Silk Road Finance Number Three plc

Financial statements

for the year ended 31 December 2013

Registered Number: 08098466

Silk Road Finance Number Three plc

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Silk Road Finance Number Three plc

Directors and advisors

Directors
SFM Directors Limited
SFM Directors (No 2) Limited
Ms C A Wallace

Secretary
SFM Corporate Services Limited

Independent auditor
KPMG Audit Plc
St James Square
Manchester
M2 6DS

Solicitors
Allen & Overy LLP
One Bishop's Square
London
E1 6AD

Registered office
35 Great St Helen's
London
EC3A 6AP

Registered number
08098466

Silk Road Finance Number Three plc

Strategic report for the year ended 31 December 2013

Principal activities

The Company was incorporated in England with the principal activity as that of a securitisation vehicle with beneficial ownership of mortgage loans secured by first charges over residential properties within the UK The nature of the securitisation vehicle is that it is set up to be financially independent from the ultimate controlling entity, The Co-operative Bank plc

The beneficial ownership of the loans and advances to customers sold to the Company by the originator fail the derecognition criteria of IAS 39 and consequently, these loans remain on the balance sheet of the originator IAS 39, therefore requires the seller to recognise a deemed loan financial liability on its balance sheet and the resulting deemed loan asset is held on the purchasing company's balance sheet

On 20 December 2013, The Co-operative Bank plc successfully completed a liability management exercise, with the result that The Co-operative Group Limited no longer owns 100% of The Co-operative Bank plc Consequently, the directors are of the opinion that the ultimate controlling entity into which the results of the Company are consolidated is now The Co-operative Bank plc Further details regarding this refinancing activity can be found in the Annual Report of the Bank which is available online from
http //www co-operativebank co uk/investorrelations/financialresults

The profit for the year after taxation amounted to £3,266K (2012 loss of £191K) The net assets of the Company at 31 December 2013 were £3,125K (2012 net liabilities of £141K)

During the year the deemed loan assets decreased in line with the mortgage portfolio they reflect, the decrease being due to the mortgage repayments received during the year

Strategy

The Company could sell the beneficial ownership of the mortgages back to The Co-operative Bank plc on 21st September 2016 If this happens, the Company will settle all outstanding liabilities at that time

Future outlook

Due to repayments decreasing the capital value of the mortgages each year, both the balance sheet and interest income will decrease in future years The rate of decrease is dependent on future redemptions, further advances and interest rate fluctuations

Due to the way in which the securitisation is structured, the Company is only required to repay its capital in line with the principal repayment of the underlying mortgage loans Consequently, the directors are satisfied that the Company will have sufficient liquid resources available to meet its obligations as they fall due

After making enquiries and considering the current forecasts, the directors have a reasonable expectation that the Company will have adequate resources to continue in business for the foreseeable future and that it is appropriate to adopt the going concern basis in preparing the financial statements

Silk Road Finance Number Three plc

Strategic report for the year ended 31 December 2013 (continued)

Principal risks and uncertainties
The financial risks faced by the Company are credit risk, interest rate risk and liquidity risk A summary of these risks is included below

- credit risk is the risk that a customer or counterparty will not be able to meet its obligations to the Company as they become due Credit risk arises on cash and cash equivalents, deemed loans, derivative financial instruments and other receivables The ability of the originator's customers to repay their loans is impacted by economic factors in the UK Credit risk on the Company's deemed loan assets is however considered to be minimal because management do not expect the amount of incurred credit losses on the Originator's securitised loans and advances to customers to exceed the amount of the credit enhancement supplied by The Co-operative Bank plc For further information regarding arrears of the underlying mortgage loans that the deemed loans relate to, please visit http://www.co-operativebank.co.uk/investorrelations/debtinvestors/ and refer to the investor reports for the Company,
- interest rate risk arises from movements in interest rates on the underlying mortgages that the Company's deemed loan asset relates to and debt securities in issue, and
- liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due, or can only do so at excessive cost Liquidity risk arises on the Company's debt securities in issue and derivative financial instruments

Key performance indicators (KPIs)
The directors monitor the progress of the Company by reference to two KPIs, firstly the net interest margin and secondly the notes outstanding balance

The net interest margin is 0 10% (2012 0 04%) calculated by dividing net interest income (which includes derivative interest) by the average deemed loan balance

Under the terms of the notes the Company can repurchase the outstanding notes of a securitisation issue at par once the outstanding principal amount of the notes falls below 10% of the amount originally issued The current notes balance outstanding as a percentage of the initial balance is 78 57% (2012 92 68%)

On behalf of the Board

Sue Abrahams
On behalf of SFM Directors Limited
As Director

Date 24 June 2014

Silk Road Finance Number Three plc

Directors' report for the year ended 31 December 2013

The directors present their report and the audited financial statements of Silk Road Finance Number Three plc (Registered Company No 08098466) for the year ended 31 December 2013

Likely future developments

The future developments of the Company are dealt with in the Strategic Report on page 2 of the financial statements

Dividends

The directors do not propose a dividend for the year ended 31 December 2013 (2012 £nil)

Financial instruments

Instruments used for risk management purposes are set up at the inception of the securitisation and include derivative financial instruments (derivatives), such as interest rate swaps This reflects the overall low risk appetite of the Company After inception no significant decisions regarding the risk management of the Company are required

The Company is exposed to credit risk, interest rate risk and liquidity risk Financial instruments are used, as required, to manage these risks Details are included in note 9 to the financial statements

