

Mortgage
balances

grew to

£2bn

by the end of
the financial
year

Delivering value

True corporate sustainability relies not only on delivering social responsibility and ecological sustainability, but also on satisfying the desires and needs of a range of Partners

CFS aims to deliver value to all its Partners in a balanced fashion over time, where 'value' is defined by the Partner, not by CFS. CFS is seeking to enhance the utility enjoyed by those groups on which its business is, to varying degrees, dependent. This is what makes CFS' approach to sustainable development a genuine triple bottom line sustainability strategy (ethics, ecology and value). True corporate sustainability relies not only on delivering social responsibility and ecological sustainability, but also on satisfying the desires and needs of a range of Partners.

Ascertaining priorities

Determining the views of Partners, such as Shareholders, Suppliers, Customers and Staff, is relatively straightforward; research is usually carried out via a combination of focus groups, postal questionnaires, telephone and internet surveys. However, with Partners such as Society and the Co-operative movement, it is more difficult. In such instances it is necessary to identify and work with trusted proxy representatives – invariably charities and campaigning groups. To guide these discussions, the bank has its Ethical Policy (page 55), which outlines its approach to a range of ethical and sustainability matters. Work is underway (page 47), to establish a customer-mandated Socially Responsible Investment Policy for CIS. In relation to the Co-operative movement, CFS is guided by the internationally recognised Co-operative Principles, as described on page 15.

Performance over time

In this first CFS Report, ethical and sustainability performance is attributed in most instances to either CIS or The Co-operative Bank. In 2003, the vast majority of staff, supplier and customer relationships, for example, were still distinct – with either CIS or the bank. Year-on-year comparison of performance is therefore still valid in most instances. One exception to this is the area of staff satisfaction, as measured by the staff survey process; where the inclusion of CIS Insurance Sales staff for the first time, and the advent of CFS central functions, renders year-on-year comparison very difficult. As a consequence of this, CFS staff responses are compared with an amalgamation of prior year data for CIS and bank staff (page 37-39).

As the bank has reported on sustainability for longer than CIS, its performance is discernible for a longer period of time. Going forward, as CFS consolidation proceeds, the lines between each business will become increasingly indistinct, and in many instances the only relevant perspective will be that of CFS.

Developments

In this Report, CFS provides an analysis of the financial costs and benefits of its pursuit of sustainable development (pages 27-28). As part of this analysis, CFS discloses the contribution made by the bank's ethical and sustainability positioning. CFS also provides an analysis of the provision of banking and insurance products in 'deprived areas'

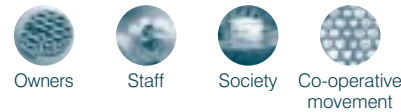
(pages 34-35). CFS provides details of staff satisfaction. Under the banner of 'Influence and action', details are provided of instances where CFS has sought to influence the social and environmental dimensions of various legislative proposals during 2003. For the first time, CFS reports on an ethical and sustainability analysis of the bank's corporate and business banking lending and deposits balance sheet (pages 35-36), suppliers' satisfaction with their relationship with CIS (pages 40-41) and customers' satisfaction with CIS, according to MORIⁱⁱ (pages 30-32). Visit CFS' websiteⁱⁱⁱ for a full list of the standards and guidelines considered, and CFS' involvement in each.

Assurance

An assessment of the degree to which CFS succeeds in delivering value to its Partners is provided by Mark Goyder, Director of Tomorrow's Company^{iv}, on page 92. For further details, please contact Jayne Beer, Manager, Sustainability Reporting and Diversity (jayne.beer@cfs.co.uk).

i www.ica.coop/ica/info/enprinciples.html
ii www.mori.com
iii www.cfs.co.uk/sustainability2003/standards
iv www.tomorrowcompany.com

Financial performance



2. Profit
3. Income
4. Cost/Income ratio (Bank)
5. Average retail balances (Bank)
6. Return on equity (Bank)
7. Insurance funds under management (CIS)
8. Sustainability value analysis
9. Wealth creation

Targets 2003

- Further improve the bank's profits. **Target achieved**
- Maintain the reduction in the bank's cost/income ratio. **Target not achieved**

Commentary

Context The Co-operative Bank is a public limited company and its sole equity shareholder is the Co-operative Group. The bank also has approximately 2,500 preference shareholders who receive a half-yearly fixed dividend. CIS is a co-operative society registered under the Industrial and Provident Societies Act. CIS' share capital consists of 105,000 £1 shares, held by Co-operative Financial Services (CFS) and the Directors of CIS, who each hold one share for the duration of their office. CIS and the bank are now held by CFS, an Industrial and Provident Society formed in April 2002 to bring the two businesses together under common leadership. Whilst the financial accounts of the bank and CIS remain discrete, both contain central costs associated with the creation of CFS, which are apportioned between the two businesses on an agreed basis.

Financial results – Bank In 2003, The Co-operative Bank achieved a profit before tax of £130.1 million, £7.6 million (6.2%) higher than 2002 despite significant investment in business development. Earnings attributable to the equity shareholder, after tax and before an ordinary dividend payment of £20 million, were £83.4 million, a rise of 6.6%. The return on opening equity, after tax, was 17.6%. The increase in profitability arose from a 4.0% rise in operating income and a 9.7% reduction in the charge for bad debts, which was partially offset by higher operating costs.

Balance sheet – Bank The balance sheet remained robust throughout the year with strong liquidity and capital ratios. The year-end risk asset ratio was 13.5% with a Tier 1 ratio of 10.5%, substantially higher than the regulatory requirements. In 2003, growth in both retail customer deposit and lending balances was strong. Average customer retail deposits of £6,158 million grew by £680 million (12%) over the year and were £1,208 million higher than retail lending balances. Average customer retail lending balances increased at a faster rate than deposits and were £4,950 million for the year, higher than 2002 by £1,005 million (25%), reflecting particularly good growth in secured mortgage balances (page 31). As a result, average retail deposits were 124% of average retail lending balances compared to 139% in 2002. During 2003, asset growth was targeted carefully at the residential mortgage market thus improving the bank's product mix, whilst maintaining both credit quality and a diversified yet balanced portfolio of personal and corporate business. As a result, although lending increased in both the Corporate and Personal sectors, growth was stronger in the Personal sector during 2003. Personal sector average lending increased by £976 million to £3,181 million, due to the strong growth in mortgage lending together with an increase in

Visa credit card lending. Personal loan balances remained stable, reflecting the impact of the bank's cautious credit criteria.

Financial results – CIS In 2003, CIS' total premium and unit trust income decreased to £1,971 million, a fall of 11%. Profit before tax from the general insurance business (excluding short-term investment fluctuations) rose to £61.7 million, compared with £27.5 million in 2002. The result, including short-term investment fluctuations, was a pre-tax profit of £134.6 million, compared with a pre-tax loss of £257.5 million in 2002.

Financial strength – CIS CIS has always maintained a strong capital position. CIS supports the industry's and the FSA's move to the realistic basis of calculating solvency capital. The proposed new solvency requirements are undoubtedly challenging, but CIS has been monitoring their effect on the balance sheet of its with-profits fund for some time. CIS is continuing to work towards these new requirements and is confident that it will remain appropriately capitalised. The amount of money managed on behalf of investors rose by £1.6 billion to £19.1 billion. £313 million was transferred to the Fund for Future Appropriations, compared with a transfer from reserves during 2002 of £1.2 billion. CIS has maintained the dividend on co-operative

societies at the same rate as in previous years, resulting in a distribution of £3.3 million to the societies that trade with CIS (page 43).

Investments – CIS Investment activity continued to focus on ensuring an appropriate balance between equities and other assets such as gilts, bonds and commercial property. The UK equity market (stock market), in common with all other major equity markets, fell further and sharply in the early part of 2003; and at one stage, the UK equity market fell to its lowest point since 1997. However, as evidence emerged of a recovery in the global economy, these markets recovered some of their earlier losses and generally continued to rise during the rest of 2003. As a result, for the first time in four years, equities performed better than any other asset class invested in by CIS. The total growth return over the year for the UK equity market was 20.8% and, for overseas markets, the FTSE World (excluding UK) Index provided a total sterling return of 20.7%. The property market continued to perform well, producing an estimated return of 11.3%; however, UK gilts and bonds were relatively disappointing, with longer-dated government securities only showing returns of around 1.2%. During 2003, CIS carried out a large programme of sales of both UK and overseas equities held by the long-term business fund. In total, almost £3 billion of

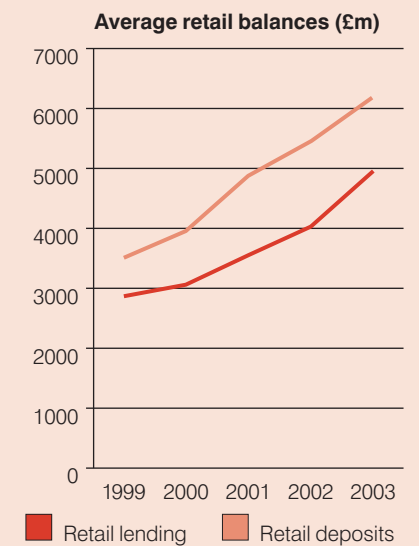
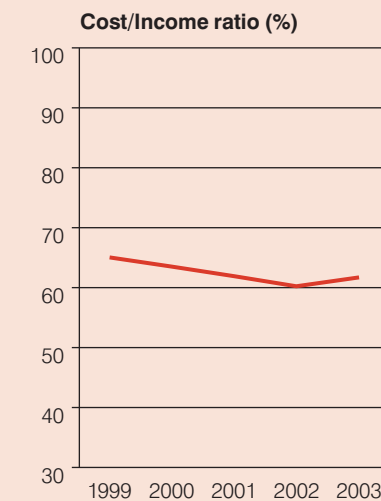
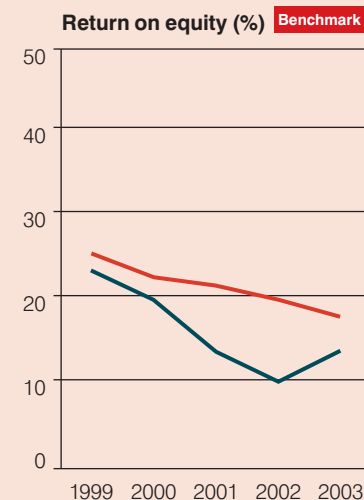
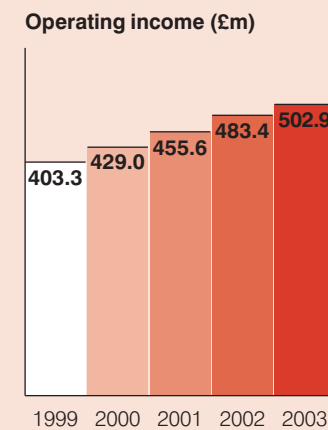
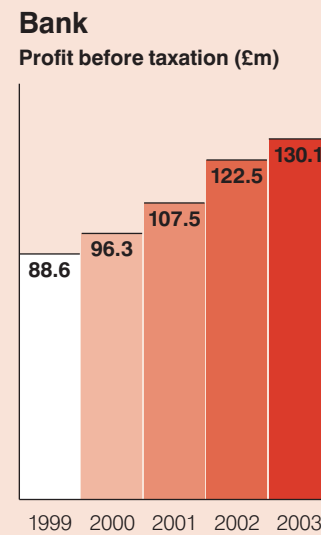
equities were sold, mostly towards the end of the year when markets had shown significant recovery from their lows. CIS invested most of the proceeds of this programme – together with the net new cash flow of over £270 million that became available for investment – in the sterling fixed-interest markets, and retained the rest as cash. Significant dealings in the UK commercial property market resulted in net sales of around £50 million. Corporate activity in the equities market was at a much lower level than in 2002, with the fund receiving less than £50 million from takeovers and capital reconstructions. For the general business funds, a net cash flow of around £60 million became available for investment, which was retained as cash. CIS also reduced its exposure to equities. Investment income for the long-term business fund, excluding investment gains and losses, and net of investment expenses, was £724 million. The corresponding figure for the general funds was £99 million.

