The Co-operative Bank

We were prepared to make bold, innovative decisions to enhance our profitability. But if you are going to be bold, you had better be sure your facts are correct.

Terry Thomas, Managing Director, The Co-operative Bank

History

In 1994, the co-operative movement celebrated the 150th anniversary of its founding. A small group of people, in 1844, had started a grocer's shop in Rochdale, England (near the city of Manchester):

> to provide the local community with a source of pure, unadulterated goods at fair prices; their guiding principle was that the co-operative should exist for the benefit of the people it served, sharing its profits among them in proportion to their purchases.

The founders of the co-operative movement articulated a strong statement of mission and ethical standards (see **Exhibit 1**). The movement spread throughout the country and was an active force, even 150 years later. In 1994, U.K. co-operative societies generated a turnover of £6 billion, mostly in food retailing, farming, food production, milk sales, funeral supplies, general retailing, car sales and financial services.

The Co-operative Bank

The Co-operative Bank (Co-op Bank) was founded in Manchester in 1872 as a department of the Co-operative Wholesale Society (CWS), a central organization formed by cooperative societies across the country, who were, by then, the dominant retailing force in the U.K. **Exhibit 2** summarizes recent financial statistics for Co-op Bank. During its first 75 years, The bank functioned mainly to serve the treasury needs of CWS's operations. Personal accounts were not emphasized though the bank did attract some personal customers from employees of co-operative societies and local authorities (municipalities).

This case was prepared by Professors Srikant Datar of Stanford and Robert S. Kaplan of Harvard, with extensive assistance from Robin Webster of The Co-operative Bank, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Aimée Hampson of Gemini Consulting provided access and background to the case situation.

From the late 1940s through 1971, Co-op Bank began to expand its branch network to support the needs of the CWS and the increasing number of other co-operative societies and local authorities that were bringing their business to it. During this time, the co-operative societies were generating large amounts of cash from their highly successful trading operations and, by 1971, Co-op Bank's deposits had grown to more than £300 million.[1] With this expansion of banking activities, CWS managers realized that they needed to separate the banking business from all their other activities. In 1971, an Act of Parliament established Co-op Bank as a separate legal entity, with the CWS holding the entire issue of share capital. Previously, Co-op Bank's results and financial position had been consolidated with those of the CWS.

Lewis Lee, the first Chief Executive of the newly structured bank, strengthened and broadened the bank's management expertise by recruiting several senior and middle managers from the larger UK clearing banks. An immediate challenge emerged when Co-op Bank's strong deposit base declined rapidly as the co-operative movement (which supplied 96% of deposits) was confronted with strong competitive pressure on its trading activities. The bank's managers recognized the need for immediate and radical actions.

To replace the lost retail deposits, Co-op Bank began to pursue, much more aggressively, deposits from personal customers. It became the first UK bank to introduce free banking for customers who maintained credit balances in their current accounts. Over the next ten years, the number and size of personal accounts increased sharply and, while deposits never regained their 1971 highs, the reliance on deposits from the co-operative sector was sharply reduced to 4% of the total.

Co-op Bank pursued a similarly aggressive policy for the asset side of the balance sheet. In 1971, loans to the co-operative movement represented 90% of assets. By the 1990s, this percentage had declined to about 10-12%, with the remaining assets evenly split between the Personal and Corporate sectors. In 1975, the bank's broadened customer base for both assets and deposits enabled it to obtain status as a settlement bank so that it could now perform clearing activities and settlements. It was the first new settlement bank in 39 years and the first ever to achieve this status from internal growth.

Co-op Bank, during the 1970s and 80s, also broadened the range of products and services for personal and corporate customers. It introduced credit cards and launched several sophisticated savings products. This broadened mix of product and services, coupled to an increasingly stringent regulatory environment, created demands for more capital which the CWS found difficult to supply because of heavy demands for investment from all its other operations. Therefore, Co-op Bank had to devise a strategy to generate sustainable capital growth from its own operations.

Terry Thomas was appointed Managing Director in 1988, after a 15 year career at Co-op Bank. Thomas had joined the bank in 1973 as its first Marketing Manager, and had taken on increasing general management responsibilities, including election to the Board in 1983. He took command of a bank that had successfully managed the transition from an almost total reliance on the co-operative movement to a viable, broad-based retail clearing bank. But new challenges had to be faced.

The UK financial services market had entered a period of radical change and restructuring. Government legislation to deregulate the financial sector was blurring traditional industry boundaries. Constraints on Building Societies' operations had been relaxed and they were now competing aggressively for products, such as current accounts, credit cards, and personal loans, that had historically been provided only by banking institutions. One of the UK's largest Building Societies, Abbey National, had even changed its status to become a bank in early 1989. New players with radically different cost structures were also entering the financial services market. First Direct was a postal/telephone/ATM service bank that had no branches. Several

[1] This amount was far greater in inflation-adjusted terms, than The Bank's deposits in 1994.

companies formed just to offer credit cards. And large retailers, like Marks and Spencer, were now marketing credit products to their considerable customer base.

