as to where an accounting decision or judgement might lie on the prudence spectrum, with a score of 1 or 7 being rated by the auditors as unacceptable.

taking prudent and sustainable actions to secure the longer-term capital position of the Firm.

3.6 Examples of these decisions included:

(1) the calculation of FVA on the Britannia Corporate Loan Book;

(2) Corporate Loan Book impairment provision decisions and the smoothing of monthly impairments to ensure that budgets and forecasts were met;

(3) the accounting/capital treatment for Finacle; and

(4) the accounting/capital treatment for Leek Notes.

Example 1: Accounting decisions in relation to Britannia Corporate Loan Book FVAs

Merger until 10 March 2010

3.7 An FVA exercise was to be carried out in order to establish what the actual value of the Britannia Corporate Loan Book[5] would be on the date of the merger, taking into account the future lifetime expected losses on the assets. Mr Tootell was the Co-op Bank senior executive responsible for overseeing this FVA exercise.

3.8 This FVA exercise was completed in a tight timeframe and performed on a selective, risk-based basis, with Mr Tootell instructing his team to complete the exercise in time for the publication of Co-op Bank's financial statements for year-ended 31 December 2009 on 17 March 2010. The final FVA on the Britannia Corporate Loan Book, reached in March 2010, was £284 million[6]. The final FVA was at the lower end of the range of potential adjustments.

3.9 The total FVA recorded against individual loans within the distressed pool remained the same despite an increase in the number of loans being identified as distressed and added to the pool, as follows:

(1) on 23 December 2009, the Firm calculated an FVA figure of £257 million which was attributable to 36 individual loans (but not including any of the

[5] Accountancy standards require loans which a firm intends to hold to maturity to be held at amortised cost. Therefore, as described above, Britannia loans needed to be "adjusted" to fair value in the combined Co-op Bank balance sheet as at the date of the merger.

[6] This was comprised of £257 million of "specific FVA" attributable to individual loans in the "distressed book" and £27 million "general FVA" relating to the "good book".

significant FVA that was due to be recorded against two particular exposures);

(2) on 26 January 2010, the Firm calculated an FVA figure of £257 million which was attributable to 37 individual loans (including £34.4 million FVA for the two particular exposures referred to in (1) above); and

(3) on 3 March 2010, the Firm calculated an FVA figure of £257 million (which became the final FVA figure calculated by the Firm) which was attributable to 52 individual loans.

3.10 The Firm, therefore, kept the overall amount of FVA recorded against individual corporate loans the same, at £257 million, and decreased the recorded value of specific individual FVA recorded against individual loans already within the pool by an identical corresponding amount to the value of the new distressed loans that were being added to the pool. As a result, the Firm managed to increase the number of loans in the distressed pool between December 2009 and March 2010 by 16 without increasing the overall amount of FVA. This FVA exercise was considered, by the Board, to provide comfort for the risks that the Britannia Corporate Loan Book posed.

10 March 2010 until 31 July 2010

3.11 Once the final FVA amount was determined in March 2010, it was not revised (even though Co-op Bank was permitted to do so for up to a year post-merger, up until 31 July 2010, under applicable accounting standards).

3.12 As a result, the FVA exercise did not take into account many of the findings of the case-by-case review of the Britannia Corporate Loan Book which was underway and completed in July 2010. In the event, the FVA was a significant underestimate of the actual impairments which were to arise on the Britannia Corporate Loan Book. Mr Tootell knew or should have known that, in the four months following the signing of Co-op Bank's financial statements for year-ended 31 December 2009, there was therefore an even greater risk that the FVA would prove inadequate, or at least would need revision, due to this ongoing detailed review.

Example 2: Corporate Loan Book impairment provision decisions and the amendment of monthly financial data

3.13 As CFO, Mr Tootell had overall responsibility for the compilation of the Firm's financial statements. His role description as CEO stated that he was responsible for managing all budgets. Throughout the Relevant Period, Mr Tootell was heavily involved in the forecasting and management of business performance including, on occasion, the impairment decision making process. Mr Tootell made a series of decisions in relation to impairment provisions which were designed to improve the short-term financial position of Co-op Bank, at the cost of taking prudent and sustainable actions to secure the longer-term capital position of the Firm.

Optimistic impairment decisions

3.14 For the 2011 interim and year-end financial statements, the external auditor approved the Corporate Loan Book impairment provisions as being within the acceptable range but, in reports to a Board committee, generally categorised the Firm's prudence for these provisions as being towards the optimistic end of the acceptable range being 5 (rating: "*balanced/optimistic*") out of 7 (with 7 being unacceptable). This evidenced a move away from its more balanced assessment of impairment provisioning in 2010 when the auditors categorised the Firm's prudence for Corporate Loan Book impairments as being 4 (rating: "*balanced*") out of 7.

3.15 For the 2012 interim financial statements, the Firm's prudence was categorised as being 4 (rating: "*balanced*") out of 7. However, on 20 December 2012, the FSA sent a letter to banks and building societies on loan loss provisioning which sought to ensure that firms took an appropriate approach to loan loss provisioning by setting out the circumstances when a provision should be made. This letter caused Co-op Bank to change its practice significantly and led to a large increase in impairment provisions both for the year-ended 31 December 2012 and in 2013. Following receipt of this letter, Mr Tootell was made aware internally, based on discussions with other firms, that Co-op Bank was a relative outlier in the industry in terms of its provisioning practices and that this letter did not cause most other firms to significantly change their practices.

3.16 Having set an overall risk appetite which was cautious, the Firm's impairment decisions should have been conducted within the context of that overall cautious risk appetite. Notwithstanding that these levels were in line with accounting standards, the Firm failed to recognise impairments for the Corporate Loan Book in line with that appetite in 2011 and 2012.

3.17 The fact that Co-op Bank, with Mr Tootell being a significant influence in the forecasting and management of business performance including, on occasion, impairment provision decisions, consistently took an optimistic view of the expected performance of the Corporate Loan Book in 2011 and 2012, resulted in the Firm being exposed to a significant risk that the actual performance of the Corporate Loan Book would fall short of the level for which the Firm had forecast.

Smoothing of impairments to match budgets and forecasts

3.18 The culture of encouraging priority for the short-term financial position of the Firm at the cost of taking prudent and sustainable actions for the longer-term led to the amendment of monthly financial data, generally to improve the Firm's short-term profit or capital position. Mr Tootell was centrally involved in this culture. In particular, in relation to impairments, from September 2010 onwards Mr Tootell applied pressure to staff to meet budgets and forecasts and, on occasions, instructed smoothing of monthly corporate impairments in order to match budgets and forecasts or to reduce the variance to budgets and forecasts.

3.19 Mr Tootell's decisions to amend impairments were not, in some instances, based on the factual circumstances of individual loans, but were instead based on a desire to achieve impairment targets. As a result of these issues, smoothed figures were reported to the Board. This meant that, on these occasions, the Board did not have an accurate understanding of impairments, profits and capital, which would have influenced their ability to make appropriate and timely strategic decisions.

3.20 Examples of this practice included:

(1) <u>February 2012: Mr Tootell's instruction to reverse a £20 million collective impairment provision</u>

In mid-February 2012, a decision was made to record a further £20 million collective impairment provision for the 2011 year-end financial statements.

This increase in provision appeared to be prompted by the auditor's indication that it intended to give the Bank a rating of 5 ("*balanced/optimistic*") out of 7 for prudence on corporate impairments (with 7 being "*most optimistic*" and both 1 and 7 being so extreme as to be considered an audit difference). The view was taken that an additional provision may have reduced the score to a 4 ("*balanced*").

It was intended to fund the increase in provision by reducing the bonus pot for pay-outs by £20 million.

After the Finance team worked over the weekend to make the necessary amendments to the financial statements, on the morning of Monday 20 February 2012, Mr Tootell made a judgment not to include the extra £20 million collective provision.