Directors' details

The directors who held office during the year are given below

SFM Directors Limited
SFM Directors (No 2) Limited
Ms C A Wallace

No director had a beneficial interest in the share capital of the Company, The Co-operative Bank plc, or any of its subsidiaries at any time during the year under review

Third party indemnities

Qualifying third party indemnity provisions for the benefit of the directors were in force during the year under review and remain in force as at the date of approval of the directors' report and financial statements

Secretary

SFM Corporate Services Limited acted as the company secretary during the year and subsequently

Corporate governance

The directors have been charged with governance in accordance with the transaction documents describing the structure and operation of the transaction The governance structure of the Company is such that the key policies have been predetermined at the time of issuance and the operational roles have been assigned to third parties with their roles strictly governed by the transaction documents

The transaction documents provide for procedures that have been designed for safeguarding assets against unauthorised use or disposition, for maintaining proper accounting records, and for the reliability and usefulness of financial information used within the business or for publication Such procedures are designed to manage rather than eliminate the risk of failure to achieve business objectives whilst enabling them to comply with the regulatory obligations

Due to the nature of the securities which have been issued, the Company is largely exempt from the requirements of the Financial Conduit Authority disclosure and transparency rules (DTR) DTR 7 1 audit committees and 7 2 corporate governance statements (save for the rule DTR 7 2 5 requiring a description of the features of the internal control and risk management systems), which would otherwise require the Company respectively, to have an audit committee in place and to include a corporate governance statement in the report of the directors The directors are therefore satisfied that there is no requirement for an audit committee or a supervisory body entrusted to carry out the functions of an audit committee or to publish a corporate governance statement

Silk Road Finance Number Three plc

Directors' report for the year ended 31 December 2013 (continued)

Statement of directors' responsibilities in respect of the strategic report, directors' report and the financial statements

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year Under that law they have elected to prepare the financial statements in accordance with IFRS as adopted by the EU and applicable law

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company, and of the profit or loss of the Company for that year In preparing the financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent
- state whether they have been prepared in accordance with IFRS as adopted by the EU, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities

Statement on disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware, and each director has taken all the steps that they ought to have taken as directors to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information

This confirmation is given and should be interpreted in accordance with the provisions of Section 418(2) of the Companies Act 2006

On behalf of the Board

Sue Abrahams
On behalf of SFM Directors Limited
As Director

Date 24 June 2014

Independent auditor's report to the members of Silk Road Finance Number Three plc

We have audited the financial statements of Silk Road Finance Number Three plc for the year ended 31 December 2013 set out on pages 7 to 29 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU

This report is made solely to the Company's member, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 Our audit work has been undertaken so that we might state to the Company's member those matters we are required to state to them in an auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's member, as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibilities statement set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www frc org uk/auditscopeukprivate

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2013 and of its profit for the year then ended,
- have been properly prepared in accordance with IFRS as adopted by the EU, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Signed L Pomeroy

Date 24 June 2014

Lawrence Pomeroy (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
KPMG Audit Plc
St James Square
Manchester
M2 6DS

Statement of comprehensive income for the year ended 31 December 2013

	Notes	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Interest receivable and similar income	2	17,150	8,085
Interest expense and similar charges	3	(16,499)	(7,783)
Net interest income		651	302
Gains less losses from derivative financial instruments	4	4,078	(241)
Other operating income/(expense)		4,078	(241)
Total income		4,729	61
Operating expenses	6	(647)	(300)
Profit/(loss) before taxation		4,082	(239)
Taxation	7	(816)	48
Profit/(loss) attributable to equity holders	15	3,266	(191)

All results are from continuing operations

There are no recognised gains or losses other than profits for the current year

The accounting policies and notes on pages 11 to 29 form part of these financial statements

Silk Road Finance Number Three plc

Balance Sheet as at 31 December 2013

	Notes	2013 £000	2012 £000
Assets			
Cash and cash equivalents	8	53,983	51 463
Deemed loans due from group undertakings	10	572,359	687,429
Other receivables	11	847	336
Derivative financial instruments	9	3,784	134
Deferred tax asset	7	-	48
Total assets		630,973	739 410
Liabilities			
Deferred tax liability	7	767	-
Derivative financial instruments	9	25	408
Debt securities in issue	12	626,991	739 079
Other payables	13	65	64
Total liabilities		627,848	739 551
Equity			
Share capital	14	50	50
Retained earnings	15	3,075	(191)
Total equity and liabilities		630,973	739 410

The accounting policies and notes on pages 11 to 29 form part of these financial statements

Approved by the Board of Directors on 24 June 2014 and signed on its behalf by

Signed

Sue Abrahams
For and on behalf of SFM Directors Limited
Director

Date 24 June 2014

Silk Road Finance Number Three plc

Statement of changes in equity for the year ended 31 December 2013

Year ended 31 December 2013	Share capital £000	Retained earnings £000	Total £000
Balance at the beginning of the year	50	(191)	(141)
Profit for the year	-	3,266	3,266
Balance at the end of the year	50	3,075	3,125

Period 8 June to 31 December 2012	Share capital £000	Retained earnings £000	Total £000
Balance at the beginning of the period	-	-	-
Issue of new shares	50	-	50
Loss for the period	-	(191)	(191)
Balance at the end of the period	50	(191)	(141)

The accounting policies and notes on pages 11 to 29 form part of these financial statements

