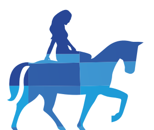
Annual Report & Accounts

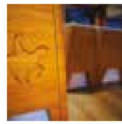
for the year ended 31 December 2018



COVENTRY
Building Society

The term 'Society' is used in this Annual Report & Accounts pages 1 to 94 to refer to the activities of the Society and its subsidiaries, except where the context indicates otherwise. Coventry Building Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority (firm reference number 150892 www.fca.org.uk).

Principal Office: Economic House, PO Box 9, High Street, Coventry CV1 5QN.



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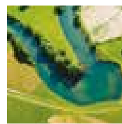

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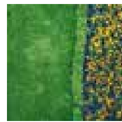

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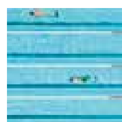

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Welcome

Putting Members First

Coventry Building Society has a simple purpose. We exist to meet the needs of members for savings and residential mortgages.

In 2018 we maintained our long record of growth by continuing to attract and retain members through competitive products and excellent service.

Our robust financial performance meant that we increased our reserves and maintained our strong capital position whilst supporting investment in infrastructure.

Strategic Report

This section outlines our performance in 2018 in the context of our overall business model.

We also explain our approach to corporate responsibility.

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Strategic Report

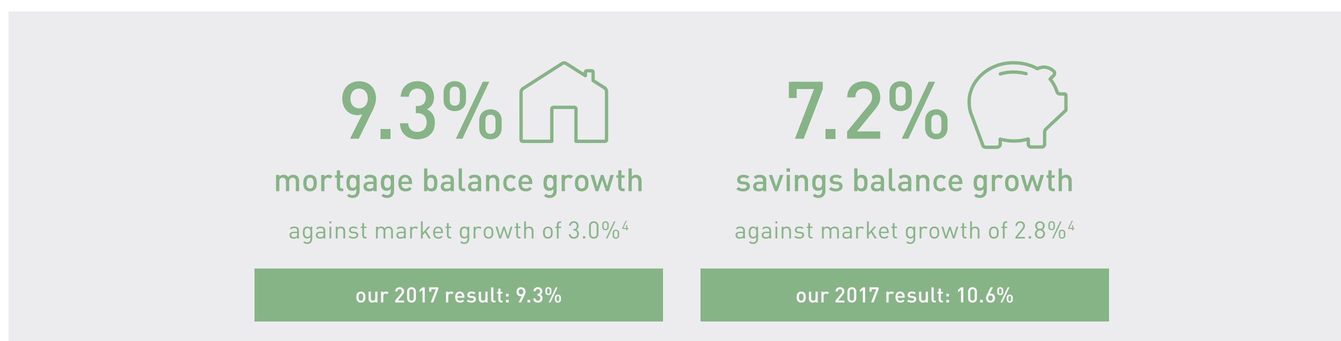
Performance Highlights

Our mission is Putting Members First. We provide simple, good value savings products and low risk residential mortgages coupled with great service. This allows us to deliver sustainable growth and maintain capital whilst investing for the future.

In 2018 we provided superior value to members.

We offered simple, easy to use products and provided good member outcomes.

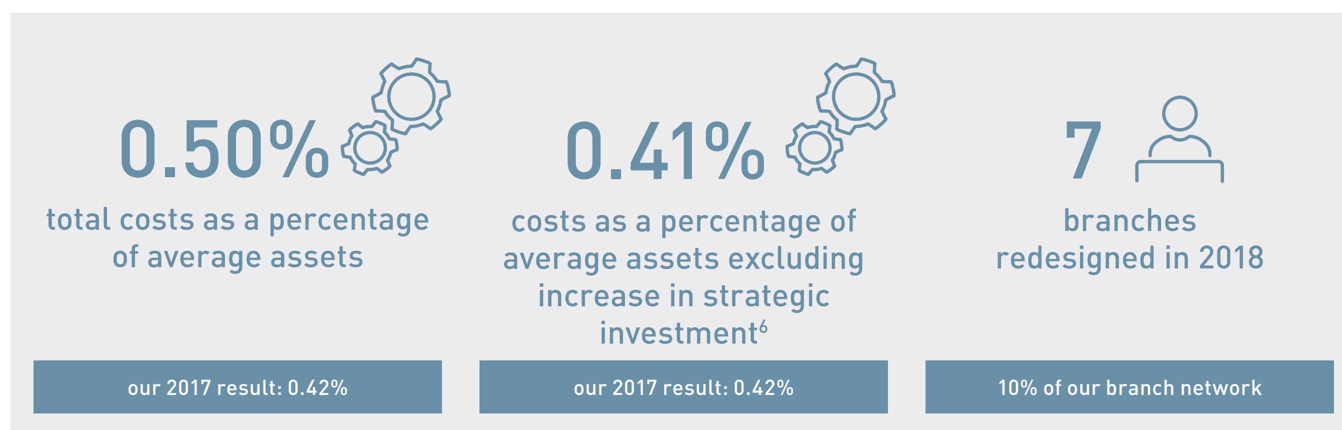
We delivered sustainable growth, balancing the needs of current and future members.



1. Based on the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
2. Source: Financial Ombudsman Service latest available information 1 January 2018 to 30 June 2018.
3. Source: Average number of members scoring 9 or 10/10 across 6 surveys totalling 48,922 responses.
4. Source: Bank of England.

We remained safe and secure, taking risks that we understand and can manage.

We spent members' money wisely, being cost-efficient whilst investing for the long term.



We valued the engagement of our people, and made a difference to our communities.

5. Source: Prudential Regulation Authority latest available information at 30 September 2018.
6. Increase in strategic investment costs charged to the Income Statement compared to 2017.

Strategic Report

Statement from our Chair

We consistently deliver growth and superior savings returns through Putting Members First.

Dear Member

I joined the Board as Chair immediately after attending the Society's Annual General Meeting on 26 April 2018. It was both a physical and a career homecoming. Growing up in Coventry, I knew the Society's importance to people in the city and have kept in touch with its progress over the years. The presentations at the AGM confirmed my view of a successful organisation, striving to do the right things for its members, its employees and the communities it serves.

At the Society we call it 'Putting Members First' and it is something I strongly believe in. During my career I have seen the good, the bad and the ugly of financial services. Almost without exception the good happens when leaders understand that supporting colleagues is the key to serving customers and making a difference in their communities. I see this working every day here at the Society, and it is something which I am committed to supporting and building on.

In many ways our strength is our simplicity. We are a straightforward building society, focused on meeting the needs of our members for savings and mortgages. This simple focus provides clarity of purpose and decision making. We balance the need to provide long-term value to our members through competitive products with the need to maintain financial strength and invest in our future.

Because of our mutual status, we can take a long-term perspective, making decisions solely on meeting the needs of current and future members without the competing short-term demands of shareholders.

Our focus on Putting Members First informs our approach to managing costs and risk. The Society has operated a low cost, low risk business model for many years because this naturally aligns to the interests of our members. Lending only where people are able to afford the mortgage repayments is not only responsible lending but makes sense for the wider membership too, as the Society makes fewer losses on its loans. Similarly, the more efficiently we operate the business, the more opportunity we have to offer favourable pricing across our membership. Our simple business model operates as a virtuous circle in which the financial strength derived from low risk operations supported by our low operating costs underpins the long-term value we give back to our savers and borrowers.

The strength of this model is particularly relevant considering the challenges of an external environment marked by increased levels of uncertainty and change. Brexit has fragmented UK political and public opinion and affected market confidence. Although we are a UK-focused business, we are not immune to a potential downturn in sentiment or activity. It is possible that there will be a period of lower house price inflation, even a correction in the London housing market, and the cost of wholesale funding may increase.

That said, low unemployment, low inflation and rising real incomes could support increased economic growth as uncertainty diminishes. We remain confident that the fundamentals of the housing and savings markets in the UK are strong and believe that our low risk, low cost business model will provide flexibility and resilience, as it has in the past, should conditions change.

Brexit, of course, is not the only source of uncertainty. The market for financial services is changing fast as new technologies raise expectations and new regulations are introduced to protect customer interests. Open Banking and new distribution channels are giving consumers more options in how they choose and manage their savings and mortgages. There is increasing competition as new service providers enter our markets and seek to build their customer base. At the same time, there are opportunities amongst this 'challenger' activity for established, well-capitalised organisations like ourselves.

I mentioned earlier the importance of having a long-term view, particularly one that has the interests of our members at its heart. In this context, the need to have the capability to take advantage of these new opportunities is clear. I am pleased that our long-term investment plans will ensure we keep pace with developments so that the Society remains relevant whilst addressing the needs of today's members. As a Board we are focused on ensuring that the Society undertakes change safely, consistent with our low risk outlook, and that we invest in the right things in the right way to deliver member benefit.

An example of this investment is the roll out of our new branch design which has received excellent feedback from members for its emphasis on the human touch. This underlines the fact that advances in technology will not change the core of who we are or what we do – which is to be a safe and secure member-owned society providing great value and straightforward savings and mortgages.

I started this statement with a personal comment on the importance of leadership. I joined the Society because I share its leadership's vision of a responsible and member-focused organisation. The Society's strength may be its simplicity but its success is that it has consistently delivered growth and superior savings returns over many years by Putting Members First. This performance depends on people across the Society, from the cashier in the branch to the Board director, sharing this vision. I am delighted to welcome two non-executive directors to the Board, who I know share our view of Putting Members First.