Customer expectations and behavior were changing as well. Customers were more willing to switch banks, and to take products from several institutions. They were becoming more price sensitive and vocal in their demands for service, including expanded use of electronic banking through telephones and ATMs. The introduction and expansion of electronic technology was transforming all existing cost structures. Significant over-capacity began to appear and institutions were competing aggressively on price for business in all sectors.

While profitability had continued to grow for Co-op Bank through the UK's economic boom of the early and mid-1980s, the UK's worst recession in more than 50 years hit the bank hard. Co-op Bank recorded losses in 1990 and 1991, particularly in loans made to the small and medium-sized enterprises that were now a significant share of the asset base. Significant losses were also occurring with personal customers, who were under great financial pressure from record levels of unemployment in the country.

Thomas recognized that the bank had to re-think its operating philosophy for the current and future competitive environment. Before under-taking any redirection, however, Thomas wanted to re-affirm the bank's fundamental values. The twenty most senior managers met to develop a Mission Statement (see **Exhibit 3**) that stressed the bank's responsibility to its customers, its employees, and its communities. The Mission Statement was enhanced by a research program culminating with a statement of **Our Ethical Policy** (see **Exhibit 4**). The Ethical Policy statement was informed by questionnaires sent to 30,000 current customers and a study of co-operative values over the past 150 years. The Mission and Ethical Policy statements created a far greater awareness of the bank's values and position in the marketplace. While some customers closed their accounts in protest, a much higher number of new personal and corporate accounts were opened after publicizing these statements.

Thomas' initial steps to restructure Co-op Bank's operations were accomplished through consolidation of personal and corporate account processing tasks. Back office tasks of personal banking operations, previously processed in branches, were consolidated into a Personal Customer Service center. Customers could call this center for the most up-to-date information regarding their accounts and could perform a variety of transactions over the telephone. Similarly many corporate banking tasks were consolidated into Regional Processing Centers. These new centers created 200 new jobs, but they also required eliminating 1,000 jobs (out of a total employee base of nearly 4,300) principally in retail branches. Laying off workers was a sensitive issue for a bank with such close ties to the co-operative and trade union movements. Co-op Bank offered attractive retirement packages and, was able to achieve the 1,000 job reduction entirely through voluntary retirements. Most of the terminations, however, were junior, low-level employees and the bank was now operating with a disproportionate number of middle managers.

Co-op Bank also increased its cross-selling activities to existing customers, and began to offer a much wider array of products for customers. Among its major new products were:

VISA GOLD CARD	A "free for life" (no annual fee) credit card aimed at high net worth individuals
VISA AFFINITY CARDS	Credit cards for specialized groups of customers (for example, The Royal Society for the Protection of Birds)
PATHFINDER	A high interest-bearing current account for personal customers, based on a plastic card with no check book
DELTA	A point of sale debit card/ATM card/check guarantee card hybrid

Major new services introduced by the bank included:

TELEPHONE BANKING	Comprehensive remote banking through a centralized operation for personal and corporate customers
INDEPENDENT FINANCIAL ADVICE	Investment advice for customers, selling products provided by other financial institutions

Some of these products, particularly Visa Gold and Visa Affinity credit cards, were highly successful. In 1990, Co-op Bank was not an issuer of Gold cards, but two years later, it had become the largest issuer of Visa Gold cards in the U.K., and by 1994 was the largest issuer in all of Europe.

Despite the new products and headcount reduction, Co-op Bank's cost-to-income ratio was high, especially when compared to Building societies with whom it was increasingly in direct competion.[2] Also, Co-op Bank was still a small player in the U.K.'s corporate and personal markets.

Project SABRE

Terry Thomas recalled the bank's situation in late 1992.

> In 1988 we had identified the need to be much more focused, in terms of both market niches and our operations. We began to concentrate on those niches and segments where we had particular advantages, and we had taken a number of steps to re-structure our operations. However, these were first steps in a process of transforming our business, and in order to continue and accelerate this process, we needed better information to help us make some important decisions.
>
> I felt we had too many products for our customer base. But none of us could agree on which were the profitable or unprofitable products and customers. Some thought the corporate sector was the most profitable by contributing a large number of profitable personal accounts. Others justified the full-line consumer product strategy by asserting that unless you offer a wide range of products the customers won't come to you in the first place. How should we balance the benefits of a wide product range against the costs? Should we promote these extra services or just have the capability to provide these extra services to the extent that certain customers want them? Or should we be out-sourcing many of these services if we can not do them effectively internally?
>
> I can remember many unproductive meetings when all we did was argue what the numbers were. Each player came to the table with his or her own set of numbers. Human nature being what it is, each of us believed my set of numbers was right and yours must be wrong, especially if yours say my products are losing more money than I think. We never actually got around to arguing or discussing, given any particular set of numbers, what are we going to do?
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> I wanted to run the bank on the facts and not on perceptions. Having a set of numbers derived by a systematic process to which everyone agrees cuts out the arguing and focuses attention on action plans. It is not very difficult, really, then to make innovative and bold decisions.