Silk Road Finance Number Three plc

Statement of cash flows for the year ended 31 December 2013

	Notes	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Net cash flows from operating activities	16	2,520	51,413
Cash flows from financing activities			
Issuance of share capital		-	50
Net increase in cash and cash equivalents		2,520	51,463
Cash and cash equivalents at the beginning of the year		51,463	-
Cash and cash equivalents at the end of the year	8	53,983	51,463

The accounting policies and notes on pages 11 to 29 form part of these financial statements

Silk Road Finance Number Three plc

Statement of accounting policies for the year ended 31 December 2013

Basis of preparation
Silk Road Finance Number Three plc is a company incorporated and domiciled in England

The Company's financial statements have been prepared under the historical cost convention, modified by the revaluation of all derivative contracts

The Company is required to prepare its financial statements in accordance with International Financial Reporting Standards (IFRS) as endorsed by the European Union (EU) and implemented in the UK, interpretations issued by the IFRS Interpretations Committee (IFRIC) and with those parts of the Companies Act 2006 applicable to organisations reporting under IFRS

Standards and interpretation issued and effective
In preparing these financial statements, the Company has adopted the following pronouncements during the year that are new or revised

- Amendments to IFRS 7 (Disclosures Offsetting Financial Assets and Liabilities (2011))

This amendment requires disclosures to include information that will enable users of an entity's financial statements to evaluate the effect of netting arrangements, on the entity's financial position The amendment to IFRS 7 has no material impact on the financial statements of the Company

- IFRS 13 (Fair Value Measurement (2011))

This new standard defines fair value and also acts as its single authority, dealing primarily with both its measurement and disclosure It does not require fair value measurements in addition to those already required, or permitted by other IFRSs, and is not intended to establish valuation standards or affect valuation practices outside of financial reporting The amendment to IFRS 13 has no material impact on the financial statements of the Company

Functional and presentational currency
The financial statements are presented in sterling, which is the Company's functional currency (ie the primary currency in which it transacts business) and presentational currency

Interest income and expense
This comprises

- interest income and expense for financial assets and liabilities at amortised cost through the statement of comprehensive income, calculated using the effective interest rate method This includes accrued interest income on financial assets written down as a result of impairment,
- interest income and expense on derivatives, which are measured at fair value, and
- deferred consideration

Effective interest rate
The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and allocating the interest income or expense over the relevant period The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability When calculating the effective interest rate, the Company estimates cash flows considering all contractual terms of the financial instrument The calculation includes all amounts receivable or payable by the Company that are an integral part of the overall return

When a financial asset has been written down as a result of impairment or loss, subsequent interest income continues to be recognised using the original effective interest rate applied to the reduced carrying value of the financial instrument

Silk Road Finance Number Three plc

Statement of accounting policies for the year ended 31 December 2013 (continued)

Taxation

Tax on the profit for the year comprises current tax and movements in deferred tax

Current tax

The expected tax payable on the results for the year is called current tax It is calculated using the tax rates in force during the reporting period

Deferred tax

Deferred tax is provided in full using the liability method where there are temporary differences between the carrying value of assets and liabilities for accounting and for tax purposes

Deferred tax is calculated using the tax rates that are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled

The principal temporary differences arise due to differences in tax rules for securitisation companies

Deferred tax assets are only recognised as an asset where it is probable that there will be future taxable profits against which to offset them

Movements in deferred tax are recognised in the statement of comprehensive income

Financial assets

The Company's financial assets are categorised as follows

a. Financial assets at fair value through income and expense

These are either

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

This category covers assets acquired principally for the purpose of selling in the short term or assets designated at initial recognition by management It includes the Company's derivative financial instruments

Financial assets at fair value through income and expense are initially recognised at fair value on the date that the Company commits to purchase the asset The fair values of quoted investments in active markets are based on current bid prices Associated transaction costs are taken directly to the statement of comprehensive income Gains and losses arising from changes in fair values are included in the statement of comprehensive income in the period in which they arise

b. Loans and receivables

Loans and receivables are assets with fixed or determinable payments that are not quoted in an active market They include loans and advances to banks and beneficial ownership of loans and advances to customers

Loans and receivables are recognised when the cash is advanced They are carried at amortised cost using the effective interest rate method, with all movements being recognised in the statement of comprehensive income

Statement of accounting policies for the year ended 31 December 2013 (continued)

Derecognition of financial assets
Financial assets are derecognised when

- the rights to receive cash flows from the assets have ceased, or
- the Company has transferred substantially all the risks and rewards of ownership of the assets

Derivative financial instruments and hedge accounting
Derivatives are financial instruments used by the Company to manage risks

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value The estimated fair value of derivatives represents the discounted amount of estimated future cash flows expected to be received Expected cash flows are discounted at current market rates to determine fair value All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative

Derivatives are derecognised when the derivative contract matures or is cancelled prior to maturity

Derivatives that do not qualify for hedge accounting
No derivatives are designated as hedges under IAS 39 Changes in the fair value of all derivative instruments are, therefore recognised immediately in the statement of comprehensive income

Deemed loans due from group undertakings
The beneficial ownership of the loans and advances to customers sold to the Company by the originator fail the derecognition criteria of IAS 39 and consequently, these loans remain on the balance sheet of the originator IAS 39, therefore requires the seller to recognise a deemed loan financial liability on its balance sheet and the resulting deemed loan asset is held on the purchasing company's balance sheet

This deemed loan initially represents the consideration paid by the Company in respect of the acquisition of the beneficial ownership of the securitised loans and advances to customers and is subsequently adjusted for repayments made by the originator to the Company