Iraj Amiri was appointed in June and brings extensive experience of internal audit, risk management and corporate governance at senior management and board level following a long career at Deloitte LLP. He is also currently a member of the Regulatory Decisions Committee at the Financial Conduct Authority.

We also welcomed Martin Stewart in September. Martin's CV includes eight years at the Financial Services Authority and our regulator, the Prudential Regulation Authority (PRA). Most recently he was PRA Director for Banks, Building Societies and Credit Unions. He has deep building society experience having worked for 19 years at board and senior management levels in the sector.

I would like to thank Ian Geden who retired from the Board following the AGM. Ian, a former Chief Executive of NFU Mutual, was a passionate advocate of the mutual sector and its importance in delivering both diversity in financial services and positive outcomes for consumers. Throughout his 10 years on our Board his contribution was measured, insightful and, above all, member-focused. I would also like to thank Roger Burnell, who was appointed to the Board in 2008 and became our Senior Independent Director in 2016. Roger will be retiring following the 2019 AGM. He has brought an understanding of customer service and a genuine commitment to simplicity and doing the right thing for members. Both he and Ian will be much missed.

Finally, and most importantly, I would like to thank all the Society's colleagues. I have met many of them in my early months and know the difference they make to customer outcomes on a daily basis. They also make a difference to the communities we serve. In doing so, their actions are guided by our CARES values – being Caring, Attentive, Reliable, Ethical and Straightforward.

Our commitment to Putting Members First, along with our CARES values, is the foundation of our corporate responsibility.

Whether it is the 10 year partnership with The Royal British Legion, the many local charities that have benefitted from raising money and awareness or our award-winning employability schools programme – Society volunteers change people's lives. This demonstrates that Coventry CARES values are far more than words on a page. I very much look forward to steering the next chapter of the Society's development for the benefit of you, our members.

Gary Hoffman
Chair of the Board

28 February 2019

Strategic Report

Chief Executive's Review

Dear Member

Coventry Building Society has a simple purpose. We exist to meet the needs of our saving and borrowing members. Our performance is equally simple to articulate. In 2018, we delivered strong growth in both savings and mortgages, continuing a long record of outperforming the market.

We delivered profit that maintains our capital position whilst providing superior returns to our members and investing in our future. In doing this, we provided an exemplary level of service to members and intermediary partners. This only happens because we have a highly engaged, enthusiastic workforce who deliver great results for members as well as making a positive and tangible difference in their local communities.

In the mortgage market we grew balances by 9%, over three times the growth in the market[1]. This, in a very price competitive environment which has seen sustained pressure on mortgage pricing despite increases in the Bank of England Base Rate.

The price competitive mortgage environment has led to noticeable changes in consumer behaviour, with the remortgage sector being particularly active both for owner-occupier and buy to let mortgages. We are also seeing further movement away from Standard Variable Rate mortgages to fixed rate loans as borrowers seek to lock in to attractive rates.

Despite the pressure on mortgage pricing, we have maintained the low risk approach to lending that is right for our members and that has been our hallmark for many years. The Society's arrears fell again in 2018, and are only one seventh of the industry average[2], meaning that members benefit from low credit losses. The weighted average loan to value of our mortgage book of 55%[3] (2017: 54%) reflects this low risk position and protects our business model from potential market or house price disruption.

Central to our mortgage growth is the strength of our intermediary partnerships. We believe borrowers should have the opportunity to receive independent advice when they take out a mortgage and we are an advocate of mortgage brokers who provide this. In turn, we work tirelessly to improve our service to brokers and their clients. In 2018, we received the Financial Adviser Five Stars award, the highest accolade for mortgage servicing, for the third year running, and we were ranked first for broker satisfaction in the wide-ranging Charterhouse annual research. We were also ranked first by Fairer Finance for mortgages, on the basis of trust, customer happiness, transparency and complaint handling.

Intrinsically we need to balance the needs of our savings and mortgage members. Interest rates in the savings market have been stubborn and moved little following two increases in the Bank of England Base Rate. We have continued to pay significantly higher savings rates to our members than the market average, which demonstrates both the strength of our business and our clear focus on Putting Members First.

In 2018, the average savings rate we paid was 1.50%, nearly double the market average of 0.78%[4]. In simple terms this means we paid an additional £227 million in interest than if we had simply matched the market average[4]. This is a further increase on the premium we have provided over many years. This consistently good value has helped us to grow savings balances by 7% in 2018, over two and a half times the market growth[1].

In addition, we have delivered award-winning service to savers. In 2018, this combination of superior long-term value and great service resulted in the Society being awarded the status of Which? Recommended Provider for savings accounts once again, one of only five providers to receive this endorsement. Fairer Finance also ranked us first amongst savings providers, for the third year running.

This independent recognition is matched by research which shows that more than 8 out of 10 members are happy to recommend us to others[5], and our overall Net Promoter Score, already exceptionally high in the industry, increased further from +72 to +75[6].

1. Source: Bank of England.
2. Source: Percentage of mortgages in arrears by 2.5% or more – Prudential Regulation Authority latest available information at 30 September 2018.
3. Indexed loan to value weighted by balance.
4. Based on the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
5. Source: Average number of members scoring 9 or 10/10 across 6 surveys totalling 48,922 responses.
6. A measure of customer advocacy that ranges between -100 and +100 which represents how likely a customer is to recommend our products and services.

At the heart of our great service delivery is our people. They share our mission of Putting Members First. I believe it is our record of consistently putting this into practice that explains the trust and engagement of colleagues at the Society. In 2018, 92% of colleagues said they were proud to work for the Society and we were again rated one of the 100 Best Companies to Work For in the UK. Whilst we work extremely hard to recruit, retain, develop and support people who want to do the right things for our members, they repay this investment many times over to the benefit of our members.

Our employees are also the driving force behind our support for communities; it is no surprise that people who are motivated to do the right things for members and demonstrate the Coventry CARES values also want to use their enthusiasm and skills to benefit charities, schools and community groups. Last year, amongst many highlights, we were awarded the Business in the Community Responsible Business Award for Educational Partnership, for our programme helping Coventry school students prepare for the world of work.

Nearly 80% of Society employees actively supported our commitment to our communities during the year, helping over 250 local and national organisations.

To sustain our great service record in the future, we have stepped up investment in our distribution, technology and infrastructure to meet the changing expectations of our members.

Our members tell us that they are already seeing the benefit of our branch redesign programme, with seven branches completed during 2018. This is a major investment for us and one which confirms both our commitment to the branch network and our understanding that what members want from their branch above all is a reassuringly human place to talk to our people. We will continue the roll out of the redesign in 2019.

We recognise and anticipate an evolving savings marketplace with new service providers emerging. We have taken an important step in this area by partnering with Hargreaves Lansdown, which offers a new way for customers to open and service our products. In 2018, we offered fixed rate bonds on their Active Savings platform and in 2019, became the first provider to offer easy access savings accounts.

We are progressing projects enhancing our technology to improve resilience, service flexibility and functionality. The work to update our data centres is progressing well with the first migrations taking place during 2018 in line with our plans. During 2018, we also completed upgrades to our telephony and credit assessment systems. However, the detailed design work on upgrading our core technology platform has indicated that this programme will be more technically complex than originally envisaged. As a result, we are replanning this activity in order to reduce the risk and future cost of the programme whilst still meeting our objectives. We are committed to doing the right thing for our members, taking stock at this early stage rather than ploughing ahead with the original plan.

We have a strong track record of being the most cost-efficient building society in the UK and aim to maintain this during this period of strategic investment. In 2018 our overall management expense ratio was 0.50% (2017: 0.42%)[7]. Excluding the significant increase in strategic investment, the ratio has remained consistent at 0.41%[8], demonstrating our continued focus on running an efficient business which allows us to return superior value to members.

In 2018, profit before tax was £202 million (2017: £243 million) maintaining our risk based capital measure at 35.5% (2017: 34.9%), the highest reported of any top 20 lender[9].

Looking forward we will need to continue to deliver despite market uncertainties, balancing the ongoing pressure on mortgage margins with continued rising member expectations and our own investment agenda. However, I am confident that the Society's financial strength, flexibility and low risk, low cost business model will continue to support our success in the short and long term.

Central to this is our clarity of purpose. I have mentioned the importance of Putting Members First on many occasions. It will continue to guide our progress going forward.

Mark Parsons
Chief Executive

28 February 2019

7. Administrative expenses, depreciation and amortisation/Average total assets.
8. Administrative expenses, depreciation and amortisation less increase in strategic investment costs compared to 2017/Average total assets.
9. Common Equity Tier 1 ratio for the UK Finance 2017 top 20 mortgage lenders (balance outstanding) – latest published CET 1 data as at 28 February 2019.

Our Business Model

Our mission is Putting Members First. We provide simple, good value savings and mortgage products coupled with great service to our members.

In this section we outline how our purpose and our business model deliver on our mission of Putting Members First. We also explain our values, which guide how we do business, and manage risk.

Our purpose – 'why we do things'

We exist solely for the benefit of our members, meeting their needs for good value savings products and residential mortgages. In delivering on our strategic objectives, we are committed to Putting Members First, which means doing the right thing for both current and future members. We fully embrace the mutual ethos on which we were founded and believe that remaining an independent mutual building society produces the best outcomes for our members and for the communities in which we operate.