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[2] The cost-to-income ratio is defined in the U.K. as the ratio of all costs (which exclude the provision for bad debts) to net interest revenue earned plus commissions.

In early 1993, Thomas launched Project SABRE (Sales And Business REengineering), a project with several related streams aimed at improving the cost income ratio and the service to customers. A key element of the project was to develop information that would enable the bank to address five corporate needs:

1. Overhead Reduction
2. Re-engineering of business processes, particularly those that did not add value to customers
3. Product Profitability
4. Customer Profitability
5. Segment Profitability

John Marper, Executive Director of Finance, recognized that Co-op Bank's cost structure, particularly those costs traditionally considered "fixed" such as in centralized services like technology, transmission, and finance had to be attacked.

> If you are going to attack the fixed cost base, you need to have a better cost system, especially one that can relate the fixed costs to products.

The bank's existing cost system was a traditional responsibility accounting system that measured expenses for geographic and departmental cost centers. Central headquarters expenses, such as information systems and document transmission, were allocated to operating segments using high-level drivers related to the volume and size of the businesses. The bank measured product revenues using fee income and net interest (equal to gross interest minus funding costs). But the estimated costs of producing these revenues were not identified.

Following a pilot exercise in Co-op Bank's check clearing center, managers became interested in activity-based costing (ABC) as a promising methodology for assigning the bank's operating expenses to its varied products and customers. An ABC team, consisting of Robin Webster, Senior Manager (and later Head of Project SABRE) Dennis Goodman, Head of MIS, Steve Kemp, Senior Business Analyst, and 8 middle managers from different areas of the bank, began model building and process data gathering. The bank also brought in Gemini Consulting to assist in the model development and to advise on the re-organization and action implications from the study in conjunction with internal management.

The bank's project team had to make several choices as it began considering the implementation of activity-based costing. How should it define resource pools? What activities should it define? Should it analyze costs by product or by customer? The bank divided its fiscal year into 13 four-week periods. Over what period should it collect the data for an initial historical analysis?

The team concluded that three periods would be reasonably representative to understand the bank's cost structure. They chose to do the analysis for March-May, 1993, the most recent three periods for which data were available.

The ABC team scanned the general ledger and identified about 210 resource cost pools, divided into three broad resource categories:

Operational Staff (85)	Infrastructure (85)	Miscellaneous (40)
Personal Network-Staff	Personal Network	Outsourced Processing Fees
Processing Centers-Staff	Visa Administration	Stationery Costs
Personal Accts. Opening	Processing Centers	Personal Check Books
	ATM Network	Visa Statements

The numbers in parentheses indicate the number of resource pools in each broad resource category. The rows in **Exhibit 5** identify the major resource cost pools that service the personal banking side of Co-op Bank's business.

Once the resource cost pools were specified, the ABC team spent eight weeks out in the operational areas identifying activities and mapping them on brown paper pasted around the project work room. The team used their knowledge, supplemented with interviews, to identify 235 activities or tasks undertaken at the bank. Examples of activities were open customer accounts, maintain customer accounts, accept checks, process transactions, close accounts, handle customer queries, issue check books, market and sell products, money market transfers, Visa transactions, ATM transactions, encode, train, process loan applications, manage risk, recover money, and prepare financial statements and management reports. The columns of **Exhibit 5** identify the eighteen principal activities related to the Bank's personal banking business.

With the resource pools specified and activities selected and defined, the ABC team then asked each area of the bank to match resource costs to the activities (see the cell entries in **Exhibit 5**). For example, to trace staff costs to activities, all employees of the bank from senior management to the clerical staff filled out time sheets identifying the time they spent on various activities. The employees' compensation (salary and benefits) was then assigned to each activity in proportion to the time spent. Computer costs were assigned based on the amount of computer time required to perform various activities. By aggregating all of the resource pool costs assigned to each activity, the ABC team derived the total costs of each activity (see Total Activity Costs row in **Exhibit 5**).

The next step traced the costs of each activity to the different bank products. The tracing was accomplished by defining activity cost drivers for each activity (see first two columns in **Exhibit 6**). The activity cost driver represented the event that triggered the performance of each activity, such as a deposit that was processed or an account that was opened. The team collected information about the quantities of each activity cost driver that occurred during the estimation period (March-May 1993). These data came from various sources: the bank's automated information system (for data such as the number of Visa transactions, checks processed, and cash deposited), manual records (for data like the number of personal accounts opened), and statistical sampling procedures (for data not recorded such as the number of customer queries and complaints handled).