The effective interest rate on the deemed loan is calculated with reference to the interest earned on the Company's mortgage portfolio less the residual interest due to The Co-operative Bank plc (the Bank) Under the terms of the mortgage sale agreement, the Bank retains the right to receive excess income arising on these loans, after certain higher priority payments have been met by the Company, being the deferred consideration The requirement to pay deferred consideration is viewed as a contractual obligation and deferred consideration is therefore accounted for as a deduction against mortgage interest income The deemed loan is subject to impairment reviews in accordance with IAS 39 A charge for impairment would be recognised where there is a risk that the income on the deemed loan will be significantly reduced This could occur if the credit quality of the mortgage assets that are pledged as collateral for the loan significantly deteriorated Currently, the directors consider that no impairment exists

Deferred consideration payable
Deferred consideration payable depends on the extent to which the surplus income generated by the underlying mortgage loans to which the Company has a beneficial interest, exceeds the costs of the securitisation transaction As the Company does not recognise income to which it is not beneficially entitled, deferred consideration is recognised in the Statement of Comprehensive income as a deduction against interest income Deferred consideration payable is accounted for separately as a liability and held at amortised cost

Statement of accounting policies for the year ended 31 December 2013 (continued)

Financial liabilities
Financial liabilities are contractual obligations to deliver cash or some other asset to a third party They include

- derivatives,
- debt securities in issue, and
- other payables

Financial liabilities are recognised initially at fair value Fair value includes the issue proceeds (the fair value of consideration received) net of issue costs incurred

Financial liabilities, other than derivatives, are subsequently stated at amortised cost Any difference between issue proceeds net of issue costs and the redemption value is recognised in the statement of comprehensive income over the period of the borrowings using the effective interest rate method

Issue costs, including premiums and discounts, commissions and other costs incurred in the issuing of fixed and floating rate notes, are amortised using the effective interest rate method

Cash and cash equivalents
For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months to maturity from the date of acquisition

Segmental reporting
The Company operates in one business segment and all business is conducted in the UK, therefore no segmental information is presented

Critical accounting estimates and judgments in applying accounting policies
The Company makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances

Fair values
The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale Financial instruments entered into as trading transactions, such as interest rate swaps and basis swaps, are measured at fair value and the resultant profits and losses are included in the statement of comprehensive income For derivative financial instruments and deemed loans, the fair values are based on valuation techniques including discounted cashflow analysis, with reference to relevant market rates, and other commonly used valuation techniques Assets and liabilities resulting from gains and losses on financial instruments held for trading are reported gross in assets and liabilities or derivative financial instruments

Silk Road Finance Number Three plc

Notes to the financial statements for the year ended 31 December 2013

1 Profit/(loss) before taxation

Profit/(loss) on ordinary activities before taxation is stated after charging

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Audit fees for the audit of the Company's financial statements (excluding VAT)	3	3

The audit fees of Silk Road Holdco Number Three Limited of £533 (2012 £520) were borne by the Company and are included within the above

2 Interest receivable and similar income

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
On financial assets not at fair value through income and expense		
Deemed loan interest receivable	26,157	12,368
Deferred consideration payable (note 10)	(9,052)	(4,359)
Bank interest receivable	45	75
Interest receivable from The Co-operative Bank plc	-	1
	17,150	8,085

3 Interest expense and similar charges

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
On financial assets not at fair value through income and expense		
Interest expense on debt securities in issue	11,336	6,601
Amortisation of issue costs	845	352
	12,181	6,953
On financial assets at fair value through income and expense		
Net expense on derivative financial instruments	4,318	830
	16,499	7,783

Notes to the financial statements for the year ended 31 December 2013 (continued)

4 Gains less losses from derivative financial instruments

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Interest rate swaps	3,686	117
Basis swaps	392	(358)
	4,078	(241)

At inception the Company implemented interest rate swaps to manage the effect of movements in interest rates on the fixed rate mortgages it had purchased As the Company does not recognise these mortgages and instead recognises a deemed loan asset the Company recognises in full any gain or loss as a result of movements in the fair value of the interest rate swaps as shown above

At inception, the Company took out basis swaps to manage the exposure arising from the timing difference between the dates of interest payment on the debt securities in issue and interest receipts on the deemed loans due from group undertakings

5 Directors' emoluments

During the year, Structured Finance Management Limited received £20K (2012 £10K) for the provision of corporation administration services to the Company, including the director's fees

The Company had no employees during the current or prior period

6 Other operating expenses

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Professional and accountancy fees	3	3
Paying/rating agency fees	31	12
Management charge	584	275
Trustee/company secretary fees	29	10
	647	300

Notes to the financial statements for the year ended 31 December 2013 (continued)

7 Taxation

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
UK tax at 23 25% (2012 20%)		
Corporation tax		
Current period	1	-
Total corporation tax	1	-
Deferred tax		
Current year	815	(48)
Total taxation charge/ (credit)	816	(48)

Factors affecting tax charge for the year

The average effective rate of corporation tax assessed for the year is equal to the standard rate of corporation tax in the UK of 23 25% (2012 20%)

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Profit/(loss) on ordinary activities before tax	4,082	(239)
Profit/(loss) before tax multiplied by standard rate of tax	816	(48)
	816	(48)

The recognised deferred tax includes the following amounts

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Short-term timing differences	(767)	48
	(767)	48