Our business model – 'what we do'

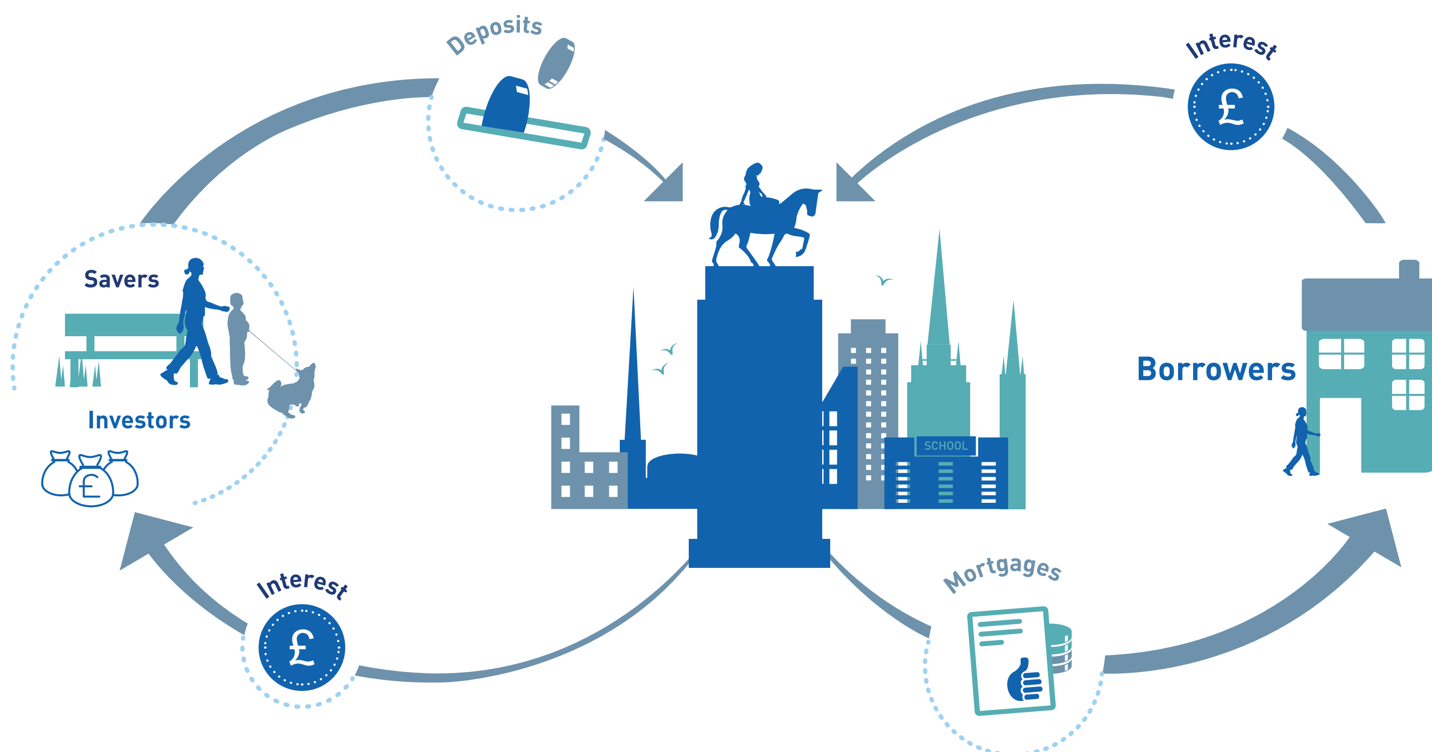
As a building society, we are owned by the savers and borrowers who are our members. We operate under the Building Societies Act 1986 which means we focus on deposit taking and mortgage lending.

We have a simple business model with simple products and simple ways of operating.

Nearly all our income is earned from mortgages on UK properties. To fund mortgage lending, we take deposits from savings members. We also raise funds from the wholesale markets to achieve funding diversity. The difference between the interest earned on mortgages and the interest paid on savings and wholesale funding generates net interest income.

Net interest income received covers operating expenses, impairment losses, provisions and taxation. The remaining profits provide the Society with the capital to protect members during periods of economic downturn, support growth and ensure the business model is sustainable.

As a mutual organisation, we do not have external shareholders or pay dividends; our customers (the members) are the owners of the organisation. This simplifies strategic and operational decision making.



Each year, with no share price considerations, we retain only sufficient profit to maintain our capital position. Our low cost and low risk business model allows us to do this whilst providing superior pricing for our members.

The Society's mutual status allows us to focus on a longer-term strategy, maintaining a consistent presence in the savings and mortgage markets and investing for the future as appropriate.

Our values – 'how we do things'

Our values guide how we do things on a daily basis to deliver our mission of Putting Members First. We call these values Coventry CARES.

CARES means we are Caring, Attentive, Reliable, Ethical, and Straightforward. All colleagues in the Society are expected to demonstrate our values.

Caring
helpful, thoughtful and kind.

Attentive
listening, engaging and improving.

Reliable
trustworthy, dependable and consistent.

Ethical
fair, honest and principled.

Straightforward
simple, easy and clear.

For more information on how our CARES values guide our interactions with key stakeholders, please see the Corporate Responsibility Report.

Supporting Coventry Pride

Tackling mud for Myton Hospice

Getting behind Children in Need

How we manage risks

Effective risk management complements our simple business model to make sure we maintain financial and operational resilience. Our risk philosophy is to be a below median risk building society in order to provide both a safe home for savers' money and superior pricing.

Principal risk categories

As a UK building society there are a number of risks which we are inherently exposed to. These principal risk categories are summarised below alongside a brief explanation of how the Society mitigates them.

Principal risk categories	Mitigation
Credit risk The risk that borrowers or counterparties do not meet their financial obligations.	Robust underwriting and affordability assessment together with appropriate credit policies mean that the Society lends responsibly and remains low risk.
Market risk The risk of a reduction in the Society's earnings and/or value as a result of financial market movements.	The Society operates within Board approved limits and uses interest rate swap agreements to mitigate the impact of changes in interest rates.
Liquidity and Funding risk The risk that the Society has insufficient funds to meet its obligations as they fall due or the inability to access funding markets or to only do so at excessive cost or risk.	The Society holds sufficient liquidity to withstand a severe but plausible stress and operates within limits set by the Board. The Society maintains a diversified funding base to avoid over-reliance on any funding source, type or term.
Conduct risk The risk that the Society's behaviour or decision making fails to deliver good customer outcomes.	The Society places good customer outcomes at the heart of its decision making. In line with Putting Members First, this reduces conduct risk. This ethos directly impacts the design of products and services and is embedded in the Society's people and communication strategies.
Operational risk The risk of loss arising from inadequate internal processes, systems or people, or from external events.	The Society actively identifies, assesses and manages the risks to which it is exposed. In addition, the Society has built business continuity capability to ensure that it can continue to serve members in the event of an operational risk event, delivering operational resilience.
Model risk The risk that an ineffective model or incorrectly interpreted model output leads to a loss, reputational damage or regulatory censure.	The Society operates robust model governance protocols, including sensitivity analysis on key assumptions, independent model validation and regular model monitoring.
Strategic risk The risk that changes to the business model or macroeconomic, geopolitical, regulatory or other factors may lead to the business model, strategy or Strategic Plan becoming inappropriate.	A simple business model which focuses on opportunities that are well understood is the main mitigant. In addition, the Society carries out a robust strategic planning process which is subject to capital and liquidity stress testing. The strategic planning assumptions are regularly reviewed to focus on risks which could become a threat to the business model over the medium to long term.

The Chief Financial Officer's Review contains more information on the risks which are particularly relevant to the Society's current financial outlook. More information on our principal risk categories and how they are managed is included in the Risk Management Report.

Strategic Report

Chief Financial Officer's Review

A robust performance in line with our financial goals.

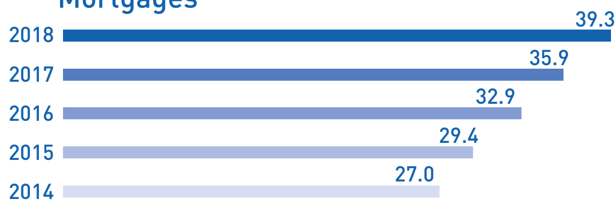
Financial Review

During 2018, the Society has delivered a robust financial performance whilst continuing to grow both mortgages and savings balances. We delivered in line with our commitment to retain only the profit we need to maintain capital ratios, whilst investing to improve services and providing favourable pricing for members. In 2018, this meant we returned £227 million of value to savings members[1], compared to £210 million in 2017.

For information relating to non-financial performance, please see the Corporate Responsibility Report. Information relating to technical terms within this report is included in the Glossary.