Activity cost driver rates (see the last column in **Exhibit 6**) were calculated by dividing the cost of each activity by the quantity of the associated activity cost driver. The activity cost driver rate could now be used to trace activity costs to individual products and customers.

The project team identified approximately 50 products or groups of closely related products. Corporate products included business loans, corporate current accounts, and leases. Personal banking products included personal loans and advances, current accounts and Visa accounts. Product costs were calculated by determining the quantity of each activity cost driver used by each of the products, multiplying these quantities by the associated activity cost driver rate, and summing across all the activities used by the individual products.

Exhibit 7 summarizes the distribution of activity costs, including funding charges, to various personal banking products (current accounts, ultra account, personal loans, Visa cards and other personal banking products. The last row of **Exhibit 7** calculates the product cost as the sum of the activity costs used by individual products.

Not all operating expenses were assigned to banking products. The project team categorized the costs of ten large activities as sustaining costs—costs of resources that were not directly related to any products. Sustaining resources supported the organization as a whole. No activities or cost drivers were defined for these resources, which included accounting, finance, strategy, planning, human resource management, and information technology development. These sustaining costs accounted for 15% of the bank's operating expenses.

Product profitability was calculated by subtracting the cost of all activities undertaken to support a particular product (bottom row of **Exhibit 7**) from the net interest revenue earned from each product plus the fees derived for performing various services for customers. For asset and liability products (such as loans, current accounts, and savings), the bank used a transfer interest rate to represent the rate at which excess funds could be invested or needed funds borrowed on the money markets.[3] The transfer rate used for most products was the LIBOR[4] rate + 1/4% (which equaled 6 1/4% during the initial estimation period); however, where funds were invested or borrowed specifically for certain products ("matched"), the actual matched rate was used.

Robin Webster, the manager leading the ABC study, described the bank's motivation for calculating product profitability for both asset and liability products:

> In addition to fee income, the bank makes money from asset and liability products in two ways: (1) by accessing sources of funds from liability products; and (2) by lending at higher risk-adjusted rates for our asset products. Using transfer rates allows us to see how well we are doing on both sides of the balance sheet. Are we raising funds from liability accounts at a net cost below our LIBOR borrowing cost? If so, and even without good lending opportunities, we could profit by investing these funds at the LIBOR rate. Are our lending operations healthy? Could we borrow money from the markets at the base rate and still turn a profit from our lending and related fee-generating activities?

Exhibit 8 shows the profitability of the individual personal banking products.

Product Decisions

The bank had always regarded the provision of independent financial advice and the sale of associated investment products as a highly profitable business. The ABC analysis (see Exhibit 8), however, indicated that this business was only generating small profits on the basis of the activity costs that could be directly assigned to it, even with no allocation of the 15% of expenses classified as "sustaining costs." This came as a particular surprise because the Bank had targeted financial advice and new investment products as a growth area in the deregulated environment.

The analysis showed that several other products were failing to generate adequate returns to pay for the sustaining costs and to support hoped-for improvements in the Bank's cost-income ratio aspirations. For example, the Bank's basic and core product, personal current accounts ("Current Account Plus"), was at best breaking even after considering sustaining costs. This finding was consistent with conventional wisdom at the Bank, and also in the U.K. banking market, where many banks were openly commenting in the press that current accounts were unprofitable. The Bank began contemplating several courses of action to improve the profitability of current accounts.

On a more positive note, all three Visa accounts were revealed to be highly profitable products. The Gold Card is a free for life card that carries a slightly lower interest rate than the Classic Card (which is an ordinary Visa Card) and the Affinity Card. The Affinity Card is attractive to some customers because a portion of the income earned on the Affinity Card is given to specified charities. The Bank saw a clear message to focus its limited marketing resources into growing its personal current accounts and Visa account businesses.

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3 For example, the net interest revenue on business loans equaled the actual interest received minus the transfer rate. For liabilities, like corporate deposits and current accounts, net interest revenue equaled the transfer rate minus the interest actually paid.

4 LIBOR is the London Inter Bank Offer Rate.

Customer Profitability

The ABC team wanted to extend the analysis to individual customers, but the bank's information systems, many dating back to the 1960s, could not readily access customers' transactions data. The team performed a limited study of customer-specific expenses, based on a sample of current accounts. They did not need to study other products in detail, since most savings accounts had fewer than two transactions per quarter, all loan products had a predictable 12 transactions per year, and credit card costs were found to be mostly constant per account.

The team determined that 55% of current account expenses were related to processing transactions, and 45% were related to maintaining accounts. The maintenance-related costs were divided by the number of accounts, and assigned equally to each account. For assigning transactions-related expenses, the team split customers into three segments—Low, Medium, and High—based on the annual turnover of funds in their accounts. From a month-long sample of customer transactions, they assigned transactions-related expenses to these three segments in the ratios of: 15%, 40% and 45%.