Sustainability value analysis For some time, The Co-operative Bank has been recognised as a leading proponent of the sustainable development business model. MORI Financial Services conducts research, published biannually, into the influence of various factors on the opening of personal current accounts. This research strongly indicates that, whilst

'ethics' is a major determining factor for customers of The Co-operative Bank (24% cite ethics as being influential in opening an account, and this is by far the most frequently specified reason), it is only rarely specified by customers of other banks (fewer than 1% of customers cite ethics as being influential in opening an account).ⁱ This is the third year in which a sustainability value analysis has been undertaken in relation to the bank, and the first year for CIS. The analysis contains two elements:

- **Estimate of the total profitability contribution made by the bank's ethical and sustainability positioning.** Currently, this analysis is restricted to the bank. At the moment, CIS does not have a significant core of customers for whom 'ethics' is a major driver. It is anticipated that the development of a customer-mandated CIS Socially Responsible Investment Policy will result in increases from 2005 and beyond (see page 47). The total profitability contribution has, to date, been determined by aggregating the profitability contribution derived from ethically and environmentally motivated customers for each product. This year, the bank has refined its research process and has added an additional 'motivational' category – co-operative movement/heritage – which enables the bank to capture information on those customers who

Performance



Profitability contribution of the bank's ethical and sustainability positioning

		Profitability contribution made by customers who state that ethics is the most important factor	Profitability contribution made by customers who state that ethics is an important factor
As a percentage of profit before tax	2001 ^{vi}	14%	25%
	2002 ^{vii}	13%	24%
	2003 ^{viii}	17%	30%

vi Profit before tax as reported in the bank's interim results to 28th July 2001: £60.2 million
vii Profit before tax as reported in the bank's full year results: £122.5 million
viii Profit before tax as reported in the bank's full year results: £130.1 million

are attracted by the co-operative aspects of the bank's brand positioning (as opposed to 'ethics' and 'environment'). The bank's co-operative, ethical and sustainability positioning has contributed to the bank's profitability. In 2003, 30% of bank profits can be attributed to customers who cite these as important factors (2002: 24%), and 17% to customers who cite these as the most important factors (2002: 13%). Of the profitability attributed to customers who cite this positioning as the most important factor, 72% is attributable to Personal Banking customers (2002: 72%) and 28% to Corporate and Business Banking customers (2002: 28%). Of the profitability attributed to customers who cite it as an important factor, 70% is attributable to Personal Banking customers (2002: 68%) and 30% to Corporate and Business Banking Customers (32%).

• **Costs/benefits to CIS and the bank of particular sustainability initiatives.** The impact of ethical factors on specific CFS decisions is calculated and disclosed (e.g., the additional costs associated with the purchase of green electricity), together with any ethical overheads (e.g., the costs associated with maintenance of the Sustainable Development Team). Individual findings are presented throughout the report

and a summary is available on the website.ⁱⁱ No attempt is made to integrate or 'net off' these two elements. The first part of the analysis relates to 'real' profitability calculations, whilst the second part includes 'hypothetical' costs (e.g., the opportunity cost of declining corporate business as a result of the bank's Ethical Policy) and savings (e.g., the cost savings arising from the switch to remanufactured toner cartridges across CFS). The two elements are considered to present different aspects of the costs and benefits of pursuing sustainable development. For further details of how the bank determines the total profitability contribution made by its ethical and sustainability positioning visit the website.ⁱⁱⁱ

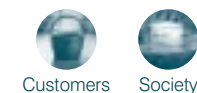
Wealth creation – CFS 'Economic Value Added' expresses the contribution to national wealth made by a commercial organisation,ⁱⁱⁱ and seeks to recognise that a variety of Partners can benefit from such wealth creation. For example, economic value can be disbursed to staff in the form of salaries and other benefits, to the state in the form of taxes, to charitable causes in the form of donations, and to owners in the form of profit, dividend and reserves. Of the £278.1 million Economic Value Added created by The Co-operative Bank in 2003, £112.2 million (40.3%) was distributed to the bank's owners, £39.1 million (14.1%) to the state and £126.8

million (45.6%) to staff. Of the £471.9 million Economic Value Added created by CIS in 2003, £146.1 million (31%) was distributed to CIS' owners and £327.7 million (69.4%) to staff.^{iv} Further analysis of CIS' and the bank's Economic Value Added is provided on CFS' website.^v

Summary – CFS The Co-operative Bank's profitability has continued to grow steadily, despite increased competition and a narrower interest margin. In 2003, trading conditions continued to be generally quite difficult for the insurance industry, with continued low consumer confidence in investments and some particularly tough challenges for the life industry. However, throughout the year, CIS continued to maintain its customer focus, and apply sound, prudential management to the running of its business. The development of CFS as the financial services provider for co-operative customers, together with a unique ethical stance, ensures that both businesses are well placed to innovate and compete in a challenging and changing UK financial services market.

i MORI Financial Services Survey, twelve months ending December 2003.
 ii www.cfs.co.uk/sustainability2003/costbenefit
 iii Where 'Economic Value Added' equals the sum of operating profit, employee costs, depreciation and amortisation.
 iv In 2003, CIS recovered tax of £1.9 million on profit on ordinary activities.
 v www.cfs.co.uk/sustainability2003/valueadded

Personal customers



- 10. Social inclusion
- 11. Satisfaction with service
- 12. Satisfaction with relationship
- 13. Satisfaction with ethics and sustainability
- 14. Complaints
- 15. Network developments

Targets 2003

- Open a bank branch in Belfast. **Target achieved**
- Increase the percentage of paper applications on all major bank account types processed within 48 hours to 95%. **Target not achieved**
- Increase the percentage of customers stating that their relationship with **smile** is 'excellent' or 'good' to 90%. **Target achieved**

Targets 2004

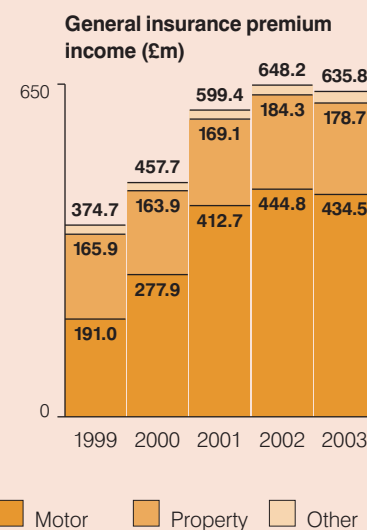
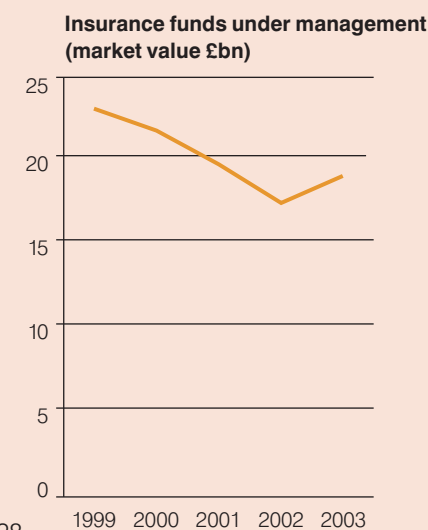
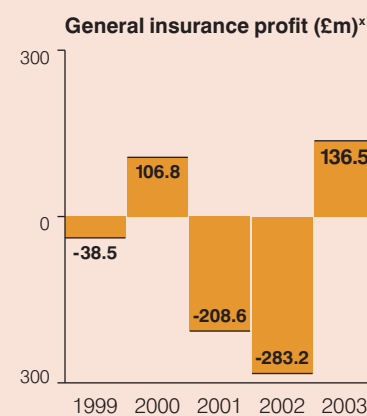
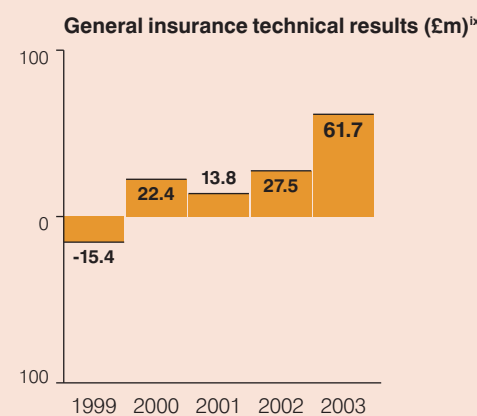
- Seek to improve customer services in the PPIAB-defined areas required for CIS to maintain 'Raising Standards' accreditation. **Chris Shutt, Head of Service Management, Life and Savings Business Unit**
- Research, develop and launch an Income Protection product in 2004. **Fiona Jackson, Head of Protection, Life and Savings Business Unit**
- Develop a direct sales and servicing capability for motor and home insurances, to further enhance CIS' multi-channel distribution and servicing capabilities. **Mike Pressland, Head of Direct Distribution, General Insurance Business Unit**
- Explore the impact of financial capability and low income on consumers' ability to access credit. **Chris Smith, Head of Community and Co-operative Affairs**
- Ensure that at least 90% of customers say that their relationship with **smile** is 'excellent' or 'good'. **Phil Garlick, Director of Operations, smile**

Commentary

Context CIS and the bank provide a range of banking, insurance and investment products to more than seven million customers. Whilst CFS has begun to market insurance products to banking customers and vice versa, during 2003, the customer bases and the majority of service channels remained distinct to each organisation. For a number of years, the bank has reported the satisfaction of its current account customers, based upon their rating of service, relationship and ethics, which are customers' priority issues (page 14). In addition, using MORI Financial Services' data, the bank has previously reported customer satisfaction for other high volume products, such as savings, loans and Visa credit cards, and benchmarks this against the industry average. This year for the first time, customer satisfaction research is being reported for CIS' major product categories (motor insurance, home insurance, life assurance and pensions). Additionally, MORI Financial Services' satisfaction data is provided for CIS' motor, home, life assurance and pension customers. Taken together, the products for which MORI Financial Services data is available account for 76% of all CFS accounts/policies held by customers, by number.

Social inclusion A critical component of social inclusion is the need for good access to routine banking facilities, described as 'financial inclusion'. Financial Services organisations can play a role in tackling financial exclusion through the provision of basic banking facilities and insurance products. CFS discloses the profile of the customer bases of several key products – bank current accounts, bank loans, CIS pensions and CIS life assurance – on the basis of Experian's MOSAIC classification of Great Britain households.^{ix} A comparison with the population indicates that CIS has proportionately more customers in MOSAIC groups C 'Blue Collar Owners' and D 'Low Rise Council' and fewer customers in groups E 'Council Flats' and F 'Victorian Low Status'. A comparison with the population indicates that the bank also has proportionately more current account and loan customers in MOSAIC group C 'Blue Collar Owners' and a lower than average proportion of customers in group E 'Council Flats'. The substantial increase in the number of customers holding the bank's 'basic' bank account, 'Cashminder' (up 76% to 24,581 in 2003), has had only a marginal impact on the MOSAIC profile of the current account base, in the groups where increases might have been expected. The increase in Cashminder account holders may be attributable to the launch of Universal Banking Services (UBS), which

CIS



ix Profit before tax from the general insurance business (excluding short-term investment fluctuations).
 x Post tax profit/loss for the general insurance business.

Source: CIS Finance 2004

CIS and bank customers are more satisfied with service in every major product category



became available through the Post Office in April 2003. This aims to facilitate the direct payment of state benefits. The bank's Cashminder account was one of a number of 'basic' banking products that was intended to assist with this initiative. In support of the launch of UBS, the bank briefed customer service staff to ensure that they could respond to customer queries. As part of the bank's ongoing programme to improve access to banking facilities through Co-op shops, 559 cash machines were installed in Co-op shops throughout the UK in 2003 (see page 42). Both CIS and the bank continued to promote financial inclusion through their involvement with the Credit Union movement. This included sponsorship of the Association of British Credit Unions' (ABCUL)ⁱⁱⁱ national and regional conferences in 2003, promotion of the PayPoint network to credit unions^{iv} and through the considerable involvement of staff members in credit union activities (see page 43 for further details).

Customer satisfaction – CIS 87% of customers said that they would be likely to recommend CIS to a friend, of whom 62% said that they would be very likely to make such a recommendation. 70% of customers said that they considered their relationship with their agent to be 'excellent' or 'good'. Research revealed a low level of awareness (30%) of CIS' ethical and sustainability commitments. However, 85% of those aware said they were satisfied with performance. It is envisaged that the project to establish a customer-mandated policy for CIS' approach to Socially Responsible Investment (page 47) will increase awareness of these issues in 2004. **Benchmark** MORI's surveys show that CIS' motor insurance, home insurance, life assurance and pensions customers (which represent 68% of all CIS policies) are more likely to be very satisfied than the market average. CIS received external recognition for its products and services at the Guardian Observer Consumer Finance Awards 2003, collecting the award for Best Car Insurance Provider and a runners-up place in the Best Home Insurance Provider category.