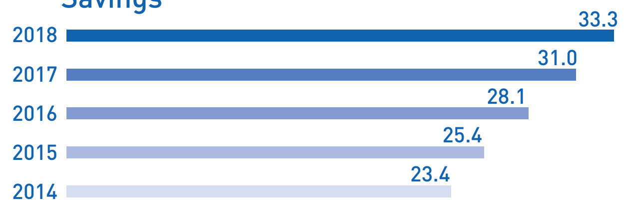
£39.3bn

Mortgages



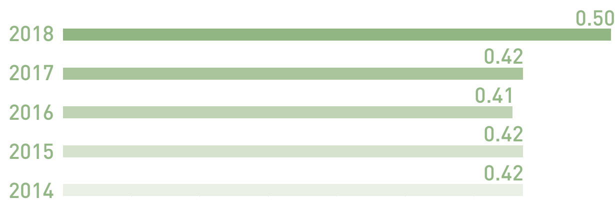
£33.3bn

Savings



0.50%

Total cost to mean assets ratio[2]



0.41%

Cost to mean assets ratio excluding increase in strategic investment[3]

£227m

Value given to members[1]

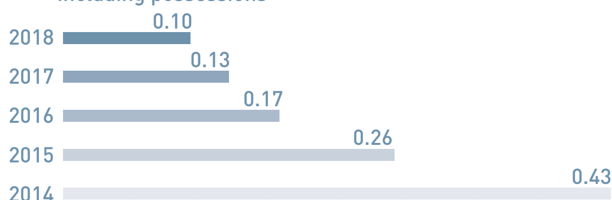
£156.1m

Profit after tax

0.10%

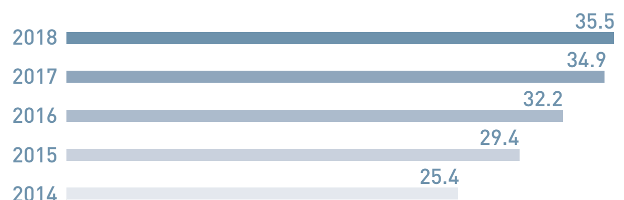
Arrears

% mortgage balances 2.5% or more in arrears, including possessions



35.5%

Common Equity Tier 1 ratio



1. This measure was not reported before 31 December 2017 and relates to the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
2. Administrative expenses, depreciation and amortisation/Average total assets.
3. Administrative expenses, depreciation and amortisation less increase in strategic investment costs compared to 2017/Average total assets.

Income Statement

Overview

In 2018, statutory profit before tax has decreased by 17% to £202 million (2017: £243 million). The decrease is primarily driven by a £41 million increase in costs relating to the Society's strategic investment programmes. Without this additional cost, profit before tax is broadly in line with 2017, reflecting growth in net interest income which covers the 8% increase in business as usual run costs[1]. We have continued to pay above market savings rates, increasing value returned to members to £227 million[2] (2017: £210 million).

Net interest income has increased to £426 million (2017: £411 million), reflecting growth in both mortgages and savings balances despite an increasingly price competitive mortgage market. The continued pressure on mortgage margins, combined with our commitment to paying superior interest rates to savings members, has resulted in a decline in the net interest margin[3] during the year.

The substantial increase in strategic investment spend has resulted in an increased cost to mean asset ratio of 0.50%[4] (2017: 0.42%). Without this additional investment, the 'run cost' ratio would have been 0.41%[5] (2017: 0.42%), reflecting the continued efficiency of our core operations and our focus on maintaining our low cost advantage.

Each year we retain sufficient profit to maintain our capital position. Our risk adjusted capital ratio (Common Equity Tier 1) has been broadly maintained during 2018 at 35.5% (2017: 34.9%). A summarised Income Statement is set out below.

	2018 £m	2017 £m
Net interest income	425.8	411.0
Other income	(1.2)	5.1
Losses on derivatives and hedge accounting	(0.3)	(0.3)
Total income	424.3	415.8
Management expenses	(221.7)	(167.9)
Impairment credit/(charge)	0.4	(0.2)
Provisions	–	(3.5)
Charitable donation to Poppy Appeal	(1.4)	(1.5)
Profit before tax	201.6	242.7

1. Costs excluding the increase in strategic investment costs compared to 2017.
2. Based on the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
3. Net interest income/Average total assets.
4. Administrative expenses, depreciation and amortisation/Average total assets.
5. Administrative expenses, depreciation and amortisation less increase in strategic investment costs compared to 2017/Average total assets.

In previous years underlying profit, representing management's view of underlying performance, was also presented to aid comparability across reporting periods. As the adjustments to statutory profit to calculate underlying profit are no longer material, underlying profit has not been reported.

Net interest income

Net interest income in 2018 was £426 million, £15 million higher than in 2017 as a result of growth in the balance sheet, partly offset by a decrease in the net interest margin.

Net interest margin has decreased by six basis points to 0.96% in the year to 31 December 2018 as we continued to pay above market rates to savers despite market pressures on mortgage pricing. This margin has been sufficient to fund expenditure and support capital.

	2018 £m	2017 £m
Net interest income	426	411
Average total assets	44,322	40,434
	%	%
Net interest margin	0.96	1.02

In 2018, net interest income included a gain of £15 million relating to the sale of a £351 million buy to let loan portfolio which improved net interest margin by three basis points in the year.

In 2017, net interest margin included a £13 million gain relating to the release of fair value adjustments which arose on the merger with the Stroud & Swindon Building Society. This improved net interest margin in 2017 by three basis points.

Our comparatively low net interest margin demonstrates that we are able to realise value from our strategy to be both low risk and cost efficient, whilst paying above market rates to members.

We believe it is likely that that there will be a further modest decrease in the net interest margin in 2019 as a consequence of continuing pricing pressure in the mortgage market and our commitment to protect savings rates as far as possible.

Other income

Other income relates to fees and commissions paid and received by the Society in addition to income from its small number of investments in equity shares. In 2018, other income was a charge of £1 million, £6 million lower than in 2017, as a result of lower general insurance fee income and the inclusion in 2017 of a £5 million gain on the sale of the Society's equity investment in Vocalink Holdings Limited.

Other income is not a strategic priority for the Society and is likely to remain immaterial to our results.

Derivatives and hedge accounting

The Society uses derivative financial instruments solely for risk management.

Income statement volatility arises as a result of the hedge accounting rules. This volatility is largely timing and does not reflect the economic reality of the hedge. An analysis of the net loss from derivatives and hedge accounting is set out in note 8 to the accounts.

Management expenses

Management expenses increased to £222 million (2017: £168 million) reflecting a £41 million increase in strategic investment spend compared to 2017 which we consider to be a reasonable benchmark year. In addition to this there has been a £13 million increase in business as usual run costs to support growth.

During the year we have invested in change programmes such as upgrading digital, print and telephony capabilities and implementing new regulation such as the Payment Services Directive requirements. The increase in strategic spend over 2017 reflects three key investments:

- Branch redesign: seven branches, or 10% of our total estate, have been remodeled as planned during the year. The redesign is proving popular with members and branch colleagues alike. In 2019 we will continue to roll out the new design to further branches.
- Enhanced data infrastructure: good progress has been made on the project to enhance the Society's data centres capability, with the first migrations taking place during 2018 in line with plans.
- Core technology platform upgrade: during 2018, we progressed detailed design and analysis for the work to upgrade our core technology platform. The analysis has identified that if we want to maintain and increase service flexibility this programme is likely to be a bigger endeavour for the Society than originally indicated and we are currently reviewing options to deliver on our objectives whilst reducing the cost and risk of the upgrade. The replanning has been recorded as an operational risk event and we have shown our performance against the investment programme delivery measure as below target for variable pay purposes, underlining the conservative risk tolerance and prudence of the Society.

Taken together, these programmes represent a substantial investment in ensuring we remain able to meet members' future needs and we expect investment costs to remain significant in 2019.

The increase in business as usual run costs of £13 million largely related to employee wage inflation, a 7% increase in headcount to support business growth and the increased cost of running the Society's IT systems reflecting both rising regulatory requirements and customer expectations.

As a result of the substantial strategic investment spend, the Society's cost to mean asset ratio has increased to 0.50%[6] (2017: 0.42%). The business as usual ratio (without the increase in strategic investment) was stable at 0.41%[7] (2017: 0.42%).

For over 10 years the Society has achieved the lowest reported cost to mean asset ratio in the UK building society sector, reflecting a consistent focus on spending members' money wisely. We expect to maintain our low cost position even with the planned additional investment activity. Our ability to manage costs effectively as we grow continues to represent a significant competitive advantage.

Further information regarding management expenses is included in note 9 to the accounts.

Arrears and impairment charge

2018 saw continued low impairments and a reduction in arrears. This reflects our low risk lending which has never included commercial or second charge lending[8], and a negligible exposure to unsecured lending (0.06% of total loan book in 2018).

There was an impairment credit of £0.4 million in 2018 (2017: £0.2 million charge). This impairment credit reflects an improving arrears position and continuing favourable economic conditions. The UK economy has seen continued moderate house price growth overall, falling unemployment and prolonged low interest rates. IFRS 9, which we implemented on 1 January 2018, requires us to factor

6. Administrative expenses, depreciation and amortisation/Average total assets.
7. Administrative expenses, depreciation and amortisation less strategic investment costs compared to 2017/Average total assets.
8. Other than as a result of small books acquired as part of the merger with Stroud & Swindon Building Society in 2010.

forward looking assumptions into impairment provisions. In light of uncertainty over Brexit and the wider global economy, we have moderated our views of forward looking economic scenarios and increased the weighting of our downside IFRS 9 scenario. This increased our impairment provision by £1 million, which is included in the £0.4 million credit.