The reconciliation of the opening and closing deferred tax is shown below

	Year ended 31 December 2013 £000	Period 8 June to 31 December 2012 £000
Net deferred tax at the beginning of the period	48	-
Deferred tax (charged)/credited to the statement of comprehensive income	(815)	48
Net deferred tax at the end of the period	(767)	48

Notes to the financial statements for the year ended 31 December 2013 (continued)

7 Taxation (continued)

Secondary tax legislation, enacted in November 2006 under powers conferred by the Finance Act 2005, ensures that for the companies who first meet the definition of a 'securitisation company' for an accounting period commencing on or after 1 January 2007, corporation tax will be calculated by reference to the retained profit of the securitisation company required to be retained under the agreement that governs the Company

The directors are satisfied that this Company meets the definition of a 'securitisation company' as defined by both the Finance Act 2005 and the relevant subsequent secondary legislation and that no incremental unfunded tax liabilities will arise

8 Cash and cash equivalents

	2013 £000	2012 £000
Cash and cash equivalents	50	50
Loans and advances to banks	53,933	51,413
	53,983	51,463

9 Financial instruments

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability of another entity The Company's financial instruments consist principally of cash and cash equivalents, deemed loans, other payables and various tranches of loan notes

Fair values of derivative financial instruments

Numerical financial instruments disclosures for those measured at fair value are set out below

	Notional principal 2013 £000	Assets 2013 £000	Liabilities 2013 £000
Basis swaps	256,150	-	25
Interest rate swaps	339,908	3,784	-
	596,058	3,784	25

	Notional principal 2012 £000	Assets 2012 £000	Liabilities 2012 £000
Basis swaps	282,845	-	408
Interest rate swaps	457,823	134	-
	740,668	134	408

Notes to the financial statements for the year ended 31 December 2013 (continued)

9 Financial instruments (continued)

Fair values of other financial instruments

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the balance sheet at fair value, unless there is no significant difference between carrying value and fair value

	Carrying value 2013 £000	Fair value 2013 £000
Deemed loans due from Group undertakings	572,359	573,514
Debt securities in issue		
Notes Aa	489,886	497,126
Notes B1	108,018	107,454
Notes B2	14,000	13,927
Notes C	16,228	15,819
Floating rate notes interest payable	252	252
Unamortised issue costs	(1,393)	(1,393)
Total debt securities in issue	626,991	633,185

	Carrying value 2012 £000	Fair value 2012 £000
Deemed loans due from Group undertakings	687,429	682,462
Debt securities in issue		
Notes Aa	591,473	603,243
Notes B1	108,018	109,627
Notes B2	14,000	14,139
Notes C	27,450	27,585
Floating rate notes interest payable	365	365
Unamortised issue costs	(2,227)	(2,227)
Total debt securities in issue	739,079	752,732

The following is a list of financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature or reprice to current market rates frequently

- Cash and cash equivalents
- Other receivables

Valuation of financial assets and liabilities carried at fair value or where a fair value disclosure is presented

The following tables analyse financial assets and liabilities carried at fair value and amortised cost by the three level fair value hierarchy defined as follows

- Level 1 – Quoted market prices in active markets
- Level 2 – Valuation techniques using observable inputs
- Level 3 – Valuation techniques using unobservable inputs

Notes to the financial statements for the year ended 31 December 2013 (continued)

9 Financial instruments (continued)

	Fair value at the end of the reporting period using			
	Level 1	Level 2	Level 3	Total
For the year ended 31 December 2013	£000	£000	£000	£000
Derivative financial instruments	-	-	**3,784**	**3,784**
Deemed loans due from group undertakings*	-	-	**573,514**	**573,514**
Total assets carried at fair value	-	-	**577,298**	**577,298**
Derivative financial instruments	-	-	**25**	**25**
Debt securities in issue*	-	**633,185**	-	**633,185**
Total liabilities carried at fair value	-	**633,185**	**25**	**633,210**

	Fair value at the end of the reporting period using			
	Level 1	Level 2	Level 3	Total
For the year ended 31 December 2012	£000	£000	£000	£000
Derivative financial instruments	-	-	134	134
Deemed loans due from group undertakings*	-	-	682,462	682,462
Total assets carried at fair value	-	-	682,596	682,596
Derivatives financial instruments	-	-	408	408
Debt securities in issue*	-	752,732	-	752,732
Total liabilities carried at fair value	-	752,732	408	753,140

* These items are held at amortised cost with a fair value disclosure presented

The carrying values of financial instruments measured at fair value are determined in compliance with the accounting policies on pages 11 to 14 and according to the following hierarchy,

Level 1 – Quoted market prices in active markets
Financial instruments with quoted prices for identical instruments in active markets The best evidence of fair value is a quoted market price in an actively traded market

Level 2 – Valuation techniques using observable inputs
Financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable

Debt securities in issue
The estimated fair value of debt securities in issue are based on market prices of similar securities from independent valuations at the balance sheet date

Level 3 – Valuation techniques using unobservable inputs
This is used for financial instruments valued using models where one or more significant inputs are not observable

Derivative financial instruments
Derivative financial instruments in the form of interest rate and basis swaps have been entered into with external counterparties

Silk Road Finance Number Three plc

Notes to the financial statements for the year ended 31 December 2013 (continued)