This decision to remove the £20 million collective provision resulted in the bonus pot being restored to its original level prior to the £20 million provision being taken. The corporate impairment provision treatment grade given by the auditors remained a 5 ("*balanced/optimistic*") on the prudence scale. The PRA does not make a finding that Mr Tootell was influenced by the impact on his bonus in making this decision to leave the overall bonus pot at its previous level.[7]

(2) <u>September 2012: pressure from Mr Tootell to ensure that the final quarterly impairment provision forecast matched the previous quarterly forecast</u>

In September 2012, Mr Tootell was determined to deliver the forecast profit figure that had been provided to Co-op Group in July 2012. It was recognised that one of the risks to achieving this was an additional amount that would need to be booked in impairment provisions against the Corporate Loan Book in the final months of the year.

Mr Tootell was determined to only report impairments that had been budgeted for in the July forecast and not to increase the impairment forecast for the final quarter of 2012. Mr Tootell emailed colleagues in mid-September 2012, stating that delivering against the half-year forecast was critical and that the September 2012 profit figures must be higher than forecast in order to maintain credibility with Co-op Group and Co-op Bank Boards. His email asked colleagues, in relation to the broader performance of the Co-operative Banking Group, to ensure that this happened and to review their figures. It stated to them that disclosing new risks or crystallised risks would not be a helpful outcome.

[7] The effect on Mr Tootell's bonus of the additional impairment provision being taken is not known.

As a result of the pressure applied by Mr Tootell, proposed impairments for October 2010 were reduced by approximately £10 million and it was planned that these would instead be recognised in December 2012 rather than October 2012, although there is no evidence that Mr Tootell was specifically aware of this. This meant that certain provisions that had been raised through the formal governance process in October 2012 were reversed, with Co-op Bank planning to book these provisions in December 2012 instead.

Mr Tootell also instructed that the final quarter forecast impairment figures be reduced to match the forecast impairment figures which had been recorded in the July quarterly forecast.

Despite evidence that the further impairment provisions would be required before the end of 2012, in October 2012 the Co-operative Banking Group (which included Co-op Bank and other subsidiary companies) reaffirmed to Co-op Group that it would achieve the profit figure that it had forecast in July.

(3) <u>April 2013: Mr Tootell's decision to delay a provision</u>

Company A was a mortgage-backed securitisation vehicle made up of various loans originating from Britannia before the merger with Co-op Bank.

The Firm had, from the end of 2012, considered raising a specific provision against Company A's exposure, and committee papers from March 2013 estimated a loss of £5 million. Before making a provision it was decided that further work was required to understand the risk. On 4 April 2013, a report suggested that the estimated loss was higher, at £7.46 million, although there is no evidence this report was shared with Mr Tootell at the time it was produced.

On 8 April 2013, a committee (which Mr Tootell did not attend) decided that Company A should be fully-impaired by £18.5 million, significantly higher than the previous estimate of loss seen by Mr Tootell. Accordingly, a full provision of £18.5 million for March 2013 was booked against Company A on 11 April 2013.

However, on or around 19 April 2013, Mr Tootell instructed the removal of the specific impairment against Company A and replaced it with a collective provision of £5 million. Mr Tootell informed colleagues that he was not prepared to agree to the provision until he was fully briefed as to the reasons why the decision had been taken even though he had been told orally what the committee's decision had been.

The reversal of the impairment provision against Company A resulted in a corresponding boost to Co-op Bank's capital position for March 2013. Only £5 million of general provisions was held against Company A, thereby overstating Co-op Bank's profits and capital position for March 2013 by £13.5 million and boosting Co-op Bank's capital position by the same amount. These overstated figures were provided to the Board and the FSA.

<u>Example 3: accounting and capital decisions in relation to Finacle</u>

3.21 Mr Tootell was responsible for the accounting and capital treatment of Finacle whilst he was CFO. He continued to be closely involved in accounting and capital decisions in relation to Finacle whilst he was CEO. Mr Tootell was responsible for accounting and regulatory capital reporting decisions in relation to Finacle from 2009 until 31 March 2013 which were not in line with Co-op Bank's stated cautious risk appetite. These had the effect of boosting the Firm's reported regulatory capital position and of deferring negative impacts on the Firm's income statement to a later period.

3.22 In 2006, Co-op Bank began a business transformation programme to re-platform its core banking software.A product called Finacle was chosen to be the platform software. This IT project was funded by Co-op Bank but held on the balance sheet of a non-consolidated sister company called CFS Management Services Limited ("CFSMS") but was, in substance, always intended for Co-op Bank's benefit. Internal presentation documents from 2008-2012 referred to at least 99% of the benefits of the new system being for the Firm and the costs of its development were in fact borne by the Firm. Save for very limited aspects, the Finacle system was never implemented, and in 2012 its development was, in effect, paused whilst options were considered in relation to the proposed Verde transaction. In June 2013, Finacle was scrapped and written-off.

3.23 Mr Tootell, in both his CFO and CEO roles, was responsible for two capital and accounting decisions in relation to Finacle which had the consequence of benefiting the Firm's capital position and which were not consistent with its stated cautious risk appetite. These had the effect of boosting the Firm's reported regulatory capital position and of deferring negative impacts on the Firm's income statement and capital to a later period. They were as follows:

(1) instead of deducting the value of Finacle from its capital declarations, as is required for intangible assets[8], and as it did in its 2010 ICAAP submission (the Firm's submission to the regulator on planning for its capital needs which the FSA/PRA reviews in setting the Firm's capital requirements), Co-op Bank chose not to deduct the value of Finacle in all other capital returns from 2009 until March 2013. Instead, Co-op Bank kept the full value of Finacle (as an intercompany debtor[9] with CFSMS) within its capital returns, including its FSA003 and FSA003+ Capital Adequacy Reports until 31 March 2013, and its 2012 ICAAP submission. This treatment as a debtor in regulatory capital returns submitted to the regulators reflected the funding that the Firm had provided to CFSMS. However, it did not reflect the substance of the Finacle project (because the debtor balance with CFSMS was backed only by the intangible asset being held for the benefit of Co-op Bank by CFSMS and so would not have been available to cover losses of the Firm) but had the effect of artificially boosting Co-op Bank's Core Tier 1 capital position by the value of the asset. In the 2012 ICAAP, this capital benefit was at least £300 million in each of the five projected years from 2012 to 2016 (with a total Core Tier 1 capital after deductions of approximately £2 billion for 2012)[10]. It was not until the Firm's 2013 year-end financial statements, after Mr Tootell had left, that Finacle was formally recognised as an intangible asset of the Firm; and

(2) in early 2013, despite strong indications and internal views that Finacle was not a viable option for Co-op Bank regardless of what happened with the Verde transaction, Mr Tootell recommended to a Board committee that it should not fully write-off Finacle and instead opt only to make a £150 million impairment provision for it in Co-op Bank's financial statements for

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[8] Regulatory capital should be available to meet any unexpected losses incurred by a firm. Where losses arise, it is often difficult to quickly realise value for intangible assets (such as licenses, patents, software etc.) which are being used by a firm in its business and, for this reason, intangible assets should be deducted from assets taken into account for regulatory capital purposes.

[9] Debtors are usually permitted to be included in assets taken into account for regulatory capital purposes because it is assumed that debts owed to a firm can be recovered from the debtor within a reasonable timeframe and the proceeds used to cover losses at the firm.

[10] Subsequently, in its year-ended 31 December 2013 financial statements, Co-op Bank restated its 2012 comparatives, bringing Finacle onto its own balance sheet instead of that of CFSMS, and deducting Finacle from its 2012 capital position as an intangible asset.

the year-ended 31 December 2012. This avoided a further loss and Core Tier 1 capital reduction at the 2012 year-end. This optimistic treatment was noted by the external auditor, who while ultimately signing off this provision, categorised it at the most optimistic end of its prudence scale being 6 ("*highly optimistic*") out of 7 (with 7 being unacceptable). Co-op Bank finally wrote-off the large majority of the remaining value (£148.4 million) of Finacle in its financial statements for period-ended 30 June 2013, shortly after Mr Tootell's departure.