The revenue side was simpler. The team identified, for each product, the income earned from credit balances and fees by individual customers. By matching this income with the assigned cost, the team could now estimate the profitability of each customer.

Next, the team identified the entry product (the first product bought by a customer). The five main entry products were Current Accounts, VISA Gold, VISA Affinity cards, VISA Classic and the Pathfinder savings account. All subsequent sales of other products (cross sales) were assigned to the entry product. The results showed that the vast majority of cross sales originated from Current Accounts.

The customer profitability analysis revealed that up to half of all current accounts, particularly those with low balances, were unprofitable. Managers at the bank began to debate several questions about current accounts. How can it make current accounts attractive to profitable customers? Should the bank combine and enhance its current account products with features such as service level warranties and restructured charges? Should it aggressively market these accounts using a special sales force backed by an advertising campaign in local newspapers and on television?

How should the Co-op discourage unprofitable customers? Should it alter its tariff to give a wide differential between customers taking credit within approved overdraft limits, and those overdrawing accounts outside approved limits where the greatest risk of loss existed, and which prompted high levels of intervention activity?

The team segmented Visa customers into profitable and unprofitable customers. The most profitable customers were customers with large unpaid balances that generated interest income, and customers who transacted frequently, thereby generating high processing fees. The Bank developed a profile of the profitable customers, and its marketing was being redirected to attract the customers with profitable behavior.

David Fawell, Marketing Manager, faced an interesting decision:

> Excluding sustaining costs, both current account and Visa customers are profitable, as I thought. But with pressure to reduce our operating expenses, I have only a limited amount of funds to market these products. I'm not sure whether these funds should be directed to prospective personal current account customers or to Visa account customers? Or should I spread the funds across both types of prospects?

Overhead Reduction and Business Process Reengineering

In addition to decisions about products and customers, the initial information from Project SABRE helped to refocus Co-op Bank from a functionally-oriented organization to a process-oriented organization. Activity costs provided a metric to evaluate the effects of business process reengineering decisions. Managers were now attempting to identify which processes were adding value to the customer and which were not, and how the efficiency of different processes could be improved. Improving efficiency would enable the bank to either take costs out of the system, or to use the extra capacity to generate more revenue.

Deeper analysis showed that much of the cost base had a high element of costs that were, in the short to medium term, fixed (for example, computer systems and bank branches) and that radical solutions were required to impact on these costs. In 1994, Co-op Bank outsourced its computer development and ATM network, and began serious negotiations to outsource its London check clearing center with a view to eliminating excess capacity and replacing fixed with variable costs.

Next Steps

While stimulated by the interesting findings of the first-pass ABC analysis, many bank managers were still unsure about the action implications. A newly introduced product like foreign currency exchange seemed to be unprofitable. Should it be discontinued or should it be retained as part of a full-service package for current account customers? Also, would department managers, accustomed to high autonomy and control over their operations, be willing to re-engineer their organization to facilitate process flows, and eventually to down-size their operations to achieve a lower cost-to-income ratio. Some managers expressed concern that as profitability improved, from better selection of products and customers, the organization's commitment to reorganize and improve would start to diminish.

Robin Webster and Steve Kemp were disappointed that such a large amount of expenses (15% of costs) had been classified as sustaining costs, where they could not be driven down to products and customers. They felt that these sustaining expenses could be reduced but because they had been treated as "fixed," independent of products and customers, they would not be targets for cost reduction. Ken Lewis, Executive Director, Group Resources, concurred. He observed that the bank's people costs had been traced readily and easily to activities that related to products and customers, but that property and information technology resources had been largely classified as business-sustaining. Lewis believed that significant opportunities existed to downsize sustaining costs by making better decisions about the types of properties the bank owned and leased, and the level and extent of information technology the bank deployed. Decisions on information technology could be critical. Unmanned, totally automated kiosks were starting to perform activities formerly done by the bank's labor-intensive branch network.

Exhibit 1

Founding Statement of International Co-operative Alliance[1]

August 22, 1895

The time has come for gathering together the scattered parts of the great co-operative movement, one in aim and one in principle into a strong international alliance.

It is to carry this great idea into execution that the International Co-operative Alliance has been resolved upon. Without interfering in local or national matters or narrowing in any way the independence of each association or national union, the alliance will form a link uniting cooperators who are pursuing very various objects in different countries.

It will thus secure mutual support to each and all, produce a more powerful volume of co-operative opinion than can be created by separate action, help to carry cooperation more successfully forward to new developments, and create means by which cooperators will be enabled steadily to learn from one another by an interchange of opinions, or reports, and of publications.

In carrying out this program the alliance will be an added cause of peace through the inhabited world.