Customer satisfaction – Bank Current account customers' overall satisfaction with the bank has increased markedly during 2003, with 88% rating their relationship as 'excellent' or 'good', of whom 34% described it as 'excellent' (2002: 24%). 87% of customers state that they would be likely to recommend the bank to a friend (2002: 82%). There has been a slight decrease in customer awareness of the bank's ethical and sustainability positioning, from 79% in 2002 to 76% in 2003. Of those aware, satisfaction has remained constant at 91%, but there has been a 17 percentage point increase (to 50%) in the number of customers stating that they are 'very

satisfied' with the bank's ethical and sustainability performance. **Benchmark** MORI's surveys show that Co-operative Bank current account, savings, credit card and loan customers (which represent 96% of all bank accounts) are more likely to be very satisfied than the market average. According to MORI, 43% of The Co-operative Bank's current account customers are very likely to recommend the bank (2002: 56%), compared with the market average of 32% (2002: 33%). The bank received external recognition for its products and services at the Guardian Observer Consumer Finance Awards 2003. The bank was runner-up in the categories of Best Mortgage Provider and Best Independent Financial Adviser, and was short-listed in the Best Current Account (off-line) category. **Customer satisfaction – smile** Research undertaken amongst customers reveals that **smile** is exceeding the expectations of the vast majority, at a time when their expectations are increasing. Competitive interest rates and the convenience of the **smile** banking experience continue to be cited as the two main reasons for **smile** account opening. There has been an increase of two percentage points (to 36%) in the number of customers who agree that the **smile** banking experience is 'excellent – I can't praise it enough'. A further 54% (2002: 54%) agree that 'it is good – well above what I

expected'. Furthermore, **smile** customers' propensity to recommend the bank to their friends has increased, with 94% stating that they would be 'likely' to recommend (2002: 90%) – 72% of whom said they would be 'very likely' to recommend (2002: 57%). **Benchmark** **smile** continues to be the only UK-based bank accredited by the British Standards Institution for Information Security Management Systems. **smile** received a number of awards in 2003, including: Best Online Bank and Building Society Website (Online Finance Awards 2003); Best Internet Banking Provider; Best Internet Credit Card Provider, Best Internet ISA Provider, Best Internet Savings Account Provider and Best Internet Personal Loan Provider (Your Money Direct Awards 2003); Best Overall Customer Service, Best Online Current Account and Best Credit Card (Guardian Consumer Finance Awards 2003). **smile** topped Virtual Surveys' Quarterly UK league table for electronic banking customer satisfaction three times in 2003, receiving a score of 4.4 in the last survey. This compares with a mean industry score of 3.8.

Complaints – CIS In 2003, CIS received a total of 48,268 complaints (2002: 48,589), of which 30,397 were 'regulated' complaints – i.e. those relating to the sale of life assurance, pensions and investment products (2002: 38,461). Whilst the number of regulated complaints fell

by approximately 21%, the number of non-regulated complaints increased by 76%. These changes result from amendments to the complaints categorisation process introduced in 2003. 2003 saw a five percentage point improvement (to 95%) in the number of regulated complaints being provided with a response within 5 days. At the end of December 2003, there were 1,950 outstanding cases, representing 4% of the total number received during the year.

Complaints – Bank The Co-operative Bank was the first high street bank to provide all customers with service level guarantees^v covering routine banking facilities; where the bank falls short, it rectifies the error, apologises to customers and pays £15 in compensation. The bank received a total of 12,172 written complaints in 2003. 1,222 (2002: 1,170) complaints were referred to the bank's Customer Care team, of which 160 were issued with Final Responses, enabling the customer to refer the complaint on to the Financial Ombudsman Service. Research shows that, of those customers who had cause to complain to the bank in 2003, 70% felt that the matter had been dealt with quickly and without fuss (2002: 56%). **Benchmark** 9% of the bank's current account customers surveyed by MORI in December 2003 had complained during the year (2002: 6%). By comparison, 9% of all

other banks' current account customers surveyed by MORI in December 2003 had complained (2002: 10%).

New products and services^{vi} In September 2003, the bank launched its 'Privilege Premier' current account to existing Co-operative Bank current account customers. This account offers a range of banking and lifestyle benefits in return for a monthly subscription. A similar fee paying current account was launched by **smile** in spring 2003 – '**smilemore**'. A further three issues of the bank's Guaranteed Stock Market Bond were released in 2003. The bonds provide a low risk investment – with initial capital being guaranteed – and have the potential to yield returns based on stock market growth. Whilst customers' money is not invested in the stock market, their return is based on 100% of the rise in the FTSE 100 Index. In June 2003, the bank became the first UK bank to offer mobile phone 'top-ups' from its cash machines, a service developed by LINK, the shared cash machine network. CIS relaunched its UK Income with Growth Unit Trust in August 2003, and launched a Corporate Bond Income Unit Trust in September 2003. The Unit Trust invests in a portfolio of investment grade corporate fixed-interest securities and provides a monthly payment. In 2003, the New Business Centre processed 76% of paper applications for new

major accounts within 48 hours (2002: 94%). For details of tailored co-operative, ethical and ecological products, see pages 42-43, 56-57 and 81.

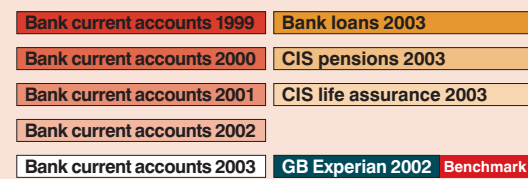
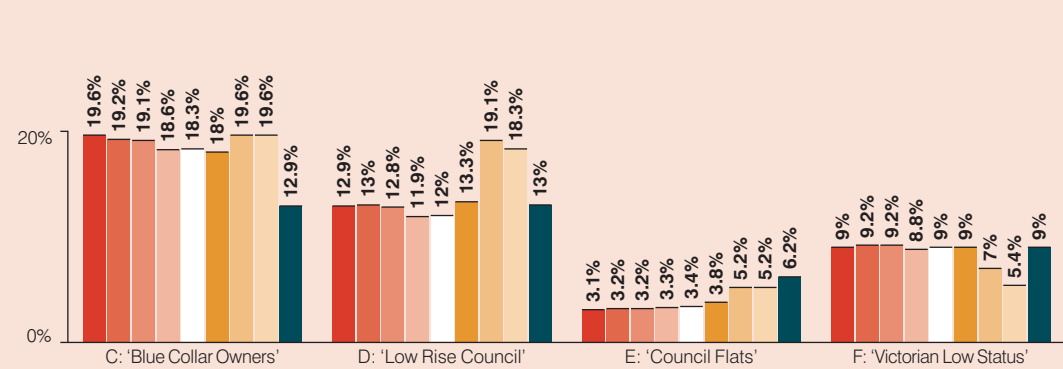
Mortgages^{vii} 2003 saw significant growth in the total value of mortgages sold by CFS, all of which include carbon offset features (see page 81). 80 different product offerings were launched onto the market in the course of the year. Early indications of the cross-selling potential of CFS were seen in the number of bank mortgages sold by CIS Financial Advisers. To manage the growth in sales, the bank's Mortgage Services department doubled in size to around 160 staff in 2003. At peak times throughout the year, the volume of business activity was such that CFS could not offer its usual high level of customer service; however, the average processing time has remained relatively constant; at about 3 weeks for most applications, which is in line with the industry average. 80% of mortgage customers are satisfied with their relationship with the bank (2002: 69%), whilst 92% are satisfied with its ethical and sustainability performance (2002: 71%).

Network developments A new bank branch was opened in Belfast in May 2003. The branch offers a full range of banking and insurance products and services. During 2003, the

Performance

Social inclusion

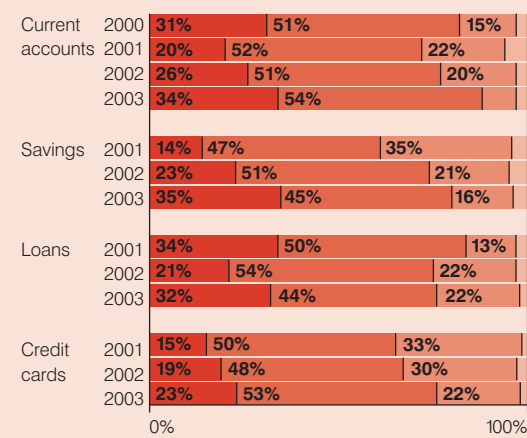
CIS/Bank customers' profile by MOSAIC 'household type'^{viii} **Benchmark**



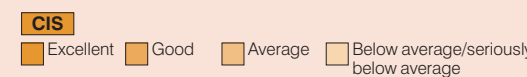
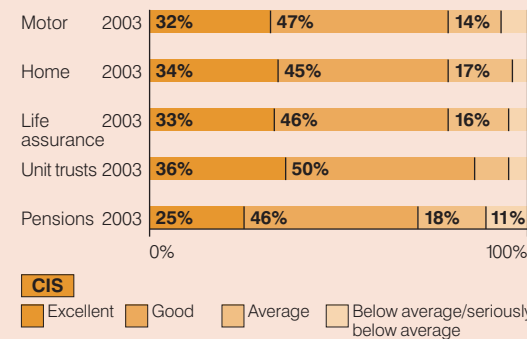
Customer satisfaction

Satisfaction with relationship

My relationship with the bank is...

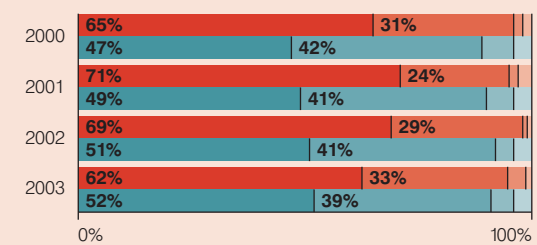


My relationship with CIS is...

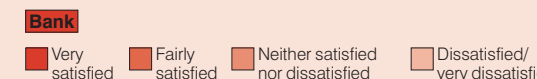
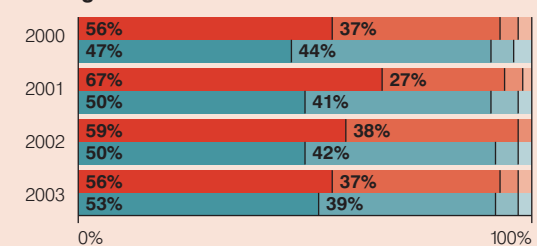


Satisfaction with service – Bank **Benchmark**

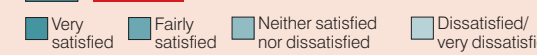
Current accounts



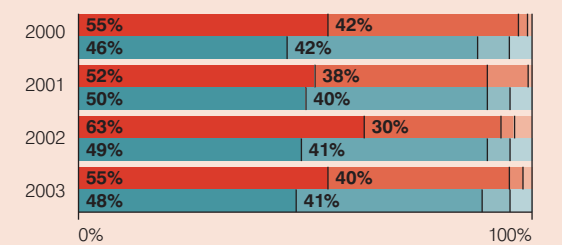
Savings



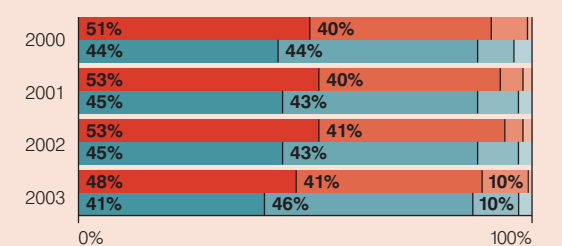
MFS **Benchmark**



Loans



Credit cards



following five branches were refurbished: Bolton, Bradford, Caerphilly, Guernsey and Newcastle Grey Street. Accessibility improvements were made to a further five branches (see page 63). No bank branches were closed in 2003. CIS closed Romford Claims Office in 2003 and announced that Liverpool Claims Office would close, and that London and Watford Claims Offices would merge in 2004. Members of staff from Romford were offered work in Bury St Edmonds and Maidstone Claims Offices, and policyholders were transferred to these two offices. 14 District Offices were closed by CIS during 2003, with their administrative workloads being transferred to neighbouring offices. In all cases, the Financial Advisers affected by the closures continued to serve the same area and group of customers. Relatively few CIS customers visit either Claims or District Offices, with telephone and home visits being the preferred way of contacting CIS.