Example 4: accounting and capital decisions in relation to Leek Notes

3.24 The Leek Notes were mortgage-backed securitisations sponsored by Britannia before the merger with Co-op Bank and issued by special purpose vehicles. Mr Tootell was responsible for capital strategy and planning in relation to the Leek Notes.

3.25 The Leek Notes were reflected as liabilities on Co-op Bank's balance sheet after the merger. There were a number of issues of the Leek Notes each with a maturity of up to 25 years. The Leek Notes paid a fixed rate of interest which was structured to increase to a higher rate commencing from a date five years from the date of issue (the "step-up" date). Early redemption of the Leek Notes at the option of the issuer was possible either at the step-up date or at the point at which the amount of the Notes in issue fell to a "de minimis" level (the "10% contract date")[11].

3.26 At the time of the merger, the liabilities under the Leek Notes were assessed for fair value. The fair value of these liabilities was calculated as less than the face (par) value and so an FVA[12] was recorded against them. The FVA was due to

[11] The "10% contract date" was the point at which the principal amount of Notes in issue fell to 10% or less of the principal amount of the date on which that issue originally closed.

[12] For accountancy purposes, where two firms combine, one firm is treated as "acquiring" the other. At the date of the merger, the acquiring firm is required to take on the assets and liabilities of the acquiree firm at their "fair value" at the date on which the firms combine. "Fair value" is the price that would be received to sell an asset or paid to transfer a liability in an orderly, arms-length transaction between willing parties. As accounting standards may have required items to be held on the balance sheet of the acquiree on a non-fair-value valuation basis, there may be a need to "adjust" the value of those items to fair value so that they can be correctly recorded in the balance sheet of the combined entity. For the purposes of the Co-op Bank merger with Britannia, Co-op Bank was treated as the acquirer and so Britannia's assets and liabilities had to be adjusted to fair value at the date of the merger (i.e. they were the subject of a FVA).

unwind[13] over the Useful Economic Life ("UEL") of the Leek Notes (or the assumed remaining period until redemption), causing a corresponding deduction to Co-op Bank's income statement each year. The longer the UEL of the Leek Notes, the more gradual the negative impact on the income statement (and, therefore, on the Firm's capital position).

3.27 Before the merger, the Leek Notes had always been redeemed at the step-up date. This meant that the UEL of the Leek Notes in issue was assumed to be five years. As market convention was to redeem at step-up, the reputational impact on Co-op Bank of not doing so would have been severe, potentially reducing its future ability to borrow from the market. As stated above, as an entity ultimately wholly owned by a mutual[14], Co-op Bank had limited options for raising funds, and a lack of access to the capital markets was even more serious than it would be for other non-mutual organisations.

3.28 In July 2009, shortly before the merger, Mr Tootell made the decision to change the assumption on the future redemption of Leek Notes from redeeming at the step-up date to redeeming at the 10% contract date, which was nearer the 25 year full life of the Leek Notes. This was reflected in the Firm's capital forecast for the combined entity which would be created via the merger, which was provided to the Board. This had the effect that, post-merger, the FVA would unwind much more gradually through the income statement, with a corresponding (short-term) positive impact on the Firm's capital position. This greatly improved the forecast performance of the combined entity in the years immediately following the merger. Mr Tootell did not seek the Board's approval to change the assumption, nor, in the weeks prior to merger once the change in assumption had been made, did he properly notify the Board of the change in assumption, nor did he ensure that the Board was adequately briefed about the significant positive impact the change had on capital and profits in the short-term. On 22 July 2009, the Board was provided with the following information:

> "*… Improved FV* [fair value] *adjustment unwind profile. FV work now indicates higher asset and higher liability adjustments (albeit netting to a relatively small adjustment). However, the high asset positive FVA*

[13] Where a liability in issue is taken on to the balance sheet at a fair value which represents a discount to its face (or redemption) value, that difference will be recognised through the income statement (with such recognition being spread over the remaining life of the liability before redemption) to reflect the fact that the liability is expected to be repaid at par.

[14] As set out above, at this time Co-op Bank was a wholly owned indirect subsidiary of Co-operative Group Limited which is a Registered Society (registered number 525R) in England and Wales.

unwinds occur first (higher than moderates case) yet the bulk of the high liability adjustment (negative unwind) will not now occur until future years. The impact is a benefit to capital in the earlier years compared to the business case.

The P&L [profit and loss] *profile is similarly strong due to the impact of the FV unwind.*"

However, the Board was only properly notified of the change in assumption in November 2009. The effects of the change in assumption were so great that the Board should have been kept fully informed given its role in determining the merits of merger and the risks to the Firm if it took place.

3.29 In the Firm's 2010 ICAAP, which Mr Tootell was responsible for, Leek Notes were recorded with the assumption of redemption at the 10% contract date, with a corresponding regulatory capital benefit of approximately £460 million over three years (2010-2012) compared to the position assuming redemption at step-up. In the 2010 ICAAP, the Firm recorded its assessment that there was no reputational risk associated with the change in assumption despite the large reputational risk to which the Firm would have been exposed if a change in the proposed timing for redeeming Leek Notes had been communicated to the market.

3.30 Despite assuming for accounting and capital purposes that it would not redeem the Leek Notes until the 10% contract date, the Firm redeemed issues 14, 15 and 16 of Leek Notes at their step-up dates during 2009 and 2010.

3.31 Mr Tootell's decision to account for the Leek Notes in such a way was not consistent with Co-op Bank's stated cautious risk appetite because it deferred the recognition of costs in the Firm's income statement and regulatory capital returns in a manner which exposed the Firm to additional risk, namely the reputational damage in not calling the Leek Notes in line with market expectation at step-up. It was estimated that this would result in Co-op Bank being shut out of the capital markets for several years.

3.32 There was a significant likelihood that the Leek Notes would be redeemed at step-up and that the balance of the face value of Leek Notes (in excess of the initial fair value and the unwind which had been recognised to date) would need to be recognised immediately on such redemption, creating a negative variance to budget because these amounts had not been accounted for.

3.33 Following on from the redemption at step-up of issue 15 of Leek Notes in June 2010, two projects (Albany and Lotus) were set up. They were tasked with avoiding the problem of redeeming the Leek Notes at step-up, which would hasten the FVA unwind, whilst managing the likely reputational risk and subsequent lack of access to the capital markets if Co-op Bank did not redeem the Leek Notes at step-up. In Project Lotus, which was discussed with the FSA and approved by the Board in March 2011, Co-op Bank restructured the terms of the Leek Notes by offering enhancements for a later redemption date, thus contractually extending the lives of the Leek Notes and slowing the FVA unwind.

4. Failure to take adequate steps to ensure proper financial due diligence of the Britannia Corporate Loan Book

4.1 Typically a due diligence process surrounding a financial services merger would include commercial, financial and legal due diligence. Commercial due diligence would seek to assess a business's outlook and the strategic fit of the two entities. Financial due diligence would seek to review the quality of the financial accounts of the entities (this is often carried out with the assistance of an expert third party). Legal due diligence would consider the legal ramifications of a merger on both entities. Essentially, the aim of such an exercise is to allow firms to understand the risks of a transaction so that these risks can be appropriately mitigated.

4.2 As CFO, Mr Tootell was responsible for the financial due diligence process for Co-op Bank. Mr Tootell was also responsible for instructing a consulting firm to assist with the due diligence work.

4.3 Between 1 January 2009 and 31 July 2009, Mr Tootell did not oversee adequately the financial due diligence process on the Britannia Corporate Loan Book in order to ensure that it adequately identified and documented the risks inherent in the book and which may have impacted on the capital position of the Firm. As a consequence, Co-op Bank and the Board were not in a position to properly consider the risks inherent in the Britannia Corporate Loan Book and they entered into the merger unaware of the extent of the risks that they faced from this book.