The objects of the alliance are[2] :

(1) To bring into relation of mutual helpfulness those who are seeking in different countries and in various ways to end the present deplorable warfare between Capital and Labor, and to organize industrial peace based on co-partnership of the worker.

(2) To promote the formation or aid the development in each country of a central institution for helping working people to establish and maintain self-governing workshops and for assisting employers and employed to establish just and harmonious profit-sharing arrangements.

(3) To form an international means of connection and communication between these central institutions through which they may render one another mutual assistance.

(4) Generally promote the employment of the profits of productive industry.

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1 From draft outline of a plan for an International Alliance of the friends of cooperative production, to be considered at an inaugural meeting at the Crystal Palace on Monday, August 22, 1895 at 3:00 p.m.

2 From ICA Archives

Exhibit 2

Selected Financial Statistics: 1990-1994 [£(000,000)]

	1990	1991	1992	1993	1994
Deposits	2,621	2,438	2,707	2,983	2,876
Loans and Advances	2,597	2,408	2,637	2,740	2,488
Profit (Loss) Before Taxes	(14.9)	(6.0)	9.8	17.8	27.5
Pre-tax return on Shareholder Funds	(9.4%)	(4.0%)	6.7%	12.0%	17.8%

Exhibit 3

Mission Statement -- 1988

We, the Co-operative Bank Group, will continue to develop a successful and innovative financial institution by providing our customers with high quality financial and related services whilst promoting the underlying principles of co-operation which are...

1. Quality and Excellence

To offer all our customers consistent high quality and good value services and strive for excellence in all that we do.

2. Participation

To introduce and promote the concept of full participation by welcoming the views and concerns of our customers and by encouraging our staff to take an active role within the local community

3. Freedom of Association

To be non-partisan in all social, political, racial and religious maters.

4. Education and Training

To act as a caring and responsible employer encouraging the development and training of all our staff and encouraging commitment and pride in each other and the Group

5. Co-operation

To develop a close-affinity with organizations which promote fellowship between workers, customers, members and employers.

6. Quality of Life

To be a responsible member of society by promoting an environment where the needs of local communities can be met now and in the future.

7. Retentions

To manage the business effectively and efficiently, attracting investment and maintaining sufficient surplus funds within the business to ensure the continued development of the Group.

8. Integrity

To act at all times with honesty and integrity and within legislative and regulatory requirements.

Exhibit 4

Our Ethical Policy - 1992

The Bank's position is that

1. It will not invest in or supply financial services to any regime or organization which oppresses the human spirit, takes away the rights of individuals, or manufactures any instrument of torture.

2. It will not finance or in any way facilitate the manufacture or sale of weapons to any country which has an oppressive regime.

3. It will encourage business customers to take a proactive stance on the environmental impact of their own activities.

4. It will actively seek out individuals, commercial enterprises and non-commercial organizations which have a complementary ethical stance.

5. It will not speculate against the pound using either its own money or that of its customers. It believes it is inappropriate for a British clearing bank to speculate against the British currency and the British economy using deposits provided by their British customers and at the expense of the British tax payer.

6. It will try to ensure its financial services are not exploited for the purposes of money laundering, drug trafficking or tax evasion by the continued application and development of its successful internal monitoring and control procedures.

7. It will not provide financial services to tobacco product manufacturers.

8. It will continue to extend and strengthen its Customer Charter, which has already established new standards of banking practice through adopting innovative procedures on status enquires and customer confidentiality, ahead of any other British bank.

9. It will not invest in any business involved in animal experimentation for cosmetic purposes.

10. It will not support any person or company using exploitative factory farming methods.

11. It will not engage in business with any farm or other organization engaged in the production of animal fur.

12. It will not support any organization involved in blood sports, which it defines as sports which involve the training of animals or birds to catch and destroy, or to fight and kill, other animals or birds.

We will regularly re-appraise customers' views on these and other issues and develop our ethical stance accordingly.