Impairment losses before recoveries in the year were £2.1 million (2017: £1.9 million) and total impairment provisions at 31 December 2018 of £11.6 million represent 5.5 years loss coverage. In 2017, impairment provisions included £2.5 million relating to a very small number of specific cases which have been positively resolved in the year. Provisions at 31 December 2017, excluding these cases, represented 5.8 years loss coverage.

The impact of implementing IFRS 9 has not been significant for the Society, as a result of our high credit quality, low risk mortgage lending and the favourable economic conditions. The IFRS 9 impairment provision on loans and advances to customers on 1 January 2018 was £0.1 million less than the reported IAS 39 impairment provision at 31 December 2017. In addition, the impact of IFRS 9 transition on regulatory capital is negligible.

IFRS 9 requires the loan book to be split into 'stages' which identify whether the loan quality is performing (stage 1), deteriorating (stage 2) or in default (stage 3). At 31 December 2018, over 96% of our loans were performing and 2.9% of loans were classified as stage 2 (deteriorating). Of the loans in stage 2, which broadly represent loans that do not meet our current very prudent underwriting standards, all but £86 million (or just 0.2% of all loans) were paid up to date at the year end. Only 0.5% or £209 million of loans were classified as stage 3 (default). The definition of default under IFRS 9 is much wider than the definition of impaired loans under IAS 39 and only £68 million, less than 0.2% of loans, would have been identified as impaired under IAS 39 (2017: £79 million, 0.2%).

More information is included in note 1 to the accounts and in the Risk Management Report.

Provisions

Provisions for liabilities and charges have reduced to £nil (2017: £3.5 million) as a result of a £1.0 million credit for Financial Services Compensation Scheme (FSCS) fees and a further £0.5 million credit for other regulatory provisions offset by a £1.5 million increase in the provision for Payment Protection Insurance (PPI) ahead of the claims deadline in 2019.

Further information on the provisions for liabilities and charges is included in note 25 to the accounts.

Charitable donation to the Poppy Appeal

The Society donated over £1 million to The Royal British Legion's Poppy Appeal during the year, which is consistent with 2017, bringing the total donated over the Society's 10 year relationship with the Legion to over £16 million.

Taxation

In 2018, the corporation tax charge was £46 million (2017: £58 million), an effective tax rate of 22.6% (2017: 23.9%). This is significantly above the statutory corporation tax rate of 19.0% (2017: 19.25%) due to a charge of £8 million (2017: £11 million) in respect of the 8% surcharge on the profits of banking companies. Further information is included in note 14 to the accounts.

Balance Sheet

Overview

Mortgage balances and liquidity have grown during the year by £3.4 billion and £0.2 billion respectively. This was funded by increases in retail and wholesale funding of £2.3 billion and £1.2 billion respectively.

	2018 £m	2017 £m
Assets		
Loans and advances to customers	**39,264.6**	35,930.9
Liquidity	**6,401.9**	6,209.5
Other	**404.4**	432.1
Total assets	**46,070.9**	42,572.5
Liabilities		
Retail funding	**33,281.6**	31,035.7
Wholesale funding	**10,313.7**	9,127.3
Subordinated liabilities and subscribed capital	**67.1**	67.1
Other	**288.1**	366.4
Total liabilities	**43,950.5**	40,596.5
Equity		
General reserve	**1,693.5**	1,553.1
Other equity instruments	**396.9**	396.9
Other	**30.0**	26.0
Total equity	**2,120.4**	1,976.0
Total liabilities and equity	**46,070.9**	42,572.5

Loans and advances to customers

Our lending strategy remains focused on high quality, low loan to value loans within the prime residential market. These loans are primarily distributed through third party intermediaries, giving the Society a regionally diverse mortgage portfolio in a cost-effective manner.

In 2018, we advanced £8.9 billion of mortgages, (2017: £8.6 billion) and mortgage balances grew by £3.4 billion (2017: £3.0 billion) increasing our market share of stock to 2.8%[9] (2017: 2.6%). The year-on-year growth in mortgages of 9.3% was significantly above mortgage market growth of 3.0%[9].

New lending continued to be supported by strong remortgage levels overall, with buy to let remortgages at 77% (2017: 79%) of new buy to let lending. New lending for owner-occupier house purchases was resilient at 55% of owner-occupier lending (2017: 53%).

The balance weighted indexed loan to value of the mortgage book at 31 December 2018 was broadly unchanged at 54.6% (2017: 53.9%). Arrears continued to improve, remaining significantly better than the industry as a whole. As at 31 December 2018, 0.10% of mortgage balances were 2.5% or more in arrears (2017: 0.13%) compared to the latest available industry average of 0.74%[10].

Our performance in 2018 continued our strategy of sustainable growth without increasing our very low risk lending profile. We continue to support members in owning their homes; a robust performance despite the price competitive mortgage market throughout the year.

Liquidity

On-balance sheet liquid assets have remained broadly stable at £6.4 billion (2017: £6.2 billion). The Liquidity Coverage Ratio (LCR) at 31 December 2018 was 202% (2017: 208%), considerably above the minimum regulatory requirement.

Liquid assets are held in deposits at the Bank of England and UK Government investment securities. This means that asset quality remains very high with 95% of the portfolio rated Aaa–Aa3 (2017: 96%). 98% of liquid assets are held in UK sovereign or UK financial institutions (2017: 99%).

Included in liquid assets are £0.9 billion of assets held at Fair value through other comprehensive income (FVOCI) as they are held to collect cash flows and to sell as appropriate. FVOCI assets are marked to market with any changes in fair value recorded through other comprehensive income. As at 31 December 2018, the balance on the FVOCI reserve was a £6 million gain, net of tax (2017: £6 million gain, net of tax[11]).

Retail funding

Retail savings increased in the year by £2.3 billion to £33.3 billion (2017: £31.0 billion), representing growth of 7.2%, compared to market growth of 2.8%[12]. The Society's savings market share increased to 2.5%[12] (2017: 2.4%).

The Society has continued to support the cash ISA market with competitive rates of interest, increasing our share of this market to 5.4%[12] (2017: 5.1%).

We opened over 176,000 new savings accounts in the year (2017: 145,000), with over 84% of mortgage loans funded by retail savings (2017: 86%).

The growth in savings reflects the quality of our products and service and the superior interest rates we pay compared to the market average. We are focused on providing superior returns to savers as far as we can despite the availability of cheaper funding from wholesale markets. In 2018, our interest rates meant that we returned £227 million[13] of value to savings members compared to market average rates, an increase of 8% on 2017 (£210 million).

Wholesale funding

We use wholesale funding to make our funding more diverse. This reduces risk and also lowers the overall cost of funding, both of which benefit members.

In 2018, we issued the first five year covered bond in the UK which was linked to SONIA[14], raising £500 million of funding. This, combined with Term Funding Scheme (TFS) drawdowns of £1.3 billion, increased on-balance sheet wholesale funding to £10.3 billion (2017: £9.1 billion) net of a £750 million covered bond maturity in April 2018.

Equity

It is important for us to grow equity to provide the capital we need to support growth.

The Society's equity is predominantly made up of its general reserve and Additional Tier 1 capital. The Society's total equity increased by £0.1 billion to £2.1 billion, reflecting retained profits generated during the year.

9. Source: Bank of England, household sector.
10. Source: Prudential Regulation Authority - latest available information at 30 September 2018.
11. Previous reporting periods this represented the Available-for-sale reserve.
12. Source: Bank of England, household sector.
13. Based on the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
14. Sterling Overnight Index Average.

Regulatory capital

We hold capital to protect members against future losses. As we grow our mortgage book the amount of capital we need to hold to meet the Capital Requirements Directive (CRD) IV increases.

The Society's CRD IV capital position[15] as at 31 December 2018 is summarised below. During the year capital available for Common Equity Tier 1 (CET 1) or 'capital resources' increased by £143 million, primarily driven by profit after tax of £156 million.

Despite mortgage growth of 9.3%, our risk based capital requirements, or risk weighted assets, have only increased by 8.0% as a result of book quality improvements reflecting an increase in house prices and lower arrears.

The net impact is that our CET 1 ratio has been maintained at 35.5% (2017: 34.9%).

We are not currently bound by regulatory leverage ratios but we monitor leverage ratios on both a CRR[16] and UK basis. The UK ratio differs from the CRR basis in that it includes a restriction on the amount of Additional Tier 1 capital that can be included in leverage capital and excludes central bank reserves from leverage exposure.

Both the CRR and UK leverage ratios have been maintained at 4.2% and 4.6% respectively (2017: 4.3% and 4.6% respectively). This is because the increase in available capital was matched by the increase in leverage ratio exposures (non-risk based) largely driven by growth in the mortgage book.

	End-point 31 Dec 2018 £m	End-point 31 Dec 2017 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	**1,614.8**	1,471.6
Total Tier 1 capital	**2,011.7**	1,868.5
Total capital	**2,011.7**	1,910.0
Risk weighted assets	**4,548.5**	4,213.1
Capital and leverage ratios:	**%**	%
Common Equity Tier 1 (CET 1) ratio	**35.5**	34.9
CRR leverage ratio[1]	**4.2**	4.3
UK leverage ratio[2]	**4.6**	4.6

1. The CRR leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation.
2. The UK leverage ratio includes a restriction on the amount of Additional Tier 1 capital and excludes central bank reserves from the calculation of leverage exposures.