4.4 In January 2009, before the signing of the merger agreement, Co-op Bank carried out a very limited review of this book. A Co-op Bank in-house team spent two days considering around 40-50 of what were considered[15] to be the largest Britannia Corporate Loan Book loans. This was carried out by a review of files which contained little information, often with no reference to the name of the borrower but to a reference number from which the borrower could not be identified. While it was understood by Co-op Bank that many of these loans were beyond its appetite in terms of LTV, the Firm was, at that stage, unable to assess properly either the connection risk (i.e., a number of loans extended to a single borrower or group of connected borrowers) or the concentration risk (i.e., the extent to which multiple exposures related to a particular risk sector).

4.5 Given the issues regarding the type and quality of the information in the lending files, this brief file review did not carry out an adequate assessment or provide an adequate picture of the risks within the Britannia Corporate Loan Book.

4.6 The work undertaken by the consultants was also necessarily limited by the fact that they did not have access to all the relevant information, including the audit files and, in some instances, supporting work papers. Mr Tootell was also aware of this limitation.

4.7 Mr Tootell did not exercise adequate oversight over this process. He did not adequately question and challenge those undertaking the review about the extent of their review and their findings. He did not request a written report to be prepared. Had Mr Tootell exercised adequate oversight and fully understood the issues with the Britannia Corporate Loan Book, then he could not have allowed the Board to take comfort from the minutes of a committee meeting of 7 January 2009, which was provided to the Board for its meeting on 13 January 2009. In the committee meeting of 7 January 2009, a very high-level oral report on the financial due diligence of the Britannia Corporate Loan Book, which was not provided by Mr Tootell, noted that there were: "*no holes but it is noted that* [Britannia] *has a larger risk appetite and processes are not as robust*" and that "*nothing was found that was beyond addressing over time in terms of policies and processes*". This oral report did not raise significant concerns in relation to the Britannia Corporate Loan Book, nor refer to the limitations in the work carried out. Mr Tootell should have challenged this more vigorously.

4.8 Mr Tootell did not ensure that the risks pertaining to the Britannia Corporate Loan Book were sufficiently identified and planned for at the time the financial

[15] Based on what was known about the extent to which individual loans were linked to a single connection. A "connection" is a term used to refer to a borrower or group of connected borrowers which are regarded as a single exposure for credit risk management purposes.

due diligence was carried out. The limited due diligence that was undertaken by the consultants did disclose warning signs that Mr Tootell ought to have heeded, but this was not followed-up on. For example, the consultants assisting Co-op Bank with the due diligence alerted the Firm to the fact that the value of the cases on the Britannia Corporate Loan Book watchlist had increased from approximately £160 million in September 2007 to £250 million in July 2008, but no further work was performed on the financial due diligence beyond January 2009.

4.9 Between January 2009 and 1 August 2009, when the merger took place, Mr Tootell did not instruct or suggest any further financial due diligence in respect of the Britannia Corporate Loan Book, notwithstanding the fact that a further "*Phase 2*" due diligence was recommended by the consultants. The scope of this further work suggested by the consultants included exploring areas such as the key risks to each loan portfolio and concentration risk.

4.10 The Britannia Corporate Loan Book was recognised at £3.7 billion in the Britannia cessation accounts dated 31 July 2009, and impairments had increased substantially from £14 million in 2007 to £58 million in 2008, having previously been fairly stable. The Britannia Corporate Loan Book included some large and highly concentrated exposures. The total exposure of the top ten connections was £1.4 billion, with the average size of other connections being in the region of £10 million. This was substantially above the equivalent values in the Co-op Bank Corporate Loan Book. Due to the limited scope of the pre-merger financial due diligence, these concentration and connection risks associated with this book only became clear to Co-op Bank upon the initiation of the FVA exercise in late-2009/early-2010.

5. Failure to take adequate steps to ensure that there was a clear, comprehensive and effective strategy for the Corporate Loan Book

5.1 When Mr Tootell became CEO in July 2011, he did not exercise adequate oversight to ensure that a clear, comprehensive and effective strategy (with well-defined objectives, responsibilities and milestones) for the Corporate Loan Book was developed and implemented by the business.

5.2 As CEO, Mr Tootell was responsible for the overall strategy for the Firm, including its management of the Corporate Loan Book.

5.3 When he became CEO, Mr Tootell was aware that a need had been identified by the Firm to develop and implement an effective strategy for managing the Corporate Loan Book, which included the Britannia Corporate Loan Book, and that there had been a lack of progress made on developing a strategy during his time as CFO up to July 2011. By this time the high concentration and connection risks of the Corporate Loan Book had become clear and the value of the Corporate Loan Book's Watchlist was increasing. Default (assets which were non-performing) exposures doubled between the fourth quarter of 2009 (£1.3 billion) and the first quarter of 2013 (£2.6 billion).

5.4 However, Mr Tootell did not ensure that the project progressed with the appropriate urgency or pace and he did not ensure that effective targets and milestones were set for those directly engaged in the task of developing a strategy.

5.5 By the end of 2011, the CABB and Finance Divisions had split CABB into core and non-core divisions, with virtually all of the Corporate assets acquired from Britannia deemed to be non-core. Initially, the split was purely for presentational purposes, however, and no separate strategy was articulated for the "non-core" portfolio. "Non-core" was defined by Co-op Bank as assets which are not consistent with the Bank's strategy and risk appetite and which are actively managed to achieve the most appropriate asset value on an individual loan basis or targeted for run down or exit.

5.6 When the split was presented to Mr Tootell and the Board in February 2012, the presentation merely noted that appropriate strategies for both the core and non-core divisions would be developed.

5.7 During the period between the start of 2012 and April 2012, the CABB and Finance Divisions collaborated with various advisors to explore the options for the non-core part of the Corporate Loan Book.

5.8 When the strategic options for the non-core part of the Corporate Loan Book were presented to Mr Tootell and other Co-op Bank senior executives in April 2012, the various options open to Co-op Bank for the non-core part of the Corporate Loan Book were summarised, but there were no firm recommendations on the strategy to take for the non-core part of the Corporate Loan Book. A presentation to the Board in May 2012 contained similar content.

5.9 While both presentations summarised to Mr Tootell (amongst others) the various options open to Co-op Bank for the non-core part of the Corporate Loan Book, neither contained any firm recommendations on the strategy to take for the non-core part of the Corporate Loan Book.

5.10 Significantly, the presentation to Mr Tootell and the Board noted that, of the £257 million of FVAs taken against the distressed pool loans in 2010, all but £36 million had already been utilised and this final £36 million was forecast to be consumed by the end of 2012. This meant that any further impairments to the distressed pool loans would be charged against the Firm's profit and loss account. In light of this, the presentation to the Board noted the need to act with pace in formulating a suitable strategy for the Corporate Loan Book.

5.11 Despite the recognised need for urgency, when the matter was revisited at the Board meeting in September 2012, once again no overarching strategy for the core and non-core parts of the Corporate Loan Book was set out or recommended in the papers that were produced.

5.12 The plan for 2013 to 2017 was finalised in November 2012 and, for the first time, included the strategy to seek to sell a portfolio of assets from the non-core part of the Corporate Loan Book. Only £327 million of assets were earmarked for sale, out of the total non-core part of the Corporate Loan Book of £2.8 billion. The sale of these assets was estimated to release £6 million of capital via the reduction in risk weighted assets, but lead to a pre-tax loss of £113 million.

5.13 However, no firm strategy or proposed course of action was outlined for the remainder of the non-core part of the Corporate Loan Book. Instead, the issue was deferred once again, with the Board due to be updated with a disposal programme in the first quarter of 2013.

5.14 In early-2013 Co-op Bank's capital position had come under increasing pressure as a result of a number of factors. First, Co-op Bank was preparing to report a large loss for 2012 which would deplete the Firm's capital resources. The losses were primarily driven by large impairments in the CABB Division, the partial impairment of Finacle and provisions raised to cover PPI redress. Second, the FSA had issued Co-op Bank with revised capital requirements on 15 January 2013 that meant that the Firm did not meet its modified capital planning buffer.