Exhibit 5
Personal Sector Products Matrix of Costs by Resource and Activity*

Resource Cost Pools	Total Resource Costs	Provide ATM Services	Clear Debit Items	Branch Operations Debit Items	Issue Personal Cheque Book	Clear Credit Items	Branch Operations Credit Items	Lending Control & Security	Customer Inquiries	Customer Correspondence	Marketing and Sales Activity	Computer Processing
Account Management Center	£ 1,557,280	£ 0	£ 2,388	£ 66,293	£ 0	£ 509	£ 0	£ 5,647	£ 903,565	£196,803	£ 134	£ 49,745
Account Opening Teams	368,355	0	0	0	0	0	0	0	0	0	0	0
ATM Network	111,031	111,031	0	0	0	0	0	0	0	0	0	0
Branch Operations	3,475,959	95,229	40,756	487,269	0	11,641	545,606	5,709	306,263	460,845	1,478,735	0
Clearing Operations	833,575	20,099	650,287	1,291	0	135,744	1,394	4,791	0	2,109	25	2,339
Collections	968,256	0	0	36	0	0	1,168	912,190	41,378	10,578	0	0
Collections Fees	329,205	0	0	0	0	0	0	329,205	0	0	0	0
Outsourced Fees	2,120,071	104,151	0	0	0	0	0	41,611	37,796	3,109	0	22,061
Financial Advisors	1,214,383	0	0	0	0	0	0	0	9,799	3,601	81,970	0
Information Technology	1,669,453	0	0	65,293	0	0	0	67,261	0	0	1,765	1,535,134
Marketing Fees and Staff	884,380	16,236	0	0	0	0	0	0	0	279	867,865	0
Postage	713,474	92,397	0	0	107,706	0	0	0	0	48,019	0	0
Regional Processing Centers	485,102	25,023	328,709	61,263	0	70,107	0	0	0	0	0	0
Stationery	277,746	0	0	0	156,243	0	0	0	0	0	0	24,728
Telesales	129,235	0	0	0	0	0	0	0	0	0	129,235	0
VISA Stamps and Statements	433,491	0	0	0	0	0	0	0	0	0	0	0
Other	55,671	26,136	0	2,655	0	0	0	14,349	0	863	2,317	7,240
Total Activity Costs	£15,626,667	£490,302	£1,022,140	£684,100	£263,949	£218,001	£548,168	£1,380,763	£1,298,801	£726,206	£2,562,046	£1,641,247

Resource Cost Pools	Statementing & Postage	Advise on Investments & Insurance	Process VISA Transactions	Issue Visa Statements	Open and Maintain Handyloans	Open and Close Accounts	Administer Mortgages
Account Management Center	£ 0	£ 0	£ 138,792	£ 0	£ 0	£ 193,404	£ 0
Account Opening Teams	0	0	0	0	0	294,181	74,174
ATM Network	0	0	0	0	0	0	0
Branch Operations	0	40,930	0	0	0	2,976	0
Clearing Operations	15,364	0	0	0	0	132	0
Collections	0	0	0	0	0	2,906	0
Collections Fees	0	0	0	0	0	0	0
Outsourced Fees	0	0	942,629	0	846,806	0	121,908
Financial Advisors	0	1,119,013	0	0	0	0	0
Information Technology	0	0	0	0	0	0	0
Marketing Fees and Staff	0	0	0	0	0	0	0
Postage	455,736	0	0	9,616	0	0	0
Regional Processing Centers	0	0	0	0	0	0	0
Stationery	3,989	0	92,786	0	0	0	0
Telesales	0	0	0	0	0	0	0
VISA Stamps and Statements	0	0	0	433,491	0	0	0
Other	2,111	0	0	0	0	0	0
Total Activity Costs	£477,200	£1,159,943	£1,174,207	£443,107	£846,806	£493,599	£196,082

* Numbers disguised to maintain confidentiality

EXHIBIT 6

Personal Sector Products: Activity Cost Driver Quantities and Rates*

Activity Description	Activity Cost Driver	Total Activity Cost	Quantity of Activity Cost Driver	Cost Per Unit of Activity Cost Driver
Provide ATM Service	ATM transactions	£ 490,302	1,021,963	£0.48
Clear Debit Items	Number of debits processed	1,022,140	5,110,299	0.20
Branch Operations for Debit Items	Number of branch counter debits	684,100	762,111	0.90
Issue Personal Cheque Book	Number of books issued	263,949	40,628	6.50
Clear Credit Items	Number of credits processed	218,001	871,004	0.25
Branch Operations for Credit Items	Number of branch counter credits	548,168	512,986	1.07
Lending Control and Security	Number of interventions	1,380,763	765,591	1.80
Customer Inquiries	Number of telephone minutes	1,298,801	7,205,560	0.18
Customer Correspondence	Number of customer letters	726,206	221,204	3.28
Marketing and Sales Activity	Number of accounts opened	2,562,046	62,120	41.24
Computer Processing	Number of computer transactions (electronic impulses)	1,641,247	16,112,471	0.10
Statementing and Postage	Number of statements issued	477,200	1,724,285	0.28
Advise on Investments and Insurance	Hours of advice given	1,159,943	32,956	35.20
Process VISA Transactions	Number of VISA transactions	1,174,207	5,125,248	0.23
Issue VISA Statements	Number of VISA statements issued	443,107	1,714,258	0.26
Open/maintain Handyloans	Number of Handyloan accounts	846,806	201,521	4.20
Open and Close Accounts	Number of accounts opened/closed	493,599	57,951	8.52
Administer Mortgages	Number of mortgages	196,082	18,609	10.54
		£15,626,667		