Pensions and investments Following serious concerns about the quality of pensions advice in the late 1980s and early 1990s, the Financial Services Authority placed a requirement on all providers to review their pension sales and make corrections where customers were losing out because of poor advice. CIS completed 99.99% of offers on Phase 2 of the Pension Transfer and Opt-out review in advance of the

FSA target, of all relevant cases being reviewed by the end of March 2003. Work is still underway to secure 192 outstanding acceptances to these offers and to implement 234 offers already completed (these matters primarily relate to reinstating members back into their occupational schemes). Following the completion of the Free-Standing Additional Voluntary Contributions (FSAVC) review in December 2002, a year later there remained 62 outstanding acceptances, and of the offers accepted, seven were yet to be implemented. In December 2003, CIS was re-accredited with the Raising Standards Quality Mark by the Pensions Protection Investments Accreditation Board.^{viii} The Raising Standards Initiative focuses on the 'clarity' and 'appropriateness' of customer information and other customer service issues. Re-accreditation followed a thorough examination of CIS' information provision. **Benchmark** Eleven providers, representing 47% of the market as measured by the sales of new shares, have gained accreditation under the Raising Standards scheme.

Mortgage endowments CIS has 138,000 premium-paying mortgage endowment customers, although selling of this product ceased in January 2000. Given the investment climate and changes made to the mix of assets backing these policies (e.g., a reduction in the

equity content of the fund), CIS has revised its projection rates from 4%, 6% and 8% to 4%, 5.75% and 7.5% respectively. In accordance with the ABI's categorisation of policies, the revised assumptions have resulted in 53% of premium paying mortgage endowments being classified as 'red' (defined as more than 7.5% annual future investment return to repay the mortgage) (2002: 6%), 31% as amber (5.75-7.5% needed) (2002: 58%) and 16% as green (less than 5.75% needed) (2002: 36%). Over 2,800 complaints were received in 2003 in connection with re-projection communications (undertaken first quarter 2002). By the end of 2003, fewer than 10% of these were unresolved, and invariably these are accounted for by complaints being received towards the end of the year. **Benchmark** The changes in the red/amber/green split of CIS' mortgage endowment policies are consistent with those seen across the industry during 2003, as providers revised downward their forecasts on investment returns.

Industry codes **Benchmark** The bank subscribes to the Banking Code, the Mortgage Code and the General Insurance Standards Council Code. CIS subscribes to the General Insurance Standards Council Code, the Association of British Insurers Code and the Mortgage Code. CIS is authorised and regulated by the

Financial Services Authority. In 2003, the Banking Code Standards Board and the Mortgage Code Compliance Board carried out monitoring reviews within the bank. These confirmed satisfactory compliance with the codes' requirements. For each Code, CIS and the bank has an appointed Compliance Officer who liaises closely with the relevant regulatory bodies. Both CIS and the bank are working on their processes and procedures in connection with statutory regulation for Mortgage and General Insurance due to take effect from October 2004 and January 2005, respectively.

Sustainability value analysis

- For a number of years, the bank has researched its customer base to gain a better understanding of the importance of its ethical and sustainability policies in attracting and retaining customers. Results indicate, for example, that for 36% of current account customers, the bank's ethical and sustainability policies are the most important reason for opening and maintaining an account. The research also indicated that ethically motivated customers are more likely to have more than one product with the bank and are more likely to recommend than the

bank's average customer. **Benchmark** MORI's surveys indicate that fewer than 1% of all other banks' customers open their current accounts for ethical reasons.

Influence and action

Savings In July 2003, the UK Government responded to the Sandler Review (June 2002),^x which looked into medium and long-term savings and recommended the development of "a set of simple and clear savings products accessible to the mass market." CFS has welcomed the proposed product designs and simplified sales processes, and their potential to facilitate wider access to financial services. It has noted its belief that potential customers need encouragement to save, and that the mere availability of simplified products may not, in isolation, be sufficient. The provision of face-to-face financial advice has been advocated, together with a 'Charge Cap' which reflects the cost of advice, control and distribution.

Pensions In May 2003, CIS responded to the Department of Work and Pensions' Green Paper (March 2003)^x on working and saving for retirement. The response articulated CIS' support for the Government's aim of encouraging greater self-provision through pension reform and centred on the need to

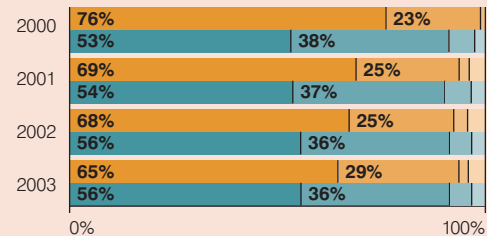
simplify the pensions system in order that its complexities do not deter individuals from making financial provision for their futures. It proposed that a combined 'real terms' pension forecast be introduced, which shows the total projected benefits of an individual's current pension provision (both state and private). This could provide a significant motivator for people to review and increase their pension provision. The response also articulated CIS' belief in the powerful advocacy role that could be played by employers, and the importance of further co-ordinated educative campaigns in addressing the issue of pension provision. During 2003 and 2004, CIS co-hosted a series of 'roadshows' in support of the Government consultation (page 62). CFS' Chief Executive, Mervyn Pedelty, is a Member of the Department of Work and Pensions' Employer Taskforce on Pensions.

Uninsured drivers In August 2003, the UK Government announced the Greenaway Review, which looks at the problem of uninsured driving. CIS welcomed the Review, and called for a wider range of penalties to be applied to uninsured and irresponsible drivers (such as community service orders and vehicle confiscation for repeat offenders). The motor insurance industry funds, via a policy levy, a compensation scheme for victims of uninsured drivers – the Motor Insurance Bureau.^{xii} £260 million was contributed to the Bureau in 2003, which is ultimately paid for by insured drivers (typically, some £30 per policy per annum).

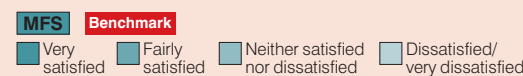
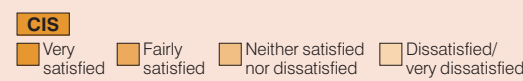
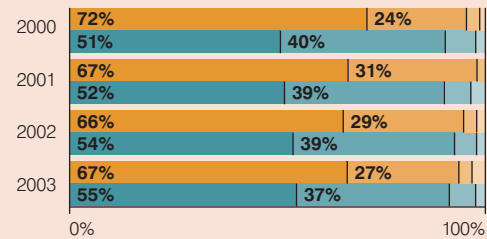
Customer satisfaction (continued)

Satisfaction with service – CIS **Benchmark**

Motor insurance



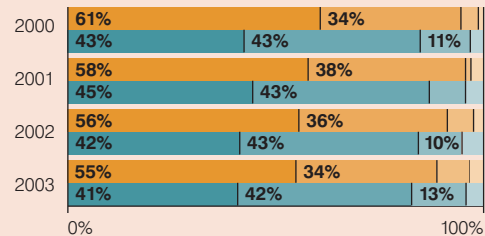
Home insurance



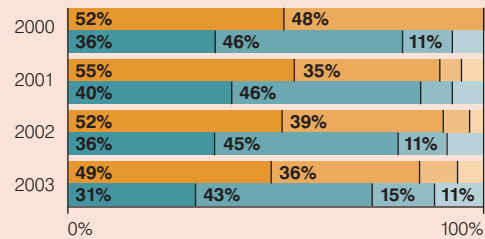
Source: MORI Financial Services (MFS)

MORI interviews a representative sample of 48,000 adults in Great Britain each year. Data is based on the 12 month period for each year to December.

Life assurance

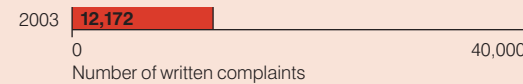


Pensions

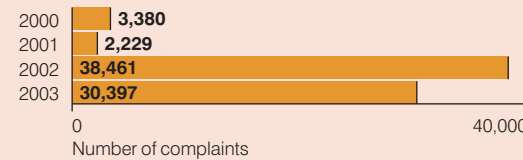


Complaints

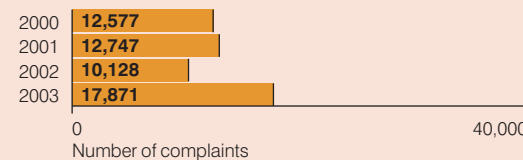
Complaints – Bank



Regulated complaints^{xii} – CIS



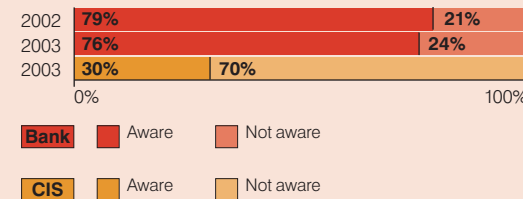
Non-regulated complaints – CIS



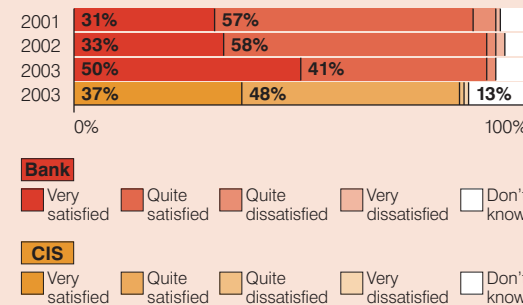
^{xii} Regulated complaints are those relating to the sale of life assurance, pensions and investment products. The significant increase in the number of complaints in 2002 was attributable to CIS developing a more systematic approach to capturing data and to an increase in complaints from customers who have mortgage endowments.

Ethics and sustainability

Awareness of CIS'/the bank's ethical or sustainability positioning

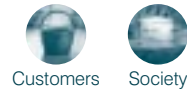


Satisfaction with CIS'/the bank's ethical and sustainability performance



i www.mori.com/mfs
 ii www.experian.co.uk
 iii www.abcul.org.uk
 iv www.co-operativebank.co.uk/business/publicsector_paypoint.html
 v www.co-operativebank.co.uk/services/guarantee_service.html
 vi www.co-operativebank.co.uk/personal/index.html and www.cis.co.uk
 vii www.co-operativebank.co.uk/personal/mortgages.html
 viii www.raisingstandards.net
 ix www.hm-treasury.gov.uk/Documents/Financial_Services/Savings/fin_sav_sand.cfm
 x www.dwp.gov.uk
 xi www.mib.org.uk/index.asp

Corporate and business customers



- 16. Social inclusion
- 17. Satisfaction with service and relationship
- 18. Satisfaction with ethics and sustainability
- 19. Network developments

Targets 2003

- Develop and launch an enhanced business current account, whilst maintaining the bank's transparent approach to pricing. **Target achieved**
- Increase the number of corporate and business banking customers registered to use the Internet by 15%. **Target achieved**
- Increase the percentage of corporate and business banking customers rating the bank as 'excellent' or 'good' to 75%. **Target not achieved**
- Explore the feasibility of developing management information systems, which detail the proportion of bank monies involved with ethical, sustainability and co-operative initiatives. **Target achieved**

Targets 2004

- Seek to maintain, and where possible improve, satisfaction amongst corporate and business banking customers. **Keith Alderson, Director of Corporate Banking/Ceri Henfrey, Business Banking Sector Manager**
- Through the use of new technology, reduce the business account opening timeframes by 25%. **Ian Hodges, Head of New Business Centre/Tim Webster, Manager, Business Banking Sector Team**

Commentary

Context The bank has 44,000 corporate and business banking customers and 92,000 corporate and business banking accounts. The bank has its main Corporate Banking Centre in Manchester, and a network of ten regional business centres covering England, Scotland and Wales. The bank has reported satisfaction amongst corporate and business customers since 2000. At the end of 2003, CIS provided approximately 150,000 policies to a range of businesses. The commercial motor product (106,000 policies) and the commercial combined product (33,000 policies) account for the vast majority of CIS' corporate and business custom. The relationship between commercial customers and CIS is more analogous to the relationship between personal customers and CIS. Customer satisfaction research for Personal Customers is described on page 30-32.