5.15 As a result, in early-2013 various projects were initiated within Co-op Bank to try to improve the Firm's capital position. Co-op Bank began to formulate a strategy for its Corporate Loan Book, looking into the potential to dispose of Corporate assets, including loans which were in the non-core part of the Corporate Loan Book. During the first few months of 2013, Co-op Bank began to reconsider its entire approach to corporate banking and to question whether it should continue providing financing to large corporates, or whether it should focus on the small business market. Co-op Bank also began to receive offers from various parties to purchase non-core assets.

5.16 Throughout this period from July 2011 to 10 May 2013, Mr Tootell did not exercise adequate oversight to ensure that Co-op Bank developed and implemented the strategy for the Corporate Loan Book. It was not until after Mr Tootell had left the firm in May 2013 that Co-op Bank properly developed and implemented a clear and comprehensive strategy for the non-core portfolio, with defined objectives and timelines.

5.17 After Mr Tootell left, the Firm decided on an active programme of disposals for non-core loans (which included Britannia Corporate Loan Book assets), with the result that in 2013, non-core customer assets were reduced from £14.6 billion to £12.5 billion, with £1.5 billion of this reduction taking place in the second half of 2013.

6. Failure to escalate key issues to the Board

6.1 Firms should ensure that key decisions, both on assuming new risks and managing existing ones, are taken at the appropriate level within the firm, including at the level of the Board where decisions are sufficiently important. Information on material risks to which a firm is, or may be, exposed should therefore be referred or reported to the Board and senior management on a timely basis.

6.2 Between 1 January 2009 and 10 May 2013, Mr Tootell did not take adequate steps to ensure that the Board was fully and adequately briefed about risks inherent to the business of the Firm of which he was aware and which had the potential to affect the capital position of the Firm. This meant that the Board was not apprised of risks and was not able to respond to the issues on a timely basis.

6.3 The matters described below were of sufficient importance to require the Board of the Firm to be briefed on them and/or for approval to be sought from the Board before the decisions had been made. What happened, however, is that in some cases, the Board was not informed of the matter at all, and in other cases the Board was only give a partial picture of what the true position was. In both aspects, the Board was unable properly to fulfil its role.

Financial due diligence on the Britannia Corporate Loan Book

6.4 Pre-merger, Mr Tootell did not adequately inform the Board of the limited nature of the financial due diligence that was carried out on the Britannia Corporate Loan Book and the risks that this could present.

6.5 As described in paragraph 4.7 above, the only report that Mr Tootell's team provided to the Board in relation to financial due diligence on the Britannia Corporate Loan Book was in January 2009 through an oral briefing to another committee (which was then provided to the Board), which provided the incorrect assurance that "*There are no holes but it is noted that* [Britannia] *has a larger risk appetite and processes are not as robust as those of Claret* [Co-op Bank] *… nothing was found that was beyond addressing over time in terms of policies and processes.*" Mr Tootell was present at this Board meeting and did not highlight to the Board that this conclusion was based on a very limited file review that had been conducted by an in-house team because he had not challenged the extent and adequacy of the review.

6.6 Mr Tootell also did not make that Board adequately aware that, despite the limited financial due diligence work that had been carried out by the in-house team and the consultants recommending that a "*Phase 2*" due diligence be carried out on the Britannia Corporate Loan Book (as referred to in paragraph 4.9 above), no further due diligence work was carried out in respect of the Britannia Corporate Loan Book. As a consequence, before the merger, Co-op Bank and the Board were not in a position to properly consider the risks inherent in the Britannia Corporate Loan Book.

Leek Notes

6.7 Mr Tootell did not adequately consult with and communicate the change of assumption in July 2009 as to when Leek Notes would be redeemed, as described in paragraph 3.28 of this Annex, to the Board pre-merger (the earliest document which properly referenced this was provided to the Board in November 2009), despite its significant capital and market reputational implications. The Board was only properly notified of this change in assumption, via another committee, in November 2009.

6.8 The Board was not properly informed of the significant market and reputational risks of changing the assumption to calling the Leek Notes at the 10% contract date instead of the step-up date until 12 May 2010, approximately nine months after Mr Tootell decided to change the assumption.

6.9 Mr Tootell's failure to ensure that the Board was fully and promptly apprised of the effect of the change in assumption on reported performance and regulatory capital undermined the Board's ability to manage the Firm's capital position on a cautious basis, or provide challenge to the accounting decision until March 2011 when Project Lotus was approved.

MAC Clause

6.10 Between 1 July 2009 and 24 July 2009, Mr Tootell did not adequately inform the Board of Britannia's declining capital position and of the risk that this might, in due course, trigger the Britannia MAC Clause. The MAC Clause gave both Co-op Bank and Britannia the ability to withdraw from the merger in certain specified circumstances. One of these specified circumstances included where Britannia's capital headroom, relative to its capital requirements, fell below £100 million prior to completion. The potential for this trigger to be met arose from Britannia buying back subordinated debt and redeeming Leek Notes, together with a continuing depreciation in the asset value and deterioration of the business plan. Whilst Mr Tootell did escalate the issue of Britannia buying back subordinated debt to the then CEO and to the Board, he did not properly escalate to them the issue of its effect on Britannia's capital level, despite its potential impact on the Board's ability to invoke the MAC Clause and the implication that Co-op Bank would need to focus carefully on capital, post-merger.

6.11 More particularly, in the Board meeting of 22 July 2009, Mr Tootell did not make the Board sufficiently aware of these potential risks to capital, even though the expiry date of the MAC Clause was only days later and the merger was imminent. Informing the Board adequately at that time would also have allowed it to consider the potential implications of a MAC Clause breach should further capital deterioration have occurred, including whether contingency planning should have been put in place. Ultimately, there was no breach of the MAC Clause.

6.12 As a consequence of the Board not receiving all the information it should have been given, the Board did not receive proper information on the deteriorating capital position of Britannia and was not prompted to consider the serious implications which this might have had for capital management in the combined entity.

Fair Value Adjustment

6.13 Mr Tootell was responsible for the FVA exercise. The exercise produced an FVA figure of the value of the Britannia Corporate Loan Book at merger which was at the lower end of the range of potential adjustments and not subsequently revisited, despite the exercise being limited in time and loans reviewed.

6.14 Mr Tootell did not inform the Board of the limited nature of the FVA exercise of the Britannia Corporate Loan Book, carried out between August 2009 and March 2010.

6.15 The Board approved the FVA figure on 10 March 2010 as part of its approval of the 2009 financial statements. At this point, and in the preceding months of the FVA exercise, Mr Tootell did not make the Board aware of the limitations to the FVA exercise in terms of the loans reviewed and the time taken to review them. In addition, the Board was not notified that it was possible for the FVA exercise to be revised until 31 July 2010. The total FVA figure for the Britannia Corporate Loan Book that was presented to the Board for sign-off in March 2010 was presented as final and never revisited or revised.

6.16 In failing to notify the Board of the limitations to the FVA exercise, Mr Tootell did not ensure that the Board knew that the Firm faced potential additional material risks from this book which could pose significant risks to the Firm's capital position in the future.

Finacle

6.17 The accounting and capital treatment of Finacle is set out in paragraphs 3.21 to 3.23 above. Mr Tootell was responsible for accounting and regulatory capital reporting decisions in relation to Finacle from 2009 until 10 May 2013 which were not in line with Co-op Bank's stated cautious risk appetite. These had the effect of boosting the Firm's reported regulatory capital position and of deferring negative impacts on the Firm's income statement to a later period.

6.18 Mr Tootell did not adequately brief the Board as to the nature of the Finacle asset and the risks inherent in funding Finacle through CFSMS and not deducting it as an intangible asset in its capital returns. These risks were that the Firm's capital was being artificially boosted by this decision. This resulted in the Board not being aware of the Firm's true capital position or the extent of the risks that the Firm faced. As a result, it was not able to plan accordingly.