15. Excluding any IFRS 9 transitional provisions which were negligible.
16. Capital Requirements Regulations.

The PRA provides the Society with a Total Capital Requirement (TCR). In 2018, the Society was issued with a TCR, equating to 11.2% of risk weighted assets, or £511 million. This sets the minimum capital which the Society must hold under Pillar 1 and Pillar 2A requirements and is driven by both balance sheet growth and risk factors determined by the PRA. The Society comfortably meets this requirement using CET 1 capital alone.

Change of auditor

During 2018, we have completed a tender process for our external audit. This is in line with the regulatory requirement to change our current auditor, Ernst & Young LLP, no later than 2020. We propose to appoint PricewaterhouseCoopers LLP as auditor for the 2019 year end, subject to member approval at our AGM. More information is included in the Board Audit Committee Report.

Additional information

Further analysis on loans and advances to customers, treasury credit risk, liquidity, wholesale funding and capital management is set out in the Risk Management Report.

Outlook

This section considers the top and emerging risks which could impact the Society's financial outlook. More information on how the Society manages risks is included in the Risk Management Report.

The Society significantly increased its spend on strategic investment programmes in 2018. These programmes are more far reaching than any that the Society has undertaken previously and increase execution and cost risks. We are strengthening our risk management processes for change management programmes which will ensure change is both delivered safely, without disruption to core operations, and within expectations. These control processes include detailed feasibility work and testing before change is made and a focus on looking for options which reduce execution and cost risk. We are satisfied that we have set appropriate investment budgets within our Strategic Plan.

During 2018, we saw continued political and economic uncertainty coupled with modest economic growth. Against this backdrop, the Society has delivered a robust financial performance – continuing to grow mortgages and savings balances at a rate that exceeds the market.

Brexit, along with concerns about the global economy, has a limited direct impact on us outside of wholesale funding. However, the wider economic consequences will impact the Society. These impacts may result in a decline in consumer confidence and the extension of the low interest rate environment.

A persistent low interest rate can make it difficult to deliver attractive rates to savers whilst providing sufficient margin. During 2018, the Society has again delivered above market interest rates to savers whilst maintaining capital strength and providing good value mortgages. Our funding plans are kept under review and our track record of attracting both retail savings and well-priced wholesale funding means that we are well positioned to manage potential risks in this area.

We are expecting to enter a period of lower house price inflation and have already seen house price falls in parts of the London market. The Society's mortgage book is geographically spread which helps mitigate risk from a fall in London house prices. More importantly, the low risk lending policy and low loan to value of the mortgage book means that we expect to remain resilient to house price reductions. Our IFRS 9 analysis indicates that even if we calculated future expected credit losses on the basis of our most severe downside economic scenario, in line with the Bank of England stress tests, the impact on year end provisions would only be an incremental charge of £14 million.

The competitive mortgage market, coupled with potential for increased wholesale funding costs, means that we believe it is likely that there will be a further modest decrease in net interest margin.

Whilst the level of uncertainty and range of potential near-term economic outcomes has significantly increased, as a building society, without share price considerations to respond to, we can and do take a long-term view. We believe the fundamentals of the UK mortgage and savings market remain strong in the medium and long-term and we expect a continued demand for the good value, straightforward mortgages and savings products that the Society provides.

Our track record, together with cost-effective nationwide distribution and robust underwriting, gives us confidence that we can continue to grow without increasing the risk profile of our lending. This allows us to invest in building future service capability and resilience whilst delivering long-term value to members.

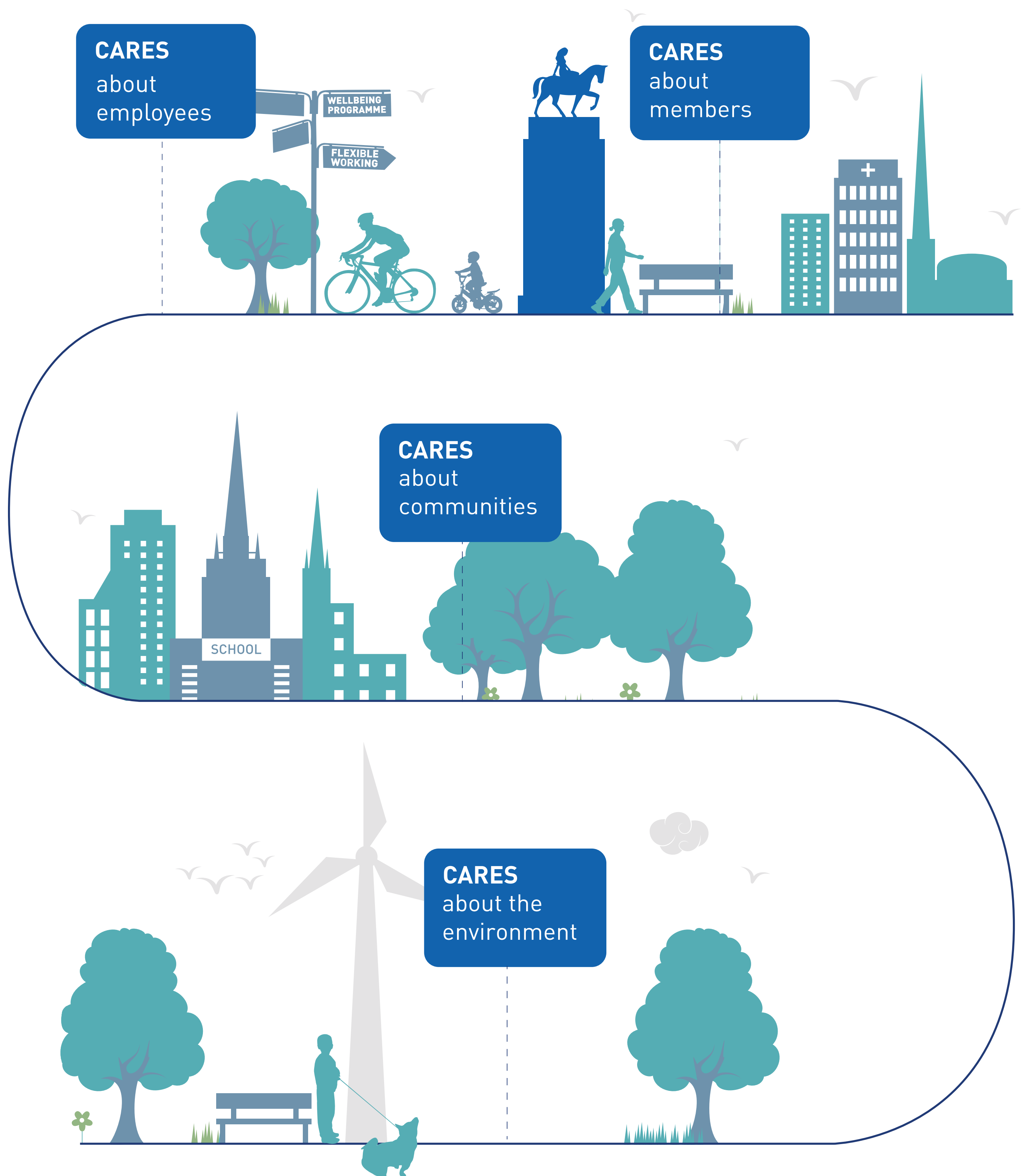
Michele Faull
Chief Financial Officer

28 February 2019

Strategic Report

Corporate Responsibility Report

Coventry CARES about its members and employees, the environment and the communities we serve...



...and strives to make a positive difference in all its interactions with them.

Coventry CARES

The Society has a simple purpose – to meet the needs of members for good value savings and residential mortgages. Putting Members First guides all decisions made by the Society.

Our Business Model, which is outlined on page 10, sets out what we do; our values of being Caring, Attentive, Reliable, Ethical and Straightforward describe how we do it.

Together, these are the foundations of our approach to corporate responsibility. We strive to make a positive difference to members, colleagues and partners, the environment and our communities, creating a virtuous circle that has Putting Members First at its heart.

Coventry CARES about members

We seek to make a positive difference to all our members by offering simple products that deliver good value over the long term coupled with excellent, human service whether members choose to deal with us through our branches, our UK contact centres or online.

For members who save with us, we seek to pay above market rates by operating cost efficiently and retaining only sufficient profit to maintain capital ratios. In 2018, we continued our record of paying savings rates that were nearly twice the market average; this meant that we returned an additional £227 million[1] of value to members.

Our focus on meeting member's needs is shown by our high member satisfaction scores; in particular our Net Promoter Score of +75[2] which is very high for financial services. In 2018, the Society was one of only five UK savings providers to be recommended by Which?. We are proud to have been awarded the Fairer Finance Gold Ribbon and ranked number 1 for savings for three years running.

> Each day I get to make a difference, whether it's helping someone find ways to make the most of their savings, or simply sitting and listening. I am proud to tell people I work for Coventry Building Society, a place that treats people as people.
>
> Amanda Bennet, branch colleague

Our colleagues are central to Putting Members First

For members who borrow from us, our key focus is to lend responsibly ensuring that repayments are affordable. This protects individual borrowers and sustains the Society's financial strength for the benefit of all members.