* Numbers disguised to maintain confidentiality

EXHIBIT 7

Matrix of Activity Costs Used by Personal Sector Products*

Activity	Total	Current Account Plus (1)	Freeflow (2)	Personal Loans (3)	Mortgages (4)	VISA Classic (5)	Visa Affinities (6)	VISA Gold (7)	Handyloan/ Fastline (8)	Independent Financial Advice and Insurance (9)	Pathfinder (10)	Deposit Products (11)
Provide ATM Services	£ 490,302	£ 403,360	£ 4,873	£ 0	£ 0	£ 25,410	£ 7,729	£ 15,447	£ 921	£ 0	£ 22,515	£ 10,047
Clear Debit Items	1,022,140	921,643	31,915	0	0	33,792	10,397	14,296	0	0	10,071	26
Branch Operations for Debit Items	684,100	487,796	9,774	1,770	0	90,131	35,775	44,617	6,151	0	5,985	2,101
Issue Personal Cheque Book	263,949	252,663	11,286	0	0	0	0	0	0	0	0	0
Clear Credit Items	218,001	91,982	2,432	4	0	53,731	20,381	45,284	1,149	0	3,004	34
Branch Operations for Credit Items	548,168	506,273	14,964	0	0	3,131	103	807	0	0	3,807	19,083
Lending Control and Security	1,380,763	532,918	26,288	91,501	20,825	540,563	6,809	143,906	5,387	4,798	4,528	3,240
Customer Inquiries	1,298,801	850,569	26,974	97,014	324	107,052	14,749	57,630	5,959	21,053	84,287	33,190
Customer Correspondence	726,206	462,178	15,510	64,409	970	56,701	2,439	23,598	6,332	13,277	58,797	21,995
Marketing and Sales Activity	2,562,046	673,641	4,189	815,211	0	202,552	54,000	197,334	41,210	398,548	85,366	89,995
Computer Processing	1,641,247	1,215,933	54,979	113,403	0	31,292	11,317	19,256	38,131	0	49,563	107,373
Statementing and Postage	477,200	336,094	18,687	19,179	66	15,241	1,433	49,277	4,430	4,088	22,740	5,965
Advise on Investments and Insurance	1,159,943	0	0	0	0	0	0	0	0	1,159,943	0	0
Process VISA Transactions	1,174,207	223,320	0	18,672	0	468,257	177,895	270,904	15,159	0	0	0
Issue VISA Statements	443,107	0	0	0	0	235,406	94,017	113,684	0	0	0	0
Open/Maintain Handyloans	846,806	0	0	0	0	0	0	0	846,806	0	0	0
Open and Close Accounts	493,599	188,373	2,786	104,346	0	51,505	1,078	35,397	11,934	0	63,062	35,118
Administer Mortgages	196,082	10,596	815	17,117	121,907	0	1,631	0	0	0	13,042	30,974
Total Activity Costs	£15,626,667	£7,157,339	£225,472	£1,342,626	£144,092	£1,914,764	£439,753	£1,031,437	£983,569	£1,601,707	£426,767	£359,141

*Numbers disguised to maintain confidentiality

EXHIBIT 8

Profitability Analysis of Personal Sector Products*

Activity	Current Account Plus	Freeflow	Personal Loans	Mortgages	VISA Classic	VISA Affinities	VISA Gold	HandyLoan /Fastline	Independent Financial Advice/ Insurance	Pathfinder	Deposit Products	Total
Net Interest	£ 5,283,472	£1,041,384	£4,530,763	£331,027	£2,856,713	£463,204	£ 808,592	£1,811,526	£ 0	£ 261,717	£960,437	£18,349,035
Net Commission	3,593,898	358,867	780,608	147,909	2,101,002	686,117	1,562,720	65,987	1,549,634	4,284	(1,141)	10,849,885
Bad Debts	(782,000)	(130,000)	(1,192,000)	(274,000)	(882,000)	(182,000)	(508,000)	(274,000)	0	0	0	(4,224,000)
Gross Profit	8,095,370	1,270,251	4,119,571	204,936	4,075,715	967,321	1,863,312	1,603,513	1,549,634	266,001	959,296	24,974,920
Activity Costs (from Exhibit 6)	7,157,339	225,472	1,342,626	144,092	1,914,764	439,753	1,031,437	983,569	1,601,707	426,767	359,141	15,626,667
Direct Profit	938,031	1,044,779	2,776,945	60,844	2,160,951	527,568	831,875	619,944	(52,073)	(160,766)	600,155	9,348,253
Allocated Infrastructure Costs	1,014,145	36,845	204,822	4,213	156,768	22,086	81,053	20,864	263,078	65,066	59,685	1,928,625
Net Profit	£ (76,114)	£1,007,934	£2,572,123	£ 56,631	£2,004,183	£505,482	£ 750,822	£ 599,080	£ (315,151)	£(225,832)	£540,470	£ 7,419,628

*Numbers disguised to maintain confidentiality