Annex B

1. BREACHES AND FAILINGS

1.1 The facts and matters to which the following conclusions relate are set out in Annex A.

Breach of Principle 3 by Co-op Bank

1.2 Principle 3 states that a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

1.3 During the period between 22 July 2009 and 31 December 2013, Co-op Bank breached Principle 3. This is because:

(1) Co-op Bank's control framework was inadequate. Firms typically employ a three lines of defence model based on appropriate management oversight of the business (first line), risk and compliance (second line) and internal audit (third line). Co-op Bank sought to put in place such a three lines of defence model but this was flawed both in design and operation. In particular:

(a) in the first line of defence, there was inadequate and inappropriate first line management oversight of the business. In particular:

(i) businesses in the Corporate Division did not properly consider risk when conducting their day-to-day business. These businesses tended to see risk as a second line responsibility;

(ii) having set a risk appetite which was cautious, Co-op Bank failed to manage its finances and capital in line with that appetite. This meant that the Firm neither adequately considered the level of risk which it assumed, nor had in place commensurate risk management capability. Examples of approaches which were not consistent with a cautious risk appetite included the Firm's decisions on FVA and impairment on the Britannia Corporate Loan Book and accounting/capital treatment for the Leek Notes and Finacle;

(iii) Co-op Bank failed adequately to identify and manage the risks associated with the Corporate Loan Book and to formulate and communicate a clear and comprehensive strategy for the management of that book until early 2013;

(iv) Co-op Bank frequently overrode its own systems and controls when making decisions in relation to the Corporate Loan Book. For example, it failed to carry out regular valuations on security held, as prescribed by its internal policy, and routinely relied on exemptions to its Key Credit Criteria ("KCC"); and

(v) a number of key issues were not brought adequately to the attention of the Board on a timely basis. For example, Co-op Bank changed the assumption in its business plan in relation to the Leek Notes (which had significant implications for its capital outlook and market reputation) but the Board was not consulted on this decision prior to it being made;

(b) the second line of defence did not provide proper independent challenge. It was poorly structured and under-resourced. In particular, its structure was fragmented and, in some cases, the first and second line roles were blurred. For example, in relation to corporate lending and capital management, second line staff took responsibility for processes which should have been conducted within the first line, resulting in a lack of independent challenge;

(c) the third line of defence did not focus sufficiently on the high-risk areas of the Firm and when it did, it did not pick up on the key issues which it should reasonably have been expected to identify; and

(d) given the significant shortcomings in the control framework, there was an even greater need for an appropriate culture within Co-op Bank in order to manage risk in a manner consistent with its risk appetite and prudent bank management more generally. However, Co-op Bank had a culture which encouraged prioritising the short-term financial position of the Firm at the cost of taking prudent and sustainable actions for the longer-term;

(2) Co-op Bank did not have adequate risk management framework policies or adequate policies and procedures in relation to corporate lending and capital management. Although the Firm, from mid-2012 onwards, took

steps towards improving its risk management framework, including engagement of an external consultancy firm to assist in defining a revised framework, it was only towards the end of the period of the breach, when new senior management had been appointed, that Co-op Bank began properly to address concerns around its risk management framework structures and policies and procedures around corporate lending and capital management; and

(3) the management information produced by the Firm, including management information for its Board, was not adequate. It was not sufficiently forward-looking and did not sufficiently highlight the key issues. For example, until February 2013 no data was collected to allow the Firm to understand the number or pattern of KCC overrides. This meant that the Board was not appropriately apprised of key issues and information, which hampered its ability to deal with them in a timely manner.

1.4 The PRA published a Final Notice explaining these failings in more detail on 11 August 2015.

Statement of Principle 6

1.5 Statement of Principle 6 states that an approved person performing an accountable function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his accountable function.

1.6 Mr Tootell breached Statement of Principle 6 and was also knowingly concerned in the breach of Principle 3 by Co-op Bank:

(1) between 1 August 2009 and 1 October 2012, by not taking reasonable steps to address the Firm's control framework failings with respect to the Banking Risk team. This failing forms part of the breach of Statement of Principle 6, and Mr Tootell was also knowingly concerned in Co-op Bank's breach of Principle 3, as set out at paragraph 1.3(1) above;

(2) between 22 July 2009 and 10 May 2013, by being centrally involved in a culture which encouraged prioritising the short-term financial position of the Firm at the cost of taking prudent and sustainable actions to secure the longer-term capital position of the Firm. This failing forms part of the breach of Statement of Principle 6, and Mr Tootell was also knowingly concerned in Co-op Bank's breach of Principle 3 as set out at paragraph 1.3(1) above;

(3) between 1 January 2009 and 31 July 2009, by not overseeing adequately the financial due diligence process on the Britannia Corporate Loan Book to ensure that it adequately identified and documented the risks inherent in the book and which may have impacted on the capital position of the Firm. This failing forms part of the breach of Statement of Principle 6;

(4) between 23 July 2011 and 10 May 2013, by not exercising adequate oversight to ensure that a clear, comprehensive and effective strategy for the Corporate Loan Book was developed and implemented by the business. This failing forms part of the breach of Statement of Principle 6, and Mr Tootell was also knowingly concerned in Co-op Bank's breach of Principle 3 as set out at paragraph 1.3(1) above; and

(5) between 1 January 2009 and 10 May 2013, by not taking adequate steps to ensure that a number of key issues were escalated to or brought to the attention of the Board on a timely basis. This failing forms part of the breach of Statement of Principle 6, and Mr Tootell was also knowingly concerned in Co-op Bank's breach of Principle 3 as set out at paragraph 1.3(1) above.

Annex C

SANCTION

1.1 The PRA has considered the disciplinary and other options available to it and has concluded that a financial penalty and a prohibition are the appropriate sanctions in the circumstances of this particular case.

Financial Penalty

1.2 The breaches of Statement of Principle 6, and Mr Tootell's knowingly concerned involvement in Co-op Bank's breach of Principle 3 occurred from 1 January 2009 and 22 July 2009 to 10 May 2013 respectively. The PRA took over prudential regulation of Co-op Bank from the FSA on 1 April 2013. As the breaches continued after 1 April 2013, pursuant to article 11(6)(b) of the Financial Services Act 2012 (Transitional Provisions) (Enforcement) Order (SI 2013/441), the PRA must apply its penalty regime set out in the PRA's Penalty Policy.

Step 1: disgorgement

1.3 Pursuant to paragraph 17 of the PRA Penalty Policy, at Step 1 the PRA seeks to deprive an individual of any economic benefits derived from or attributable to the breach of its requirements, where it is practicable to ascertain and quantify them.

1.4 There is insufficient evidence to suggest that Mr Tootell derived any financial benefit directly from the breaches. The PRA therefore has decided not to disgorge any sum from Mr Tootell.

1.5 The Step 1 figure is therefore **£0**.

Step 2: seriousness of the breach

<u>Relevant revenue</u>

1.6 Pursuant to paragraph 18 of the PRA Penalty Policy, at Step 2 the PRA determines a starting point figure for a punitive penalty having regard to the seriousness of the breach by the relevant individual, including any threat or potential threat it posed or continues to pose to the advancement of the PRA's statutory objectives. Pursuant to paragraph 20 of the PRA Penalty Policy, the

PRA will ordinarily determine a figure at Step 2 based on the individual's annual income. "Annual income" means the gross amount of all benefits, including any deferred benefits received by the individual from the employment in connection with which the breach of the PRA's requirements occurred. The PRA calculates an individual's annual income during the tax year preceding the date when the breach ended ("relevant income").

1.7 In this instance, the breach ended on 10 May 2013. Therefore, the tax year preceding this date is from 6 April 2012 to 5 April 2013 ("the 2012-13 tax year").