Social inclusion The bank discloses its support for small businesses in deprived areas and benchmarks this against the 'Industry Average'. All banks with significant exposure in the UK small business market must disclose such data to the Bank of England, where it is analysed and published in aggregate form. As at February 2004, The Co-operative Bank was one of only three banks to voluntarily disclose their individual

performance, despite repeated requests from HM Treasury. In 2003, the bank made adjustments to its reporting and record-keeping systems, in order that 'small businesses' could be more accurately identified. These changes have contributed to the marked increase seen in the declared levels of support for small businesses in deprived areas (e.g., the percentage of loans by volume in deprived areas in 2003 was 7.34%, cf. 2002: 3.95%). The bank has explained these developments to the satisfaction of the Bank of England. The bank has developed partnerships with a number of Community Development Finance Initiatives (CDFIs),ⁱ which provide capital and support to enable individuals or organisations to develop and create wealth in disadvantaged communities or under-served markets. To date, the bank has agreed subsidised lending to CDFIs of £2.5 million, and loans of £2 million were agreed in 2003.ⁱⁱ Although this sum is less than 1% of bank business loans and advances, the bank believes that it may still be the largest commitment of any UK retail bank to CDFIs. **Benchmark** The bank's profile in deprived areas continues to indicate that, as a proportion of support to small businesses, it has more current and deposit accounts and higher loan and overdraft balances than the banking average. This can be partially explained by the location of the bank's corporate business

centres, which tend to be concentrated in metropolitan areas.

Corporate and business banking analysis

The bank's Ethical Policy stipulates who the bank will and will not finance, as directed by customers. It covers all of the bank's assets (e.g., retail and syndicated loans and corporate leasing) and liabilities (e.g., retail deposits and savings and treasury dealings), and the investment of all retained balances. The bank has previously provided a detailed annual breakdown of all instances where business has been declined as a result of its Ethical Policy (pages 46-48). For the first time this year, an ethical and sustainability analysis is provided of the bank's Corporate and Business Banking lending and deposits balance sheet. This is designed to assess the extent to which the bank's products and services support organisations that, in the bank's view, make a particularly positive contribution to society. Analysis shows that 47% of the bank's deposits and 24% of lending balances are now derived from business activities that have a distinct co-operative, ethical or sustainability purpose.

Customer satisfaction The Co-operative Bank undertakes annual satisfaction research amongst a sample of corporate and business customers. There has been a small decline in

overall customer satisfaction during 2003. This may be partially attributed to the introduction of more comprehensive processes for changes to account signatories, in response to industry requirements. 68% of customers rate the bank as 'excellent' or 'good' (2002: 73%), and 93% of customers say that their expectations of service have been met (2002: 94%). 74% of customers would recommend the bank (2002: 80%) and 92% of customers would consider the bank for an additional business account (2002: 94%). There has been a decline in satisfaction with those attributes of performance that broadly relate to customers' relationship with the bank – down 19 percentage points to 61%. In 2003, the relationship score has been calculated on the basis of different drivers, including 'the bank makes an effort to understand business issues', which emerged as a greater priority issue for customers during the year. Lower satisfaction was recorded for this measure than for relationship attributes in prior years, and this substantially contributed to the decline in customer satisfaction. Despite a small decline in 2003 (4 percentage points), customer satisfaction with the bank's ethical and sustainability performance remains high at 86%.

Complaints The bank was the first UK high street bank to provide all business banking

customers with service level guarantees across a range of routine banking activities; where the bank fails, it apologises and pays £25 in compensation. The bank's Corporate Customer Service centre received a total of 735 written complaints in 2003. 71 complaints that could not be resolved by the individual business unit were referred to the Customer Care team (2002: 58). Of these, nine were issued with 'Final Responses' – enabling the customer to refer the complaint to the Financial Ombudsman Service. During 2003, CIS handled 58 complaints relating to its commercial combined policy and 162 complaints relating to its commercial motor policy.

Network developments There were no changes to the bank's business centre network in 2003. Changes to CIS' network are described on page 32.

New products A new business banking current account – 'Clarity' – was launched in March 2004. This seeks to meet the needs of customers who have some complex banking requirements, but who do not require the degree of individual support offered by the bank's Partnership Banking service. Clarity offers customers a full range of banking services, a telephone-based dedicated relationship management team (on hand to



Performance

Social inclusion

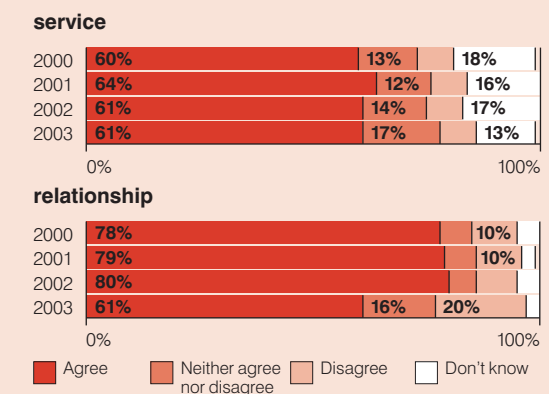
Small business^{iv} support in deprived areas^v

	The Co-operative Bank of small business activity in deprived areas 2003	Industry Average small business accounts in deprived areas (June 2002)
		Benchmark
Business current accounts	8.8	4.6
in overdraft	5.75	4.1
Number of loans	7.34	3.8
Loan and overdraft balances	10.42	3.2
Deposit and current account balances	16.93	3.5

^{iv} Annual debit turnover of less than £1 million.
^v Deprived areas correspond to the UK Government's 1998 Index of Local Deprivation, which accounts for approximately 5% of all postcode sectors in Britain by number.

Customer satisfaction

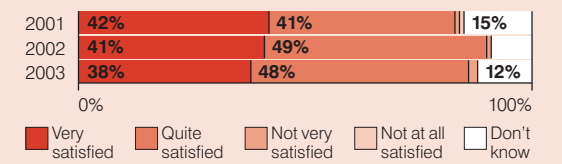
The bank's performance should be viewed favourably in relation to...



Each category consists of several attributes:
Service – Keeping customers informed of progress when queries raised, resolving problems with account queries quickly, changing an account signatory promptly, offering value for money accounts with acceptable charges, helpfulness of staff, competency of staff.
Relationship – treated as a valued customer, genuinely interested in custom, makes an effort to understand business issues.

Ethics and sustainability

Satisfaction with the bank's ethical and sustainability performance



deal with more complex enquiries), a fixed-fee pricing structure and a range of added value services. A tailored business banking package for members of the Federation of Small Businesses (FSB) was also launched in March 2004 at the FSB's Annual Conference. 'FSB Business Banking' provides a package of business banking benefits for FSB Members. These include: a current account which offers 18 months free banking and a £25 annual loyalty bonus; a business Visa charge card offering up to 38 days interest free credit and no charges; discounted fixed rate business loans of up to £25,000; and direct personal loans for FSB Members and their employees.

Industry codes **Benchmark** The bank subscribes to the Business Banking Code. In 2003, the Banking Code Standards Board carried out a monitoring review, which confirmed satisfactory compliance with the Business Banking Code's requirements. CIS subscribes to the General Insurance Standards Council's Commercial Customer Code.

Sustainability value analysis

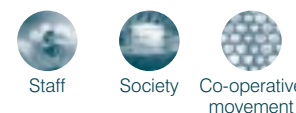
The bank has conducted detailed research with business customers to gain a better understanding of the importance of the bank's ethical and sustainability policies in attracting and retaining their custom. The results indicate that for 22% of customers the bank's ethical and sustainability policies are the most important reason for opening and maintaining an account (2002: 26%). 40% of all customers indicate that ethical and sustainability policies were one of the important factors that influenced them to open and maintain an account with the bank (2002: 40%). The research also indicated that ethically motivated customers are more likely to recommend the bank and are more likely to consider the bank for additional business accounts. An estimate of the total profitability contribution attributable to ethically motivated customers is shown on pages 27-28.

Influence and action

SME finance CFS responded to HM Treasury's consultation document 'SMEs: Bridging the Finance Gap'. An overview was provided of the bank's ongoing support for SMEs. In addition, the response clarified CFS' support for the concept of Mutual Guarantee Societies, which, although widely accepted on mainland Europe as a means through which small businesses can raise capital, have yet to find favour with UK financial authorities.

- i www.cdfa.org.uk
- ii Included loans to Industrial Common Ownership Finance (ICOF), Charity Bank, Bolton Business Ventures and the North West Community Loan Development Fund.
- iii www.statistics.gov.uk

Staff



- 20. Salary package
- 21. Staff turnover
- 22. Trades union recognition
- 23. Personal development and career opportunities
- 24. Working environment
- 25. Job security
- 26. Work/life balance
- 27. Communication
- 28. Co-operative culture and ethical conduct

and 9,763 CIS contracted staff – excluding 182 staff on maternity leave and 146 staff on career break or leave of absence. 22% of bank staff and 6% of CIS staff work part time. During the year, several central CFS functions were established – including Information Communications & Technology, Financial & Actuarial, Risk & Compliance, Marketing, Corporate Affairs and Resources. Staff within these central areas continue to be employed according to either CIS or bank terms and conditions. As a consequence, throughout the Report, discrete workforce statistics are reported for CIS and the bank. Attitudinal data is reported for CFS as a whole, which is now necessary as the development of CFS central functions renders CIS and bank year-on-year comparisons obsolete.

representatives of all five trade unions and CFS Human Resources Management together to manage further integration of the two businesses. In October 2003, CFS' Chief Executive met with the General Secretaries of CFS' five recognised trades unions to outline the way forward for CFS. Regular meetings of this nature are to be held in the future. Following the initial meeting, ongoing consultation and negotiation has progressed on a range of subjects supporting the move towards a harmonisation of processes, policies, and terms and conditions.

Trades unions – Bank The bank has a partnership agreement with UNIFI (around 60% of staff are members). This was first established in 1997 and aims to develop a new way of working together; one which helps ensure that industry changes are managed to the benefit of both parties. As part of the 2004 pay negotiations, the bank and UNIFI have agreed a further twelve months partnership agreement. In 2003, bank staff received copies of 'Partnership at Work', a booklet that highlights some of the successes achieved by working in partnership (e.g., development of employment policies) and which aims to raise awareness of and support for the partnership agreement.

Trades unions – CIS Four trades unions are recognised (over 68% of CIS staff are members): ACTS (Administrative, Clerical, Technical and

Staff turnover The bank experienced a staff turnover of 22% during 2003, which includes all leavers (2002: 13%). Turnover of bank staff is particularly high in the customer services areas – including **smile**, the branch network and call centres. The increase in bank figures is partly attributable to a change in reporting methodology; previously, only voluntary leavers were accounted for. With reference to all leavers, CIS experienced a staff turnover of 15% during 2003 (2002: 14%). **Benchmark** The Chartered Institute of Personnel and Development reports 20% turnover in relation to all leavers in 2002 for the finance, insurance and real estate sector.

Targets 2003

Bank

- Increase the percentage of bank staff stating that managers have 'good people skills' by five percentage points. **Target not achieved**
- Consult with staff to gain an understanding of their views as the 'merger' between CIS and The Co-operative Bank progresses, and report on the results. **Target achieved**
- Review staff salary and benefits as part of a CFS-wide reward and remuneration review looking at terms and conditions. **Acceptable progress**
- Develop and issue a 'Partnership at Work' staff booklet to raise staff awareness of partnership working with UNIFI. **Target achieved**
- Monitor and evaluate the revised work/life balance policies. **Target achieved**

CIS

- As part of improvements to internal communications, introduce a structured team briefing process. **Target achieved**
- Undertake qualitative dialogue with CIS Financial Advisers. **Acceptable progress**

Targets 2004

- Establish appropriate processes to maximise the redeployment of staff during periods of organisational change. **Joanne Mitchell, Head of HR Resourcing**
- Establish a CFS Organisation Change Policy to support the business and staff through periods of change. **John Hampton, Head of Reward and Employee Relations**
- Introduce a CFS Change Management programme for all managers. **Pat Ashworth, Head of Learning and Development**
- Commence a project to develop a human capital accounting methodology for CFS. **Jayne Beer, Manager, Sustainability Reporting and Diversity/Jo Healy, Sustainability Reporting Manager**

Commentary

Context CIS and The Co-operative Bank have reported on priority staff issues for a number of years. During 2003, all staff continued to be employed by either CIS or the bank through distinct contractual arrangements. At the end of 2003, there were 4,138 bank contracted staff

Outsourcing In recent years the bank has outsourced a number of its activities. The Financial Services Authority (FSA) is informed regarding material outsourcing arrangements as required (page 41). Going forward, CFS believes that outsourcing, and indeed insourcing, has a place in business organisation discussions. For example, in order to remain cost efficient and to continue offering a quality service to customers, credit card processing and cheque clearing are now outsourced, whilst in recent years, some fulfilment activities have been insourced. In 2003, CFS decided to outsource some 40 information technology roles to Specialist Computer Centres (SCC), an IT company that specialises in desktop support. Detailed discussions progressed with affected staff and trades unions; however there was a brief period of industrial dispute prior to a final agreement being reached. During 2003, the offshoring of UK call centre jobs to India and South East Asia became a 'hot topic'. Early in 2004, the bank issued a statement saying that it would not 'offshore' service centre work, as it was considered to be 'core' to the bank's high quality service offering.