Taking out a mortgage is one of the biggest financial commitments our members make. Whether they are first time buyers, moving home or remortgaging, we believe that access to independent expert advice is important. That is why brokers are central to the vast majority of our mortgage lending.

Our service to brokers is vitally important as it underpins member experience. In 2018, we retained the Financial Adviser Five Star award for exemplary mortgage service. Our commitment to brokers is reflected in the increased numbers of relationship managers, both on the ground and in our specialist contact centre, and valuable performance service pledges that make sure our service to brokers is consistently reliable.

Continuing to provide a relevant and welcoming branch network is an essential part of our service. Our new accessible and inclusive branch design demonstrates the importance we put on our branches as places that provide a much-needed human space for our members to engage with us.

We know that safety and security are important concerns for our members and we are committed to informing and protecting members from fraudulent activity. This can take many forms, from the provision of dedicated channels and providing specialist support for vulnerable members to in-branch training sessions to raise awareness and help members protect themselves.

1. Based on the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
2. A measure of customer advocacy that ranges between -100 and +100 which represents how likely a customer is to recommend our products and services.

Coventry CARES about colleagues and partners

At the heart of our service proposition to members are our colleagues. The way we recruit, develop, support and engage our people remains central to delivering our corporate responsibility objectives.

All colleagues demonstrate our CARES values in their day-to-day activities and in return we seek to make a positive difference to their working lives. We have very strong colleague engagement and in 2018, we retained our place in the Sunday Times Best 100 Companies to Work For.

Our high colleague engagement stems from the trust that colleagues have in the Society's purpose. 92% say they are proud to work for the Society and 94% say they would recommend the Society's products and services.

The trust between colleagues and the Society is enhanced through engagement with both Unite the Union and My Society, a forum which brings together representatives from across the business. Peter Ayliffe, as Deputy Chair, is nominated by the Board as the non-executive director for representing the interests of the Society's employees to the Board. Peter attends My Society meetings as part of his responsibilities to listen to colleagues' views and ensure that they are reflected in Board activities.

> I am proud to work for an organisation that allows us to give time and attention to not only our members but our community too. The attitude and ethos of the Coventry is something that I find massively refreshing.
>
> Donna Chilton, branch colleague

A successful and fulfilling working relationship is more than a shared commitment to Putting Members First; we believe it has to offer colleagues scope for development and fulfilment. We have worked hard in recent years to develop and deliver an Employee Value Proposition which reflects the values of the organisation and the aspirations of all colleagues. The resulting focus on internal mobility, personal and career development has meant that we filled 41% of vacancies internally (2017: 43%). We have active graduate and apprenticeship programmes to increase entry routes into the Society and in 2018 we had 48 colleagues in such schemes. In 2018, we further developed our wellbeing programme which focuses on physical, mental and financial wellbeing for all colleagues.

We are committed to treating all colleagues fairly and to maximising opportunities for all. The following sections set out our position on diversity and inclusion, our gender pay gap and our CEO pay ratio.

Diversity and inclusion

Our activities to improve diversity and inclusion are making a positive impact and during the year we saw colleagues from Black, Asian and Minority Ethnic (BAME) backgrounds, representing 27% of new joiners (2017: 15%). At the same time more women are taking up development and career opportunities. In 2018, women accounted for 58% of all roles filled internally and for 67% of places on our development programmes. We have signed up to the Women in Finance Charter – this aligns with our ongoing commitment to progress gender diversity, particularly in more senior roles. This progress is supported by a culture that prioritises wellbeing and flexible working.

Gender pay gap

Our mean gender pay gap has decreased by 1.5% during the year to 31.6% (2017: 33.1%). Our pay scales are set solely on an objective view of each role and we are committed to equal pay regardless of gender. The gender pay gap arises because we have a greater proportion of women in non-managerial or customer service roles and more men than women in managerial, technical or specialist roles which attract higher pay.

We have a number of initiatives, including some outlined above, that we expect to reduce the Society's gender pay gap. Whilst the number of women working within our technology teams continues to be ahead of national averages, it remains the case that more technical and specialist roles are filled by male employees. This will limit the speed at which we can reduce the gender pay gap.

CEO pay ratio

We have voluntarily reported the Chief Executive to colleague salary ratio at 31 December 2018, ahead of the requirement to do so for the year ending 31 December 2019. Our ratio (based on the total salary of the Chief Executive compared to the median salary for all colleagues) is 27:1. We will continue to monitor this ratio in future. More information can be found in the Directors' Remuneration Report.

Whilst our colleagues are the cornerstone of our service to members, we increasingly work with strategic partners who are a key part of our service delivery, from filling our cash machines to installing our new branch designs and providing IT services. We work to ensure their approach meets our high ethical standards of conduct.

Human rights and modern slavery

The Society has zero tolerance to slavery and human trafficking and we are committed to ensuring there is no modern slavery or human trafficking in our supply chains or in any part of our business. Due to the nature of the Society's business, the chance that slavery or human trafficking will occur is low; however, we are not complacent on these issues. More information is included in our Modern Slavery and Human Trafficking statement at www.coventrybuildingsociety.co.uk/corporate-governance.

Anti-corruption and anti-bribery

We operate a zero tolerance approach to bribery and corruption. The Society has a strong culture of ethical behaviour and expects its colleagues and individuals acting on its behalf to act with integrity in all dealings related to its business.

Our anti-bribery policy reflects legal requirements and ensures that all colleagues, contractors, directors and suppliers are aware of their responsibilities in this area. All colleagues complete anti-bribery training annually. Monitoring and enforcement mechanisms are in place to ensure the policy is complied with. There are also resources in place to ensure contractors and third parties engaged by the Society are appropriately assessed.

Coventry CARES about the environment

As we grow, the resources we use increase. Understanding our impact on the environment and managing this in a responsible and sustainable way is important, challenging us to find new ways to reduce our environmental impact.

In 2018, we completed an initial assessment of our carbon footprint to establish a benchmark, with the objective of achieving the Carbon Trust Triple Standard. Our plans include targets for energy use, resources, transportation, property and waste management. We intend to report our progress against our environmental plan in future Annual Report & Accounts.

We have already seen progress against these targets. All electricity in our branches and head office sites comes from renewable sources. We are incorporating energy saving technology, including LED lighting, in all refurbishments including our branch redesign programme. Our core data infrastructure programme is deploying cloud-based services, which use less energy than conventional data storage.

We are working towards using paper and printed material more carefully. Today we produce over 12 million pieces of literature per year. All of this comes from recycled paper sources or sustainable forests. We recycle materials wherever possible and do not send any waste to landfill. Across the Society, we collect used paper and general waste such as plastic bottles and empty aluminium or tin cans. Recyclable waste goes to local centres for reuse or to be taken back to raw form and recycled into new products. General or contaminated waste goes to the direct energy scheme, which generates fuel to generate hot water for public buildings in the local area.

We are committed to reducing paper use further and continue to see increased uptake of paperless statements and electronic AGM packs. Our new branch designs include digital screens and 'compare us' tablets which allow product and interest rate information to be provided to customers without the need for paper.

Digital screens and tablets in our new branch design

We also have initiatives aimed at reducing carbon emissions, including making charging points available for colleagues' electric vehicles, and facilities for cyclists.

Coventry CARES about the communities we serve

Making a positive difference to the communities where our members and colleagues live and work is a well-established part of life at the Society and in 2018, 79% of colleagues participated in community activity.

Nationally, we have supported The Royal British Legion for 10 years. During our decade-long partnership we have donated over £16 million through our popular Poppy Bonds and Poppy ISAs, and colleagues have raised over £200,000 and given over 3,300 hours of volunteering time. In 2018, it was very special to celebrate our 10 year partnership as the Legion led the nation in commemorating the 100th anniversary of the end of World War 1. As part of this we created an installation in Coventry train station commemorating the service men and women from Coventry who lost their lives in the War.

Remembering Coventry service men and women

We continue to support a wide range of local charities and community groups, through the grants from our Charitable Foundation and our Community Partner programme. This programme is led by colleagues across the Society and we support it by encouraging colleagues to take paid leave to engage in community work. We also match funds raised by colleagues and make community donations to clubs and societies where our people volunteer. In 2018, colleagues supported over 250 charities through fundraising and volunteered over 8,000 hours. Some examples of these activities are:

- More than 50 colleagues took part in a Sleep Out to support the charity Coventry Cyrenians – a charity supporting homeless people.
- The Earlsdon Branch team walked 10 miles to raise £1,706 for their community partner, the Coventry Resource Centre for the Blind.
- Over 500 colleagues supported Sport Relief as part of the Society's Step Up for Sport Relief team.

We support colleagues in participating in community work as it reflects the CARES values that are important to all of us and builds engagement. We are also seeing that colleagues learn valuable skills and gain confidence when working on community activities. This is particularly apparent in our partnership with Employability UK, a programme that helps students develop the skills and knowledge they need at the start of their working careers. This won Business in the Community's Best Educational Partnership award in 2018, with 141 students from schools in Coventry and Warwickshire completing the programme with the guidance of Society volunteers.

> We are incredibly grateful for the support we've had and the response has been very friendly and supportive. The Society should feel extremely proud of its employees. Thank you so much!
>
> Source: Coventry Haven Women's Aid

Our city is a key part of our local community and we continue to be a leading supporter of Coventry's 2021 UK City of Culture programme. These are exciting times for the city and as one of its oldest businesses and biggest employers, becoming the UK City of Culture represents a fantastic opportunity to engage colleagues and members, raise Coventry's profile and attract new people to live and work in the city.