1.8 The PRA considers Mr Tootell's relevant income to be **£709,399**.

Step 2 factors

1.9 Pursuant to paragraph 20(d) of the PRA Penalty Policy, the PRA will apply an appropriate percentage rate to the individual's relevant income to produce a figure at Step 2 that properly reflects the nature, extent, scale, and gravity of the breach. In determining a percentage rate reflecting the seriousness of the breach, the factors to which the PRA may have regard include, as appropriate, the factors set out at paragraph 21 of the PRA Penalty Policy.

1.10 The PRA considers the percentage rate applied to Mr Tootell's relevant income should be **35**%, for the following reasons:

(1) as CFO until 22 July 2011 and Acting CEO/CEO thereafter, Mr Tootell held senior positions at Co-op Bank;

(2) Mr Tootell was responsible for all aspects of financial and management accounting and financial and capital planning as CFO and for all aspects of Co-op Bank as Acting CEO/CEO;

(3) Mr Tootell's breaches, as set out in this Notice, occurred over a long period of time, spanning almost 4½ years;

(4) Mr Tootell's breaches were serious. They had the clear potential to impact on the safety and soundness of the Firm and posed a high risk to the PRA achieving its statutory objective of promoting the safety and soundness of PRA-authorised persons. Due in part to these breaches themselves, it is not possible to determine whether the capital shortfall at Co-op Bank could have been avoided. Had Mr Tootell promoted a culture which was in

line with Co-op Bank's own stated cautious risk appetite, structured and organised an effective Banking Risk team before 1 October 2012, overseen adequately the financial due diligence on the Britannia Corporate Loan Book, exercised adequate oversight of the development and implementation of the Corporate Loan Book strategy after he became Acting CEO in July 2011, and adequately brought key issues to the Board on a timely basis, this may have increased the prospects of the Firm dealing with the issues that it faced more effectively and in a more timely manner; and

(5) Mr Tootell did not deliberately or recklessly breach regulatory provisions and no findings of dishonesty or lack of integrity are being made in relation to him.

1.11 Therefore, the Step 2 figure is **35**% of **£709,399** = **£248,289**.

Step 3: mitigating and aggravating factors

1.12 Pursuant to paragraph 24 of the PRA Penalty Policy, the PRA may increase or decrease the starting point figure for a punitive penalty determined at Step 2 (excluding any amount to be disgorged pursuant to Step 1, which is not applicable in this instance) to take account of any factors which may aggravate or mitigate the breach or other factors which may be relevant to the breach or the appropriate level of penalty in respect of it. The factors that may aggravate or mitigate the breach include those set out at paragraphs 25 and 26 of the PRA Penalty Policy.

1.13 The PRA considers that the following factors are relevant:

(1) Mr Tootell has co-operated under investigation as the PRA would expect (PRA Penalty Policy, para 25(c));

(2) Mr Tootell has no previous disciplinary or compliance record with the PRA or FCA (PRA Penalty Policy, para 25(e)); and

(3) Mr Tootell's breach took place during a period when the banking industry was under some considerable pressure which ultimately led to the collapse of a number of well-known financial institutions. Mr Tootell should have had a greater focus on the need for a more robust approach to Co-op Bank's control framework in this environment.

1.14 The PRA does not consider that, in the circumstances, these factors are sufficient to justify any adjustment to the Step 2 figure.

1.15 Therefore the Step 3 figure is **£248,289**.

Step 4: adjustment for deterrence

1.16 Pursuant to paragraph 27 of the PRA Penalty Policy, if the PRA considers the penalty determined following Steps 2 and 3 is insufficient effectively to deter the person who committed the breach and/or others who are subject to the PRA's regulatory requirements from committing similar or other breaches, it may increase the penalty at Step 4 by making an appropriate adjustment to it.

1.17 The PRA does not consider an adjustment for deterrence is appropriate in this instance. The Step 4 figure is, therefore, **£248,289**.

Step 5: settlement discount – application of any applicable reductions for early settlement or serious financial hardship

1.18 Pursuant to paragraph 29 of the PRA Penalty Policy, the PRA and the individual on whom a penalty is to be imposed may seek to agree the amount of the penalty and any other appropriate settlement terms. The PRA Settlement Policy provides that the amount of the penalty which would otherwise have been payable may, subject to the stage at which a binding settlement agreement is reached, be reduced. Paragraph 26 of the PRA Settlement Policy provides that, where the PRA proposes to impose a financial penalty under the Act and a proposed settlement agreement is negotiated by the parties, approved by the PRA's settlement decision makers and concluded, the person concerned will be entitled to a reduction in the amount of the financial penalty (as set out at paragraph 28 of the PRA Settlement Policy).

1.19 As the PRA and Mr Tootell reached an agreement at an early stage of the PRA's investigation, a 30% discount therefore applies to the Step 4 figure.

1.20 The Step 5 figure would therefore be **£173,802**.

Conclusion

1.21 The PRA therefore considers it appropriate to impose on Mr Tootell a financial penalty of **£248,289** (before the Stage 1 discount), reduced to **£173,802** (after Stage 1 discount), for his breaches of the Statement of Principle 6 and his knowingly concerned involvement in Co-op Bank's breaches of Principle 3.

Prohibition

1.22 Pursuant to paragraph 35 of the PRA Penalty Policy, the PRA may, in addition to imposing a penalty, make a prohibition order under section 56 of the Act. Such an action reflects the PRA's assessment of the individual's fitness to perform regulated activity or suitability for a particular role and does not affect its assessment of the appropriate penalty in relation to a breach of its requirements.

1.23 Under section 56 of the Act, the PRA may make a prohibition order if it appears to it that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by a PRA-authorised person or a person who is an exempt person in relation to a PRA-regulated activity carried on by the person.

1.24 The Act does not prescribe the matters which the PRA should take into account when determining fitness and propriety for the purposes of making a prohibition order. When considering whether a person is fit and proper in this context, the PRA may, amongst other things, take account of any matter to which it may have regard under section 60 when an application for approval is made. In deciding on an application for approval, section 61 of the Act permits the PRA to have regard to the qualifications, training, competence and personal characteristics of the applicant.

1.25 Under FIT 1.3.1 G, the most important considerations in such assessment are the person's: (1) honesty, integrity and reputation; (2) competence and capability; and (3) financial soundness. When determining a person's competence and capability, FIT 2.2.1A G explains that the PRA will have regard to all relevant matters including, but not limited to, whether the person has demonstrated by experience and training that the person is suitable, or will be suitable if approved, to perform the controlled function. In relation to Mr Tootell, the PRA has reflected on this guidance, and taken account also of guidance previously set out in the FSA Handbook, and from 1 April 2013, the PRA Handbook, which was in effect during the Relevant Period.

1.26 Mr Tootell breached Statement of Principle 6 and was knowingly concerned in Co-op Bank's breach of Principle 3. The gravity of Mr Tootell's breaches, as described in paragraph 1.10 of Annex C above, mean that he is not a fit and proper person to carry out a significant influence function, in relation to a regulated activity carried on by a PRA-authorised person, or a person who is an exempt person in relation to a PRA-regulated activity carried on by the person, as a result of his lack of competence and capability.

1.27 Accordingly, it is appropriate for the PRA to make an order, pursuant to section 56 of the Act, prohibiting Mr Tootell from performing any significant influence function in relation to a regulated activity carried on by a PRA-authorised person, or a person who is an exempt person in relation to a PRA-regulated activity carried on by the person on the grounds that Mr Tootell is not a fit and proper person to perform such functions.

Annex D

1. PROCEDURAL MATTERS

Decision Maker

1.1 The settlement decision makers made the decision which gave rise to the obligation to give this Notice.

1.2 This Final Notice is given under sections 57 and 67 of the Act and in accordance with section 390 of the Act. The following statutory rights are important.