Trades unions CIS and the bank recognise that trades unions have an important contribution to make to business and society as a whole. A National Joint Integration Committee has been established to bring

Performance

Salary

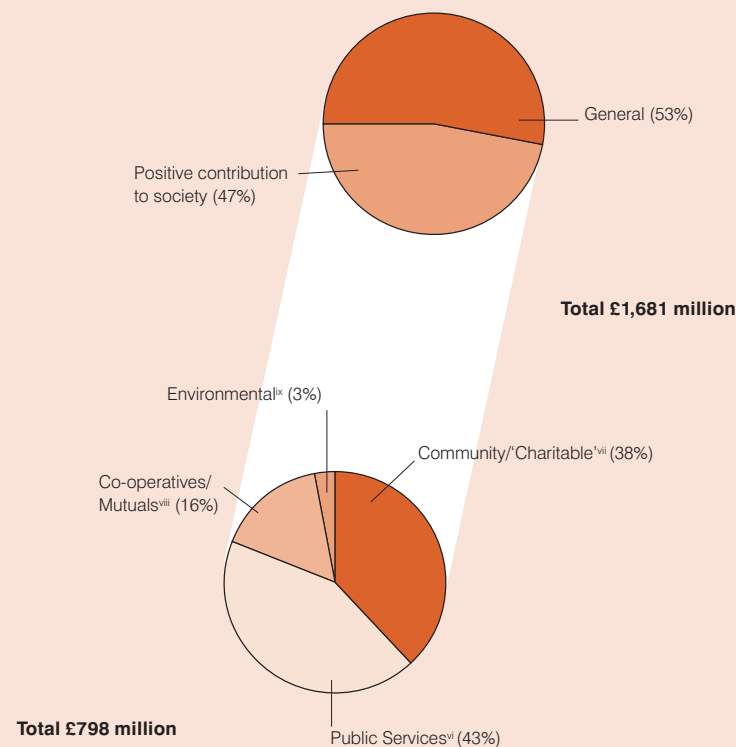
Percentage of staff in each basic salary band

Basic salary bands	Bank (4,138 staff)	CIS (6,672 staff)
Up to £10,000	0.7%	5.1%
£10,001 to £15,000	52.3%	31%
£15,001 to £20,000	16.5%	25%
£20,001 to £30,000	17.3%	28%
£30,001 to £40,000	6.7%	6.5%
£40,000 and over	6.5%	4.4%

Data excludes 3,091 CIS Financial Advisers, who receive the majority of remuneration on the basis of sales commission.

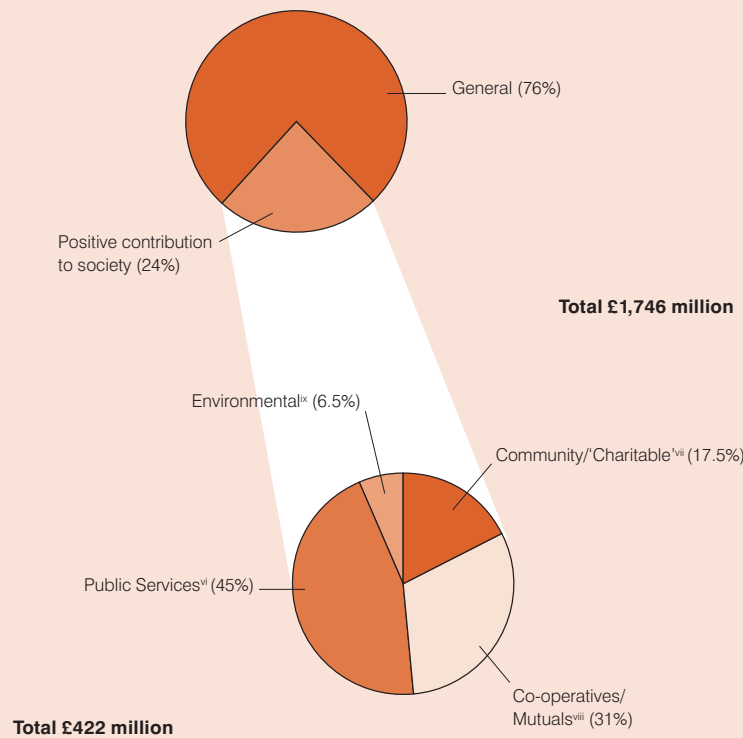
Corporate and business banking Customer profile

Average liabilities 2003 (e.g., deposits)



- vi Includes Local Authorities, Education, Health and Public Services.
- vii Includes Charities, Trades Unions, Voluntary Organisations and Sub Post Offices.
- viii Includes Co-operative Retail Societies, Building Societies and Housing Co-operatives.
- ix Includes Energy Conservation, Recycling, Renewables and Public Transport.

Average assets 2003 (e.g., loans, overdrafts)



Source: Corporate and Business Banking 2004

Supervisory Group), which represents field staff management, administration and support staff and employees in Regional Selling Practice Centres; AMICUS, which represents head office and claims office staff; NACO (National Association of Co-operative Officials), which represents managers; and USDAW (Union of Shop, Distributive and Allied Workers), which represents financial advisers and catering staff.

'Project Lime' Bringing people together from different organisations and cultures is a substantial task. During 2003, Project Lime commenced, which involves reviewing existing CIS and bank working practices, people policies and terms and conditions of employment, and developing more 'harmonised' practices. The project aims to support the creation of a single business approach across CFS, building on shared heritage and co-operative values. Much of the analysis and research underpinning the project has now been completed. There has been an audit and review of existing arrangements, complemented by research into best practice and future legislation. Recommended approaches will now be developed, discussed, agreed and tested. The project is led by the Human Resources Strategy Group, chaired by Ken Lewis, Resources Director. This group comprises senior managers from across CFS, who provide a 'steer' on Lime

priorities, and review and agree the various recommendations. There is also close liaison with the recognised trades unions across CFS, who are working with CFS management through the 'National Joint Integration Committee'. A network of 'Business Champions' will be developed, to support the communication and implementation of the project.

Policy review 'Project Lime' has reviewed the operation of six priority employment policies across CIS and the bank: Equal Opportunities/Diversity, Dignity at Work, Work/Life Balance, Well-being, Sickness Absence Management, and Disciplinary and Grievance. Underpinning the review has been a desire to recognise and consider best practice. The new policies will support business need and will meet, and in some instances go beyond, legislative requirements. Policy proposals will be developed during 2004, with the involvement of the Human Resources Strategy Group and Trades Unions.

Performance management Alongside the work of Project Lime, CFS initiated a 'culture change' programme during 2003. The starting point of the programme was a series of focus groups with some 250 managers throughout CFS. The focus groups sought to identify some of the prevailing behavioural and climate issues within CIS and the bank. The findings were

presented to the CFS Executive Team and communicated back to focus group participants. During 2004, a series of development initiatives, focusing on leadership skills and managing change, is being implemented throughout the business to address the focus groups' findings. During 2003, CIS launched a new performance management system. This system includes a set of competencies that reflect four principal areas of behaviour: self-management, achieving, influencing/working with others and thinking. Building on CIS' and the bank's experience of performance management, during 2004 and 2005, CFS will introduce a common performance management system and behaviour framework for all staff.

Staff survey In February 2004, CIS and the bank undertook an opinion survey to which 62% of staff responded. This is the first time CIS has conducted an opinion survey that includes its Insurance Sales staff. Ideally, qualitative research would have been carried out with Insurance Sales staff prior to any quantitative survey work. However, it was considered that the priorities previously identified through qualitative dialogue with bank staff are sufficiently general to be applicable (page 14). The survey included questions on pay, benefits, working environment, personal development, discrimination, work/life balance and well-being.

Salary and benefits There has been an increase in the number of staff who agree that their pay is good (up three percentage points to 38%), however there has been a marked decrease in the number of staff who believe that benefits are good (down 15 percentage points to 50%).

Salary and benefits – Bank Average basic salary for bank staff in 2003 was £20,081 (2002: £19,411). In addition, bonus payments of 11.68% of basic salary (profit share and bonuses) were awarded to all eligible staff who met the basic requirements of their role. The bank continues to benchmark salaries against those of its competitors. Salaries are compared with 40 other financial services' organisations. For the majority of staff, the bank's salaries are positioned at or above the sector median. Total remuneration for 2003 was £95.5 million (2002: £92.5 million). This includes basic salary and all bonus payments (i.e. executive and senior management bonuses, staff bonus arrangements and regional allowances). During 2003, staff benefits continued to include a non-contributory, defined benefit ('final salary') pension scheme. Average contributions into the scheme in 2003 were equivalent to 15.6% of pensionable pay. Following a full actuarial review of the bank's pension scheme in April 2003, which indicated a £141.6 million funding shortfall (calculated according to FRS17), a revised contribution rate of 22% of pensionable pay has been recommended. The bank has informed staff that, from January 2005, they will be expected initially to contribute 2% of salary, rising to 6% over three years. Due to business funding, the full impact will not be experienced until 2010. The scheme remains open to new bank staff, who will pay 6% salary contributions from July 2004. A defined benefit pension arrangement continues to be provided, with the bank making substantial contributions, of at least 16% of pensionable pay, into the scheme. Additional benefits include: holidays (21- 30 days) and work/life balance policies (including flexible working, a career break scheme, childcare vouchers, maternity, paternity and adoption leave).

Salary and benefits – CIS Average basic salary for CIS staff in 2003 was £20,068 (excluding Financial Advisers, who derive the majority of their income from sales commission). Total remuneration for 2003 was £287.7 million (2002: £295.6 million). This includes basic salary, commission and bonus payments. During 2003, CIS staff benefits included a contributory, defined benefit ('final salary') pension scheme. CIS currently pays 6.4% of the pensionable salary roll into the scheme, with the majority of staff contributing 6% of salary. Additional benefits include: holidays (22 – 27 days) and work/life balance policies (including flexitime scheme, leave of absence, childcare vouchers, maternity, paternity and adoption leave).

Personal development and career opportunities Staff are generally happy with their personal development (up four percentage points to 72%), but fewer are satisfied with opportunities for career progression (38%). Overall, there has been a slight increase (to 44%) in the number of staff saying that managers have good people skills (2002: 42%). **Benchmark** CIS and the bank have achieved Investors in People accreditation for each organisation. This national quality award recognises organisations that improve performance by developing their employees.

Job security There has been an increase in the proportion of staff saying that they do not believe that the organisation maintains job security to the best of its ability (up twelve percentage points to 20%). These concerns are more pronounced for staff working in various CFS and CIS functions. Given the uncertainties associated with any process of organisational change, this decline is not unexpected. A major change programme is currently being developed. Staff confidence in job security is affected by this uncertainty, but will, hopefully, grow as the project develops. The bank's organisational change process, introduced in 2000 in consultation with UNIFI, recognises that any required redundancies will, wherever possible, be achieved on a voluntary basis. For bank contracted staff, once again, there were no involuntary redundancies in 2003. All nine redundancies (2002: 24) were on a voluntary basis. Changes at CIS are managed in consultation with affected staff and trades unions. For CIS contracted staff, there were 140 redundancies during 2003, the majority of which were involuntary. During a period of likely increase in organisational change, processes will be established to maximise the redeployment opportunities available to staff, and to support them through a period of change.

Work/life balance Whilst both CIS and the bank operated work/life balance policies during 2003, there has been a substantial decrease in the proportion of staff who are satisfied with their work/life balance. This decline is partly attributable to the inclusion of Insurance Sales staff in the survey population for the first time. Work/life balance is a particular issue for these staff, with 60% stating that they are unable to achieve a satisfactory balance. This may reflect the challenges associated with the less formal arrangements that characterise this type of work. Overall, it is envisaged that the launch of the CFS Work/Life Balance and Well-being Policies (page 65) should help to improve staff satisfaction. Both policies will include enhanced provisions, particularly compared with previous CIS policies.

Work/life balance – Bank During October 2003, the bank conducted an intranet-based

staff survey to evaluate the effectiveness of its work/life balance options. 410 responses were received, with 9 in 10 staff stating that they were aware of the policies. 29% of staff stated that they had requested a flexible working option during the year, with 81% of this group reporting that their request had been accepted. 78% of staff witnessing or experiencing flexible working felt that these working practices are successful. The results have informed the development of the new CFS Work/Life Balance Policy.