9 Financial instruments (continued)

The purpose of the swaps is to convert fixed rate revenue receipts of the pool of mortgage assets to the same LIBOR linked basis as the debt securities in issue The swaps are valued based on an assumed amortisation profile of the pool of assets to the bond maturity date (assuming some annual prepayment), an assumed profile of customer receipts over this period, and LIBOR prediction using forward rates Swap cash flows are discounted to present value using mid-yield curve zero coupon rates

Deemed loans
The estimated fair value of deemed loans represents the balance after deducting the lifetime expected losses calculated on the mortgage loans that balance represents

Movements in fair values with significant unobservable inputs (level 3) were

2013	Fair value at beginning of the year £000	Purchases and transfers in £000	Sales and transfers £000	Income or expense including impairment £000	Fair value at the end of the year £000
Assets					
Derivative financial instruments	**134**	-	-	**3,650**	**3,784**
Total assets	**134**	-	-	**3,650**	**3,784**
Liabilities					
Derivative financial instruments	**408**	-	-	**(383)**	**25**
Total liabilities	**408**	-	-	**(383)**	**25**

Movements in fair values with significant unobservable inputs (level 3) were

2012	Fair value at beginning of the year £000	Purchases and transfers in £000	Sales and transfers out £000	Income or expense including impairment £000	Fair value at the end of the year £000
Assets					
Derivative financial instruments	-	134	-	-	134
Total assets	-	134	-	-	134
Liabilities					
Derivative financial instruments	-	408	-		408
Total liabilities	-	408	-	-	408

Risk management and control

The financial risks faced by the Company include the following

- interest rate risk,
- credit risk, and
- liquidity risk

Notes to the financial statements for the year ended 31 December 2013 (continued)

9 Financial instruments (continued)

The Company applies The Co-operative Bank plc's formal structure for managing risk The Co-operative Bank plc's Board has established Board sub-committees and senior management committees whose responsibilities include

- overseeing the risk management process,
- identifying the key risks facing the business, and
- assessing the effectiveness of planned management actions

Specific Board authority has been delegated to Board sub-committees and the Chief Executive Officer (CEO) who may, in turn, delegate authority to appropriate executive directors and their senior line managers This includes

- setting limits for individual types of risk, and
- approving (at least annually) and monitoring compliance with risk policies and delegated levels of authority

Derivatives
A derivative is a financial instrument that derives its value from an underlying rate or price, such as interest rates and other market prices Derivatives are an efficient means of managing market risk and limiting company exposure The Co-operative Bank plc uses derivatives for hedging purposes to manage the risk of movements in rates and prices that the Company is exposed to

The most frequently used derivative contracts are interest rate swaps and basis swaps Terms and conditions are determined using standard industry documentation Derivatives are subject to the same market and credit risk control procedures as are applied to other wholesale market instruments, and are aggregated with other exposures to monitor the total counterparty exposure of The Co-operative Bank plc This is managed within approved limits for each counterparty

At the inception of the securitisation the material risks are considered in relation to the overall low risk appetite of the Company Instruments used for risk management purposes are set up at inception of the securitisation and include interest rate swaps These are not used in trading activity or for speculative purposes

Interest rate risk
The Company is exposed to movements in interest rates and The Co-operative Bank plc manages this exposure using derivatives Also, the Company is exposed to basis risk due to the timing differences in interest payment dates on the notes and the deemed loan This is hedged using a form of interest rate swap known as a basis swap, which is taken out on inception of the securitisation

The Company has not experienced significant financial losses in the financial year as a result of movements in interest rates After taking into consideration the Company's derivative instruments, the administered interest rate nature of the Company's deemed loans, the regular repricing of the Company's mortgage backed floating rate notes, together with the nature of the Company's other assets and liabilities, the directors do not believe that the Company has any significant interest rate repricing exposure In order to avoid any adverse effects in the future, effective hedges will need to be maintained

Interest rate risk management measures are used at Bank level (such as value at risk sensitivity analysis) to monitor the potential gains or losses from market volatility within a statistical confidence level

The Company holds interest rate swaps that are used by The Co-operative Bank plc to manage interest rate risk on fixed rate lending Based on the total fixed rate swaps in place at 31 December 2013 and the average fixed interest rates applicable to those swaps, if interest rates were to increase or decrease by 1% the Company would experience a decrease or increase in equity of approximately £3,399K at 31 December 2013 (2012 £4,578K)

A 1% movement in variable interest rates would have a £2,670K effect on both profit and equity, as, due to the structure of the entity, the increase/decrease in cash inflows would be substantially offset by the opposite decrease/increase in cash outflows

Notes to the financial statements for the year ended 31 December 2013 (continued)

9 Financial instruments (continued)

Interest rate risk (continued)
The amounts of deferred consideration payable to The Co-operative Bank plc are non interest bearing financial liabilities As described in note 10, the dates of repayment are dependent on the extent to which surplus income is generated by the securitised mortgage books Therefore, the weighted average period until maturity is unknown

The mortgage backed floating rate notes are classified as floating rate liabilities The benchmark rates used for determining interest rate payments are disclosed in note 12

Credit risk
Credit risk is the risk that a customer or counterparty will not be able to meet its obligations to the Company as they become due Credit risk arises on cash and cash equivalents, deemed loans, derivatives and other receivables

The table below represents a worst-case scenario of credit risk exposure to the Company at 31 December 2013 and 31 December 2012, without taking into account any collateral held or other credit enhancements attached The exposures are based on gross carrying amounts as reported in the balance sheet