Manner of and time for Payment

1.3 In view of the impact of the penalty on Mr Tootell's financial circumstances, the PRA has decided that the the sum of £173,802 should be paid in three instalments by Mr Tootell to the PRA, as follows:

(1) £57,934 to be paid by no later than 28 January 2016, 14 days from the date of the Final Notice;

(2) £57,934 to be paid by no later than 14 January 2017, 1 year from the date of the Final Notice; and

(3) £57,934 to be paid by no later than 14 January 2018, 2 years from the date of the Final Notice.

The financial penalty must be paid on these dates.

If the financial penalty is not paid

1.4 If any, or any party of, an instalment is outstanding on the day after it is due to be paid to the PRA (in accordance with paragraph 1.3 of this Annex), the PRA may recover the full outstanding amount of the financial penalty as a debt owed by Mr Tootell and due to the PRA.

Publicity

1.5 Sections 391(4), 391(6A) and 391(7) of the Act apply to the publication of information about the matter to which this Notice relates. Under those provisions, the PRA must publish such information about the matter to which this notice relates as the PRA considers appropriate. The information may be published in such manner as the PRA considers appropriate. However, the PRA may not publish information if such publication would, in the opinion of the PRA, be unfair to the person with respect to whom the action was taken or prejudicial to the safety and soundness of PRA-authorised persons.

PRA contacts

1.6 For more information concerning this matter generally, contact Robert Dedman at the PRA (tel: 020 7601 4444).

APPENDIX 1

DEFINITIONS

1. The definitions below are used in this Final Notice:

1.1 "the Act" means the Financial Services and Markets Act 2000;

1.2 "Britannia" means the Britannia Building Society;

1.3 "CABB" means Corporate and Business Banking, also known as "Corporate";

1.4 "Common Equity Tier 1 capital" means the sum of: common shares that meet the criteria for classification as common shares for regulatory purposes and which meet the criteria for inclusion in CET1 capital, stock surplus (share premium), retained earnings, accumulated other comprehensive income and other disclosed reserves and regulatory adjustments applied in the calculation of CET1;

1.5 "CFSMS" means CFS Management Services Limited;

1.6 "Co-op Bank" means The Co-operative Bank PLC;

1.7 "Co-op Group" means The Co-operative Group, the mutual society that operates a diverse range of businesses;

1.8 "Corporate" means the Corporate Banking Division of Co-op Bank, also known as "CABB";

1.9 "Corporate Loan Book" means the corporate and commercial loan book overseen by the Corporate and Markets (CAM)/Corporate and Business Banking (CABB) directorates of Co-op Bank;

1.10 "CRE" means Commercial Real Estate;

1.11 "the FCA" means the body corporate known as the Financial Conduct Authority;

1.12 "the FSA" means the body corporate known until 1 April 2013 as the Financial Services Authority;

1.13 "FSA003 and FSA003+ Capital Adequacy Reports" mean the quarterly and monthly reports made by a firm to the regulator which contained financial information relevant to the solvency of the firm;

1.14 "FVA" means Fair Value Adjustment – a merger-related adjustment which brought the book value of an asset or liability in line with the notional price that market participants would pay or receive in an orderly transaction as at the merger date, or 1 August 2009 in this case;

1.15 "ICAAP" means Internal Capital Adequacy Assessment Process – firms are required to go through this to identify how much current and future capital is necessary and to assess risks to capital and explain how these will be mitigated against;

1.16 "KCC" means Key Credit Criteria;

1.17 "LCO" mean Legal Cutover – being the date on which the FCA and PRA came into existence i.e. 1 April 2013;

1.18 "LTV" means Loan-To-Value;

1.19 "MAC Clause" means Material Adverse Change clause;

1.20 "Notice" means the PRA's Final Notice;

1.21 "the PRA" means the body corporate known as the Prudential Regulation Authority;

1.22 "the PRA's Penalty Policy" means "The Prudential Regulation Authority's approach to enforcement: statutory statements of policy and procedure April 2013 – Appendix 2 – Statement of the PRA's policy on the imposition and amount of financial penalties under the Act";

1.23 "the PRA's Settlement Policy" means "The Prudential Regulation Authority's approach to enforcement: statutory statements of policy and procedure April 2013 – Appendix 4 - Statement of the PRA's settlement decision making procedure and policy for the determination and amount of penalties and the period of suspensions or restrictions in settled cases";

1.24 "Principle" means a principle of the FSA's or PRA's Principles for Businesses;

1.25 "the Relevant Period" means the period between 1 January 2009 to 10 May 2013;

1.26 "Statements of Principle 6" means the statement of principle 6 of the Statements of Principle and Code of Practice for Approved Persons;

1.27 “the Transitional Provisions Order” means the Financial Services Act 2012 (Transitional Provisions) (Enforcement) Order 2013;

1.28 “the Tribunal” means the Upper Tribunal (Tax and Chancery Chamber);

1.29 “UEL” means useful economic life – a measurement of the life of an asset; and

1.30 “Verde” or “Project Verde” is the name used within Co-op Bank to describe the proposed acquisition of 632 branches of the Lloyds Banking Group.

APPENDIX 2

RELEVANT STATUTORY AND REGULATORY PROVISIONS

1.1. The PRA's general objective, set out in section 2B(2) of the Act, is promoting the safety and soundness of PRA-authorised persons. Section 2B(3) of the Act provides that the PRA's general objective is to be advanced primarily by (a) seeking to ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system, and (b) seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

1.2. Section 66 of the Act provides that the PRA may take action against a person if it appears to the PRA that he is guilty of misconduct and the PRA is satisfied that it is appropriate in all the circumstances to take action against him. A person is guilty of misconduct if, while an approved person, he has failed to comply with a statement of principle issued under section 64 of the Act, or has been knowingly concerned in a contravention by a relevant authorised person of a relevant requirement imposed on that authorised person.

1.3. Section 56 of the Act provides that the PRA may make an order prohibiting an individual from performing a specified function, any function falling within a specified description or any function, if it appears to the PRA that that individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by a PRA-authorised person or a person who is an exempt person in relation to a PRA-regulated activity carried on by the person. Such an order may relate to a specified regulated activity, any regulated activity falling within a specified description, or all regulated actives.

RELEVANT REGULATORY PROVISIONS

Statements of Principle and Code of Practice for Approved Persons

1.4. The FSA's and the PRA's Statements of Principle and Code of Practice for Approved Persons have been issued under section 64 of the Act.

1.5. FSA's Statement of Principle 6 (in force until 31 March 2013) states:

"An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function."

1.6. PRA's Statement of Principle 6 (in force from 1 April 2013) states:

"An approved person performing an accountable function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his accountable function."

1.7. The Code of Practice for Approved Persons sets out descriptions of conduct which, in the opinion of the FSA or the PRA (as applicable), do not comply with a Statement of Principle. It also sets out factors which, in the FSA or the PRA's opinion (as applicable), are to be taken into account in determining whether an approved person's conduct complies with a Statement of Principle.

Principles for Businesses

1.8. The FSA and PRA's Principles for Businesses' ("PRIN") have been issued under section 64 of the Act.

1.9. Principle 3 states:

"A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems."

The Fit and Proper Test for Approved Persons

1.10. The part of the PRA Handbook entitled "The Fit and Proper Test for Approved Persons" ("FIT") sets out the criteria that the PRA will consider when assessing the fitness and propriety of a candidate for a controlled function. FIT is also relevant in assessing the continuing fitness and propriety of an approved person.

1.11. FIT 1.3.1G states that the PRA will have regard to a number of factors when assessing the fitness and propriety of a person. The most important considerations will be the person's honesty, integrity and reputation, competence and capability and financial soundness.

The PRA's policy for exercising its power to impose penalties and make a prohibition order

1.12. The PRA's policy in relation to the imposition and amount of financial penalties and making prohibition orders is set out in the PRA's Penalty Policy.

1.13. The PRA's Penalty Policy states that the PRA may, in addition to imposing a penalty, make a prohibition order under section 56 of the Act and that such action would reflect the PRA's assessment of the individual's fitness to perform a regulated activity or suitability for a particular role.