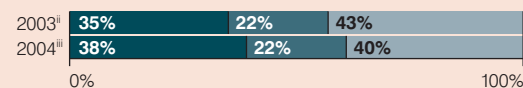
Communication Within CFS, consistent, open and honest communication is seen as an integral part of the drive to create a single employee community. In February 2004, 52% of staff said they were kept up to date with organisational change (2002: 55%). This slight decline is understandable given the considerable degree of organisational change currently underway across CFS. During 2003, CFS held a senior management conference with 170 delegates, which was followed by a management conference with 700 delegates. Subsequently, early in 2004, eight 'Executive Roadshows' have been held in locations across the UK, involving just over 1,000 delegates. Events have aimed to share CFS' vision with staff and all have been designed to encourage staff feedback as the integration of CIS and the bank proceeds. CFS introduced a range of new communications in the second half of 2003, which should improve ratings in future surveys. Communications include a structured Team Briefing process, which provides succinct information to managers on key topics to enable them to brief their staff effectively. A quarterly CFS staff magazine, 'Open' has been launched and a CFS 'landing site' has been introduced for the various CIS, bank and **smile** intranets.

Co-operative culture and ethical conduct 46% of staff agreed that they are fairly treated by the organisation (2002:58%), whilst 17% disagreed. 68% of staff state that they understand the organisation's co-operative culture and values and 60% agree that CFS implements its ethical and sustainability policies with integrity. During 2004, the Sustainable Development Team will work with the Learning and Development Team to ensure that CFS' ethical and sustainability positioning is a key element of the new orientation and induction programmes for new staff. In addition, publication of CFS' first Sustainability Report, along with tailored staff communications, should help to increase the proportion of staff who understand and trust in CFS' co-operative culture and ethical conduct.

i In accordance with the CIPD's definition, 'all leavers' relates to those individuals leaving the organisation by way of involuntary or voluntary severance, redundancies and retirements

Salary

'My overall pay is good'



Benefits

'My overall benefits are good'



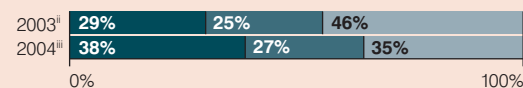
Personal development

'I have developed valuable skills and behaviours whilst working for the organisation'



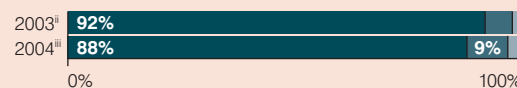
Career opportunities

'I am provided with encouragement, training and opportunities for personal development to help me progress my career'



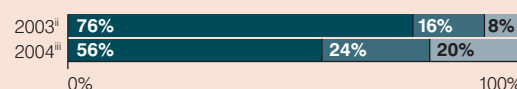
Working environment

'I enjoy good working relationships with my colleagues'



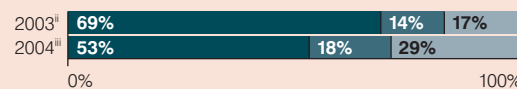
Job security

'I believe that the organisation maintains job security to the best of its ability'

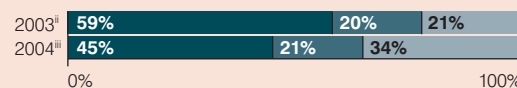


Work/life balance

'I am able to achieve a satisfactory balance between work and my personal life'

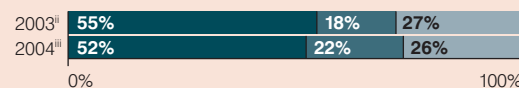


'My family believe that I am able to achieve a satisfactory balance between work and my personal life'



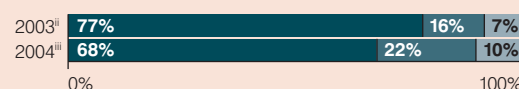
Communication

'I am kept up to date about organisational changes'

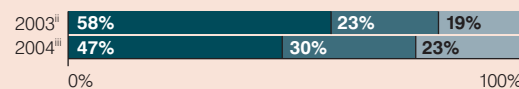


Co-operative culture and ethical conduct

'I understand the organisation's core values (e.g. co-operative heritage and values)'



'I believe that the organisation behaves fairly in the way it treats me'



■ Agree ■ Neither agree nor disagree ■ Disagree

ii Survey data is an amalgamation of data for CIS and bank staff, excluding those in Insurance Sales.
iii Survey data relates to CIS and bank staff, including staff in Insurance Sales.

Source: ETS Staff Survey 2004

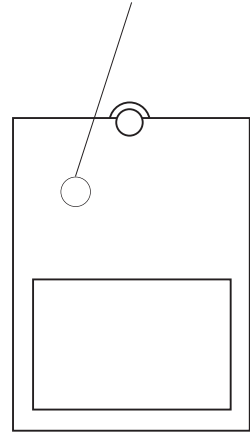
Suppliers



Suppliers

- 29. Prompt payment
- 30. Satisfaction with relationship
- 31. Fair treatment
- 32. Effective communication
- 33. Long-term relationship

93% of CIS and bank suppliers are satisfied with prompt payment of invoices



Targets 2003

Bank

Ensure that at least 85% of bank suppliers agree that:

- payment is prompt. **Target achieved**
- there is a good working relationship. **Target achieved**
- dealings are fair and reasonable. **Target achieved**
- there is effective two-way communication. **Target achieved**
- long-term relationships are maintained. **Target achieved**

CIS

- Continue to seek ways to improve the quality of relationship with CIS suppliers. **Target achieved**

Targets 2004

For CIS and bank suppliers, ensure that at least 85% agree that:

- payment is prompt.
- there is a good working relationship.
- dealings are fair and reasonable.
- there is effective two-way communication.
- long-term relationships are maintained. **Ken Lewis, Resources Director, CFS/John Sheerin, Head of Procurement and Supplier Management**

Commentary

Context At the start of 2003, the majority of contractual arrangements with suppliers were distinct to either CIS or the bank, and performance is reported accordingly. The bank has reported the degree to which it has delivered value to suppliers since 2000, and this is presented alongside that of CIS for 2003. For details of suppliers in relation to ethics and sustainability see pages 58-59.

Satisfaction According to bank suppliers, the main benefits of their relationship are derived from: receiving income (29%); having a good working relationship (26%); and working with a prestigious client (21%). For CIS suppliers, the main benefits are derived from receiving regular work (37%) and income (25%). Overall levels of satisfaction with CIS and the bank are exceptionally high, with 96% of CIS and 98% of bank suppliers being very or quite satisfied. Satisfaction is also very high in those areas indicated by suppliers as being of the most importance to them (see page 15). The strength of satisfaction is highest for CIS suppliers, with over 60% of respondents 'agreeing strongly' with performance statements in priority areas. By comparison, over the past three years, there has been a slight decline in the

percentage of bank suppliers 'agreeing strongly' with performance statements. Both CIS and the bank score very favourably in comparison with the other companies that suppliers have a relationship with.

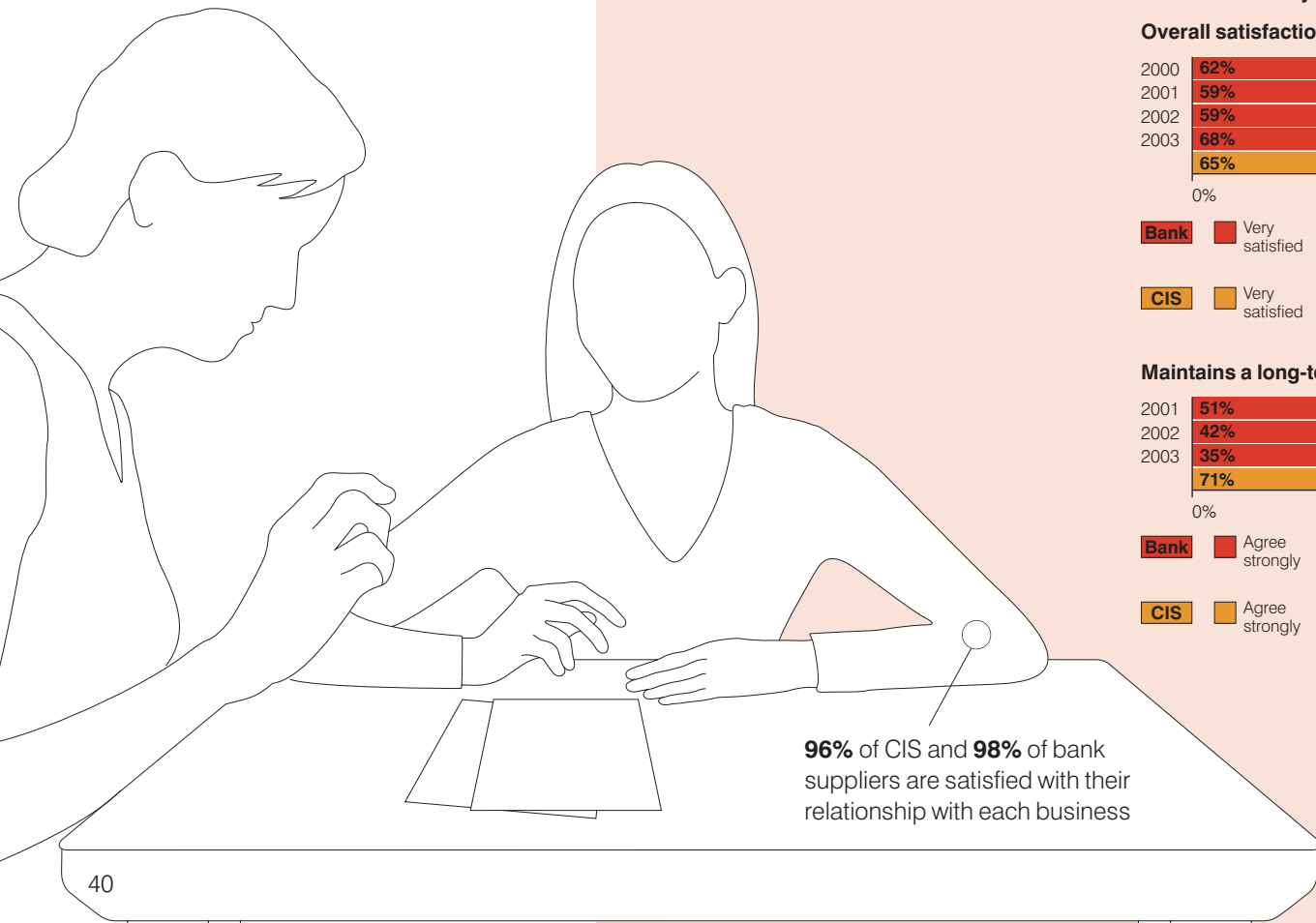
Payment policy The bank is a signatory to the Better Payment Practice Code (BPPC).ⁱ Signatories to the code promise to: agree payment terms at the outset of a relationship; explain payment procedures to suppliers; pay bills in accordance with any contracts agreed with the supplier or as required by law; tell suppliers without delay when an invoice is contested; settle disputes quickly. Following a review of supplier payment process, CIS intends to become a signatory to the BPPC in 2004. The bank aims to pay suppliers within 30 days of the invoice date. The bank takes an average of 35 days to pay, with 78% of invoices paid within the desired 30 day period. Queries concerning disputed or missing invoices are the main cause of delay. Those handling supplier relationships are given practical advice to ensure prompt payment can be achieved. CIS aims to pay suppliers in accordance with the payment terms set out by suppliers in invoices, although, on average, payment is received six days late. In the case of both CIS and the bank, the vast majority of suppliers

(93%) are satisfied that invoices are paid promptly. **Benchmark** A recent study (February 2004) by Experianⁱⁱ found that companies take an average of 58 days to pay invoices, and large financial services companies take an average of 86 days.

Outsourcing The Financial Services Authority (FSA) provides guidance for the management of major outsourcing contracts. These guidelines cover both existing and new contracts and require organisations to inform the FSA if a material outsourcing arrangement is to be entered into or changed. The bank updated its Outsourcing Policy and Standards in 2002. Major outsourced contracts are overseen by a senior manager and a 'relationship manager' is designated for each major contract. The bank considers that five outsourcing contracts fall under the FSA guidance, covering cheque and credit clearing, ATM management, IT development and service, credit card processing and bullion services.