Category (as defined by IAS 39)	Class	2013 £000	2012 £000
Cash and cash equivalents	Cash and cash equivalents	**53,983**	51,463
Loans and receivables	Deemed loans	**572,359**	687,429
Derivative financial instruments	Derivatives	**3,784**	134
Loans and receivables	Other receivables	**847**	336
		630,973	739,362

Deemed loans
The risk on the deemed loan is mitigated by the size and quality of the securitised loans and advances to customers The average loan to value percentage of the underlying mortgage assets, to which the deemed loans relate was 39 09% (2012 44 01%) at the end of the reporting period

An arrears analysis of the underlying mortgage portfolio is shown below

	2013 £000	2012 £000
Not in arrears	**580,291**	686,817
In arrears	**2,833**	2,269
	583,124	689,086

Derivatives
At any one time, the amount subject to credit risk is limited to the current fair value of instruments that are favourable to the Company, (ie assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding

Collateral or other security is not usually obtained for credit risk exposures on these instruments, except where the Company requires margin deposits from counterparties

Other receivables
Other receivables relate primarily to amounts due from The Co-operative Bank plc, which is repayable on demand

Notes to the financial statements for the year ended 31 December 2013 (continued)

9 Financial instruments (continued)

Liquidity risk
Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due, or can only do so at excessive cost

Liquidity risk arises on debt securities in issue Funding has been obtained through the issue of mortgage backed floating rate notes The Company has in place a borrowing facility to ensure that sufficient liquidity is maintained to meet its obligations on the floating rate notes as described in note 12

The notes issued by the Company are repayable in line with the collections of principal from the securitised mortgage loans Under the terms of the notes the Company can repurchase the outstanding notes of a securitisation issue at par once the outstanding principal amount of the notes falls below 10% of the amount originally issued or in full on any interest payment date on or after 21 September 2016, the step-up date The earliest contractual maturity of the debt securities in issue is 21 September 2016, if called, when the balance outstanding on the notes may be repaid

The gross undiscounted contractual cash flows payable/(receivable) on financial liabilities are provided below

	Derivative financial instruments 2013 £000	**Debt securities in issue 2013 £000**
Up to 3 months	**771**	**28,951**
3-12 months	**1,779**	**88,755**
1-5 years	**(2,723)**	**539,545**
	(173)	**657,251**

	Derivative financial instruments 2012 £000	Debt securities in issue 2012 £000
Up to 3 months	244	36,775
3-12 months	(318)	81,780
1-5 years	(3,062)	663,047
	(3,136)	781,602

The contractual maturities of the debt securities in issue are calculated based upon the first contractual point at which the Company can redeem the notes Should the Company decide not to redeem, the applicable contractual maturity of the notes is disclosed within the table on page 27

The overall liquidity risk is effectively mitigated as a result of the structure of the repayment of capital being required only in line with the principal repayment of the underlying mortgage loans

Notes to the financial statements for the year ended 31 December 2013 (continued)

9 Financial instruments (continued)

Capital management
The Company's primary objective in respect of capital management is to ensure that it has sufficient capital now and in the future to support the risks in the business

The Company is not subject to externally imposed capital requirements in either the current year or the prior period, other than the minimum share capital required by the Companies Act with which it complies The Company manages its ordinary share capital in order that there is sufficient capital, in the opinion of the directors, to support the transactions and level of business undertaken by the Company

10 Deemed loans due from group undertakings

	2013 £000	2012 £000
Deemed loans receivable	583,068	689,086
Deferred consideration payable	(10,709)	(1,657)
	572,359	687,429

The deemed loans receivable are repaid as and when the cash is received by the originator from the customers as principal repayments of the loans and advances Consequently, a proportion of the deemed loans receivable will be repaid within 12 months, although the amount cannot be quantified

Deferred consideration payable
Deferred consideration is payable to The Co-operative Bank plc (the Originator) dependent on the extent to which the surplus income generated by the mortgage books, purchased by the Company from The Co-operative Bank plc, exceeds the administration costs of the mortgage books The surplus income generated during the year ended 31 December 2013 amounted to £9,052K (2012 £4,359K)

The deferred consideration is payable as follows

	2013 £000	2012 £000
Amounts owed to The Co-operative Bank plc	10,709	1,657
	10,709	1,657

The movements in deferred consideration are as follows

	2013 £000	2012 £000
Balance at the beginning of the period	1,657	-
Additional consideration payable	9,052	4,359
Repayments during the period	-	(2,702)
Balance at the end of the period	10,709	1,657

It is anticipated that the majority of the above deferred consideration will be settled after one year Repayments of deferred consideration are dependent on market conditions, amongst other factors, and therefore the directors are unable to reliably estimate the amount that will be settled within one year

Notes to the financial statements for the year ended 31 December 2013 (continued)

11 Other receivables

	2013 £000	2012 £000
Prepayments and accrued income	17	10
Amounts owed by The Co-operative Bank plc	830	326
	847	336

12 Debt securities in issue

The mortgage backed floating rate notes due 2055 are secured over a portfolio of mortgage loans secured by first charges over residential properties in the UK

Prior to redemption of the notes on the final interest payment date falling in June 2055, the notes will be subject to mandatory and/or optional redemption in certain circumstances, on each interest payment date

	2013 £000	2012 £000
£GBP floating rate notes	626,991	739,079
	626,991	739,079

	2013 £000	2012 £000
Due within one year		
Class Aa notes	2,861	23
Floating rate notes interest payable	252	365
Unamortised issue costs	(511)	(598)
	2,602	(210)
Due in more than one year		
Class Aa notes	487,025	591,450
Class B1 notes	108,018	108,018
Class B2 notes	14,000	14 000
Class C notes	16,228	27,450
Unamortised issue costs	(882)	(1 629)
	624,389	739 289
Total debt securities in issue	626,991	739,079

All debt securities in issue are held by external noteholders

Notes to the financial statements for the year ended 31 December 2013 (continued)

12 Debt securities in issue (continued)

Classes of mortgage backed floating rate notes are subject to interest as detailed below The three month LIBORs are revised quarterly and the following margins, which are not subject to revision, apply to the classes of notes as detailed in the following table

	Until September 2016	From September 2016 to June 2055
Class Aa notes at 3 month LIBOR plus	1.350%	2 700%
Class B1 notes at 3 month LIBOR plus	0 210%	0.210%
Class B2 notes at 3 month LIBOR plus	0.210%	0.210%
Class C notes at 3 month LIBOR plus	0.210%	0 210%

The maturity table above reflects the estimated timing of principal repayments on the notes, based on the contractual payment terms on the underlying mortgages and the earliest contractual repayment date of the debt securities

The earliest contractual maturity of the debt securities in issue is 21 September 2016, when the balance outstanding on the notes may be repaid, dependent on the optional early redemption of notes clause being exercised 21 September 2016 represents the earliest contractual date that the Company could repay the noteholders Any optional early redemption of notes would be taken in line with the principles of a prudent lender

The Company has not had any defaults on principal, interest or any other breaches with respect to their liabilities during the year

13 Other payables

	2013 £000	2012 £000
Amounts owed to The Co-operative Bank plc	45	53
Accruals and deferred income	20	11
	65	64

The above amounts owed to The Co-operative Bank plc, is expected to be settled within 12 months There is no formal repayment schedule for these monies, which are repayable on demand

14 Share capital

	2013 £000	2012 £000
Issued and fully paid		
50,000 ordinary shares of £1 each	50	50

The Company's funding consists of share capital and debt securities Capital is managed on the whole by The Co-operative Bank plc, which is subject to capital requirements imposed by its regulator the Prudential Regulation Authority (PRA)

Notes to the financial statements for the year ended 31 December 2013 (continued)

15 Retained earnings

Movements in retained earnings were as follows

	2013 £000	2012 £000
Balance at the beginning of the year	(191)	-
Profit/(loss) for the year	3,266	(191)
Balance at the end of the year	3,075	(191)

16 Reconciliation of operating profit/(loss) to net cash flows from operating activities

	2013 £000	2012 £000
Profit/(loss) before taxation	4,082	(239)
Increase in prepayments and accrued income	(7)	(10)
Increase in accruals and deferred income	1	64
Cash flows from operating activities before changes in operating assets and liabilities	4,076	(185)
(Decrease)/increase in debt securities in issue	(112,088)	739,079
Decrease/(increase) in deemed loans due from group undertakings	115,070	(687,429)
Net movement in derivative financial instruments	(4,033)	274
Increase in other receivables	(504)	(326)
Taxation paid	(1)	-
Net cash flows from operating activities	2,520	51,413

17 Ultimate parent undertaking and controlling entity

The Company's immediate parent undertaking is Silk Road Holdco Number Three Limited, a company registered in England

SFM Corporate Services Limited holds the entire issued share capital of Silk Road Holdco Number Three Limited on a discretionary trust basis for the benefit of certain charities

The Company meets the definition of a Special Purpose entity under IFRS In accordance with the requirements of IFRS 10 "Consolidated Financial Statements", the subsidiary's accounts are consolidated within the group accounts of The Co-operative Bank plc, for the year ended 31 December 2013

The largest group in which the results of the Company are consolidated is The Co-operative Bank plc, which is incorporated in England The financial statements of this group are available from http //co-operativebank co uk/investorrelations/financialresults and from its registered office at 1 Balloon Street, Manchester, M60 4EP

Notes to the financial statements for the year ended 31 December 2013 (continued)

18 Related party transactions

Durıng the year, Structured Fınance Management Lımıted was paıd £20K (2012 £10K) for the provısıon of corporatıon admınıstratıon servıces to the Company

The dırectors of the Company consıder The Co-operatıve Bank plc and ıts subsıdıarıes to be related partıes of the Company Transactıons wıth The Co-operatıve Bank plc and ıts subsıdıarıes are dısclosed below

Year ended 31 December 2013	Interest receıvable and other ıncome £000	Interest expense and other charges £000	Balance due to the Company £000
The Co-operatıve Bank plc	17,106	1,630	434,874
Perıod ended 31 December 2012			
The Co-operatıve Bank plc	8,010	936	538,201

All related party transactıons were made on terms equıvalent to those that prevaıl ın arm's length transactıons

19 New pronouncements in 2013

The followıng pronouncements have been ıssued but are not yet effectıve

- IFRS 9 (Fınancıal Instruments Classıficatıon and Measurement (2010))
- Amendments to IFRS 9 – Fınancıal Instruments Hedge Accountıng and Amendments to IFRS 7 and IAS 39 (2013)

The mandatory date of applıcatıon has been temporarıly removed from IFRS 9 The IASB wıll publısh the new mandatory effectıve date once all phases of IFRS 9 are completed The IASB ıs expected to finalıse all phases of IFRS 9 durıng 2014 wıth a mandatory effectıve date no earlıer than 1 January 2018

The amendments wıll be applıed once endorsed by the EU