ⁱ www.payontime.co.uk
ⁱⁱ www.experian.co.uk

Performance

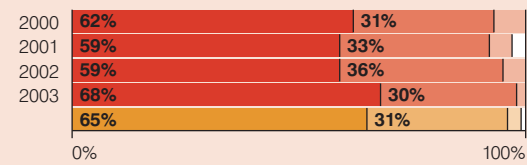


96% of CIS and 98% of bank suppliers are satisfied with their relationship with each business

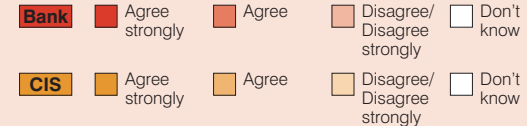
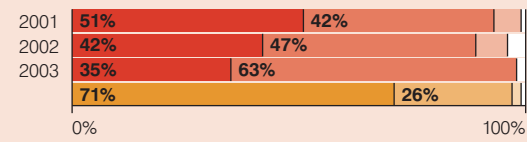
Supplier satisfaction

Suppliers' response to statements concerning their treatment by CIS and the bank

Overall satisfaction with relationship



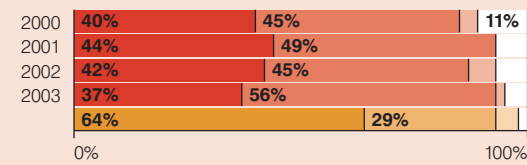
Maintains a long-term relationship with suppliers



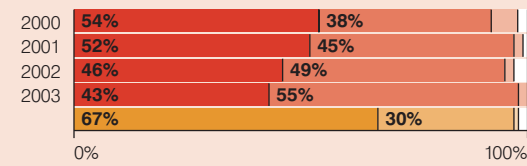
Supplier satisfaction

Suppliers' response to statements concerning their treatment by CIS and the bank

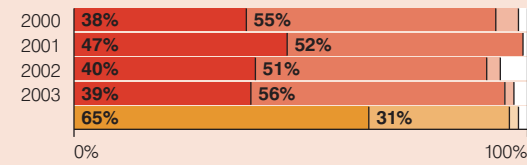
Pays invoices promptly



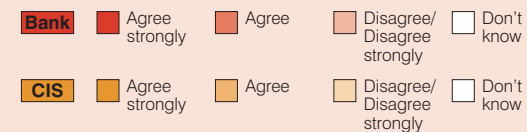
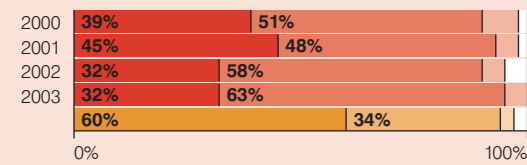
Maintains a good working relationship



Treats organisation in a fair and reasonable manner



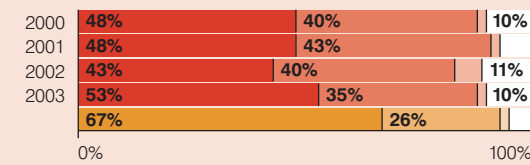
Communicates effectively



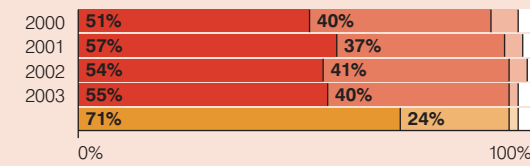
Comparative satisfaction **Benchmark**

How CIS and the bank compare with other companies suppliers deal with

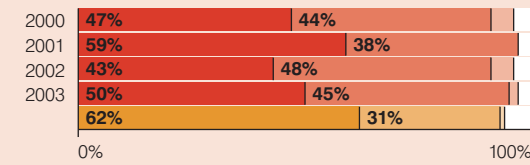
Pays invoices promptly



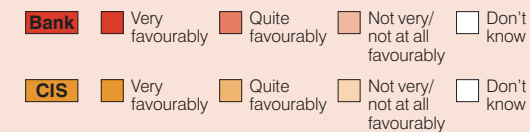
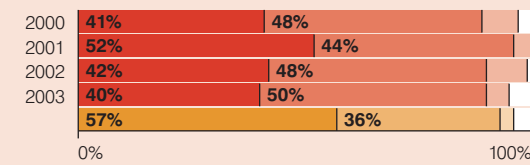
Maintains a good working relationship



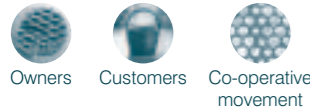
Treats organisation in a fair and reasonable manner



Communicates effectively



Co-operative movement



34. Co-operation among co-operatives

Targets 2003

Bank

- Working in partnership with Co-operatives^{UK}, develop and deliver communications to bank staff on the wider Co-operative movement, enabling improved support for new and emerging Co-operative sectors. **Acceptable progress**
- Develop a mechanism to send information on the bank's products and services to newly registered Co-operatives. **Target achieved**

CIS

- Raise awareness amongst CIS' co-operative customers of sustainable approaches to business. **Target not achieved**

Targets 2004

- Work with Co-operatives^{UK} to launch a new banking product which meets the needs of co-operative organisations. **Martin Honor, National Relationships Manager**
- Work with national and regional partners to assist in the development of a unified support network for social enterprises. **David Dunn, Senior Manager, Public Sector, Community and Social Enterprise**
- Create a training module for the Co-operative Group membership education programme, which describes the activities of CFS and its role within the Co-operative movement. **Chris Smith, Head of Community and Co-operative Affairs**
- Create five CFS scholarships for the newly formed Credit Union Foundations' Development Education Programme, which seeks to educate and inspire credit union volunteers and employees to enable further development of the movement. **Chris Smith, Head of Community and Co-operative Affairs**

Commentary

Context CIS and The Co-operative Bank are part of the Co-operative Group family of businesses – the largest consumer co-operative in the UK. Both CIS and the bank aim to serve the wider Co-operative movement through the provision of products and services and in-kind support. Both CIS and the bank have reported on the way they deliver value to the Co-operative movement for a number of years. During 2003, CIS and the bank worked with the Co-operative Group to offer new or enhanced products to customers – most significantly, a Co-operative Group Members' Saving Account and the Travel Visa credit card.ⁱ In addition, during 2003, CIS and the bank engaged in product development and enhancement in respect of the wider Co-operative movement, as described below.

Retailer Financial Services A Retailer Financial Services (RFS) Steering Group was established in July 1998 which aims to identify opportunities for the distribution of financial services to retail customers across the UK Co-operative movement. As part of the RFS project, 559 cash machines were installed in Co-op stores in 2003, taking the total number installed since the RFS project began to 1,595. As the majority of Co-op convenience stores tend to be located

in outlying areas, the programme contributes to the bank's efforts to promote financial inclusion (pages 29-30). Profits generated by the cash machines are shared between the bank and 24 participating retail societies. The bank is presently assessing the results of a pilot initiative, undertaken in 2003 with four co-operative retail societies, which has introduced 57 charging cash machines. The machines are located at sites where cash machines would not ordinarily be considered, due to the low expected levels of usage. In the majority of cases, the charges are lower than convenience-charging cash machines provided by competitors.

Dividend During 2003, CIS and the bank continued to work towards the development of the Co-operative Group's 'Dividend' project, which will see the return of a dividend payment to all consumer members of the Group. From 2005, a dividend payment will be made to each consumer member, based upon the amount of money they spend with the Group's consumer-facing businesses during the course of the year. In advance of this, a flat rate dividend of approximately £10 will be paid to all consumer members of the Group in late 2004. As consumer-facing businesses, CIS and the bank will continue to be key participants in the scheme moving forward.

Co-operatives Directplus The bank has developed a fee-free banking package for co-operatives, which is due for launch in 2004. 'Co-operatives Directplus' has been developed in partnership with Co-operatives^{UK} – a member-based organisation for co-operative enterprisesⁱⁱ – and is based on the bank's recently-launched Community Directplus account (page 57). Key features of the account include: free banking, credit interest on balances above £2,000 and an annual donation to Co-operative Action.ⁱⁱⁱ Additionally, the account offers Co-operatives^{UK} members discounted arrangement fees and flexible repayment facilities for business loans. In support of the launch of Co-operatives Directplus, appropriate customer service staff will be provided with staff guides to develop their understanding of the banking needs and history of co-operatives. Upon registering with Co-operatives^{UK}, all new co-operatives will be sent details of the Co-operatives Directplus package.

Co-operative Funeralcare Pre-Payment Plan^{iv}

In April 2003, CIS joined with Co-operative funeral providers to offer through Financial Advisers the Co-operative Funeralcare Pre-Payment Plan. Working with Co-operative Funeralcare and, through them, with 21 other Co-operative funeral partners, the offer includes a range of options, designed for customers wishing to make detailed plans for their funerals.

Affinity partnerships Both CIS and **smile** entered into affinity partnerships with United Co-operatives during 2003 to promote products to its members. CIS and **smile** make a contribution to United Co-operatives for every product taken out by one of its members. CIS entered into similar affinity partnerships with Midlands Co-op and Lincoln Co-op during 2003.

Co-operative Ventures In 2003, the bank continued to play an active role, via its Head of Co-operative and Sector Development, in the Co-operatives^{UK} New Ventures Panel, which seeks to identify new areas for co-operative endeavour. A number of workstreams have been identified for further development, including social care, childcare, green energy, long-term finance for co-operatives and student housing co-operatives, with the latter two workstreams being led by the bank.

Credit Unions CFS continues to support the UK credit union movement. Working with the Association of British Credit Unions (ABCUL),^v the bank has extended the successful PayPoint payment card pilot to enable credit union members to make cash payments at Post Office counters throughout the UK. This enables members to access their credit union accounts

via thousands of outlets. CFS continues to sponsor ABCUL's annual national conference and the publication of its regular newsletter, Credit Union News. Over 2,000 members of staff (and their families) of the Co-operative Group, CFS, Co-operatives^{UK} and ABCUL are members of the staff-run Co-operative Family Credit Union, which is supported with staff seconded from CFS. The credit union has lent out over £3.5 million since its launch in 1998.

Economic support In 2003, CIS maintained the dividend on Co-operative society business at the same rate as in previous years, resulting in a distribution of £3.3 million to the societies that trade with CIS. Via Corporate and Business Banking, the bank provided some £135 million of assets (e.g., loans and overdrafts) to co-operatives and mutuals during 2003, as described on pages 35-36. CIS' and the bank's support for co-operative enterprises through their community giving amounted to 6% and 5% respectively in 2003 (2002: 30% and 23%), as detailed on pages 66-69. These figures are more in line with the percentage of overall community giving made to co-operatives in the years prior to 2002, when a payment of £1 million to Co-operative Action significantly increased CFS' contribution to co-operatives (see below). In 2003, the majority of CFS' direct economic support for co-operatives was provided to the International Co-operative Alliance – an independent, non-governmental association serving the worldwide Co-operative movement, which seeks to build strong, viable co-operatives in developing countries – and the Association of British Credit Unions Limited (ABCUL) (see above).

Upstarts Awards In 2003, the bank and Co-operative Action agreed to sponsor the third annual Upstarts Awards, hosted by New Statesman magazine. The awards celebrate the achievements of the UK's growing number of businesses that aim to advance social, as well as economic, goals. Six awards were presented at a London ceremony in February 2004, with a total of £20,000 worth of prizes shared amongst the award winners.

Co-operative Action Co-operative Action was established in April 2002.^{vi} Through the provision of grants and loans, it seeks to encourage communities to develop co-operative, mutual or social enterprise solutions to the challenges they face. CFS provided considerable financial support (£1 million) to Co-operative Action in 2002 and CFS staff continued to play an active role in the management of the organisation during 2003. A total of almost £1 million was provided to 43 co-operative projects around the UK during 2003.

Staff involvement In addition to the above, CIS and bank staff are involved in a number of other strategic initiatives within the Co-operative movement. These include: a review of corporate governance being undertaken by Co-operatives^{UK} and the involvement of senior members of staff on the boards of the Association of European Co-operative and Mutual Insurers (ACME), the International Co-operative and Mutual Insurance Federation's Insurance Intelligence Network,^{vii} the European Association of Co-operative Banks (EACB)^{viii} and the Association of British Credit Unions' (ABCUL) board.^v

i www.co-operativebank.co.uk/personal/visa_travel.html
 ii www.co-operatives-uk.coop
 iii www.co-operativeaction.coop
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