Risk Management Report

All business involves risks and in this section you will find details of the risks that the Society is exposed to and how they are managed.

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Risk Management Report
Introduction

Introduction

This Risk Management Report explains the principal risks the Society is exposed to and how it manages them.

The Society operates a simple business model, delivering simple products. It operates solely within the UK retail financial services market and only takes risks that are understood and can be managed. More information on the Society's strategy and business model is in the Strategic Report.

As a UK building society, there are a number of risks which the Society is inherently exposed to. These principal risk categories are credit risk, market risk, liquidity and funding risk, conduct risk, operational risk, model risk and strategic risk. This report sets out how the Society manages each of these risks. Holding capital is one of the ways that the Society protects members from the impact of a risk event, so this report also summarises the Society's capital position.

Top and emerging risks

In addition to the principal risk categories noted above, the Society's top and emerging risks are identified through the Society's risk management processes. These are specific risks within the Society's principal risk categories that are significant for the Society throughout its Strategic Plan. The top and emerging risks and details of how they are mitigated is set out below.

Top and emerging risks	Principal risk category	Mitigation
UK political and economic uncertainty There is a risk that uncertainty around Brexit or the political environment could impact the wider economy through reduced confidence. In turn, this could impact the wholesale funding market, house prices and employment. There is also a risk that the very low interest rate environment will continue in the medium term.	Strategic and funding risk	As a UK-based financial institution, Brexit has limited direct impact on the Society outside of wholesale funding. The UK housing market fundamentals are expected to remain strong over the medium to long term. The mortgage market has remained resilient, with significant remortgage activity in 2018. The Society's mortgage book is geographically spread which mitigates the risk from a fall in London house prices. Combined with the Society's low risk lending policy, we expect to remain resilient to economic challenges. Funding plans are kept under review and the Society's record of attracting both retail savings and well-priced wholesale funding allows it to manage risks in this area.
Market environment There are a number of factors which taken together could exert pressure on the Society's net interest margin. These include pricing pressures in the mortgage market, new entrants and a slowdown of house purchases in the short term.	Strategic risk	The Society's simple business model means that we focus on simple, low risk mortgages and savings and leveraging our deep experience in addition to effective partnerships with intermediaries. Our strong business fundamentals mean that we can respond to market pressures and our cost-efficient business model allows us to remain financially resilient whist continuing to offer superior value to members.
Change and execution risk The Society is undertaking a number of strategic investment programmes which are far more wide reaching than any that the Society has completed previously. This activity increases cost and execution risk.	Operational risk	The Society's change programmes will deliver additional resilience and flexibility and therefore reduce risk once implemented. In particular, the programmes focus on enhanced data centre capability and an upgrade of the core technology platform. The Society believes that it is putting the necessary risk management processes for change management programmes in place which will ensure change is both delivered safely, without disruption to core operations, and within expectations. These control processes include detailed feasibility work and testing before change is made and a focus on looking for options which reduce execution and cost risk. The Society is satisfied that it has set appropriate investment budgets within its Strategic Plan.

Controlling and managing risk

Overview

The Society's Enterprise Risk Management Framework (ERMF) has continued to operate effectively during 2018. Its primary purpose is to set out the Board's approach to managing risk and risk oversight by: defining risk strategy; risk appetite; governance and control; and risk management in light of the Society's purpose and objectives. The Society will continue to enhance the ERMF in response to changes and developments within the Society, best practice and regulatory requirements. The ERMF is approved by the Board on an annual basis.

Three lines of defence

The Society's ERMF is structured along the 'three lines of defence' model which is recognised as an industry standard for risk management.

- **First line of defence** – risk management is primarily the responsibility of all managers and employees of the Society.
- **Second line of defence** – independent oversight is required to challenge managers and employees effectively. This is provided through the Risk function.
- **Third line of defence** – the Society's Internal Audit function is responsible for providing independent assurance.

The key accountabilities of the three lines of defence within the Society are illustrated below:

1st line – The business (Risk management)	2nd line – Risk oversight	3rd line – Internal Audit
> Owns and manages the Society's risks. > Responsible for compliance with relevant regulation and legislation. > Identifies, manages and mitigates the risks of the Society. > Defines and operates controls. > Assesses key risk indicators and market conditions. > Produces management information and reports on risk.	> Designs, interprets and develops the Enterprise Risk Management Framework, and monitors business as usual adherence to the framework. > Provides oversight, challenge and assurance over the management of risks. > Develops compliance policies, supports delivery of regulatory change and monitors and reports on regulatory issues.	> Conducts independent testing and verification of the efficacy of the Society's business model, controls, policies, processes and business line compliance. > Provides assurance that the risk management process is functioning as designed.

Risk management
The Society identifies, assesses, manages, monitors, escalates and reports risks through risk and control self-assessment, risk indicators and risk management information.

These processes deliver risk management objectives to:

- Identify risks to the Strategic Plan and Society objectives.
- Assess risk exposures by impact and likelihood.
- Respond to risks by evaluating them against the Society's risk appetite, formulating associated management responses and monitoring the agreed management action plans and progress.

Risk strategy
The risk strategy is set by the Board. It sets the risk management approach that incorporates risk culture, the Board's risk appetite and the adoption of the 'three lines of defence' model.

Risk culture
Risk culture supports the Society in achieving its stated purpose and objectives at acceptable risk. It is reflected in behaviours exhibited by the Board and employees with regard to risk awareness, risk taking and risk management.

The Society's risk culture is built on the following three elements:

- **Tone from the top** – the Board and executive management act and encourage employees to act with openness and integrity, especially in the fair treatment of customers, and to escalate observed non-compliance. Employees are encouraged to report risk incidents and 'near misses'.
- **Accountability** – employees understand the core values of the Society and its approach to risk. Where individuals have specific risk management responsibilities, these are included within role profiles and objectives, and employees understand that they will be held accountable for their actions and risk taking behaviours. Substantially all Society roles are covered by the 'Strengthening Accountability in Banking' regulatory framework, which addresses the conduct expected of those working within financial services.
- **Incentives** – the Society's performance management arrangements promote the Society's desired risk management behaviours and attitudes. In particular, the Society does not pay any sales incentives to employees.

Board risk appetite
The Board sets high level risk appetite statements to articulate the risks that the Board is willing to take in delivering the Strategic Plan. This provides a framework for business decision making.

The Board's strategy is to be a below median risk building society which also provides a backstop against the underlying risk appetite statements and limits. Where the Society can meet its strategic objectives and remain well within its risk appetite, the Board expects it to do so.

Performance and adherence to Board limits is reviewed by the Executive Risk Committee (ERC), the Board Risk Committee (BRC) and the Board.

Stress testing and planning
The Society employs stress testing as a key tool to understand and manage the impact of risks crystallising. This includes scenario and contingency planning as well as an understanding of the Society's resilience to internal and external shocks. Stress testing forms a key component of the Society's capital and liquidity assessments.

The stress testing that the Society undertakes is designed to confirm the Society has sufficient capital and liquidity resources under a range of severe forward looking scenarios to remain within its risk appetite.

More detail on the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) together with reverse stress testing is set out in the following sections covering Capital, and Liquidity and Funding risk.

Governance and control

The Society has established a number of committees to oversee and monitor risk. These include first line risk committees, which are responsible for each of the Society's principal risk categories, and a second line Risk Oversight Committee (ROC) which considers all risk categories. The Board delegates to the BRC the task of overseeing the Society's risk management arrangements as a whole. The Chief Risk Officer (CRO) reports to the Chief Executive and has an independent reporting line directly to the Chair of the BRC.

The Society's third line Internal Audit function provides independent assurance and the Chief Internal Auditor has an independent reporting line directly to the Chair of the Board Audit Committee (BAC).

Further information on the BRC and BAC is included in the Directors' Report on Corporate Governance and in the Board Audit Committee Report respectively.

The Board

Board Risk Committee (BRC)

Chair: Martin Stewart, Non-executive Director

- Oversees the identification and management of current and potential risk exposures.
- Evaluates the design and completeness of the Society's Enterprise Risk Management Framework with reference to risk strategy, culture and principles.
- Reviews key risk policies and the principal risk appetite statements, recommending these to the Board for approval.
- Oversees the Society's Risk and Compliance functions, including their independence.

Board Audit Committee (BAC)

Chair: Iraj Amiri, Non-executive Director

- Reviews the adequacy and effectiveness of internal control and risk management processes.
- Monitors the integrity of the financial statements.
- Monitors the effectiveness of the external auditors.
- Receives reports from and scrutinises the activities of the Internal Audit function.

Chief Executive

Executive Risk Committee (ERC)

Chair: Mark Parsons, Chief Executive

- Oversees and monitors strategic risk.
- Ensures that risk is being identified and managed effectively across the Society.
- Exercises executive risk oversight for each of the Society's Principal Risks.
- Ensures that the Society's risk management framework remains effective.
- Considers any emerging risks which may impact the Society's Strategic Plan.
- Considers reports from the various Risk Committees and CRO. These reports are also submitted directly to the BRC to ensure independent non-executive committee oversight of the Society's risk exposures.

Risk Oversight Committee (ROC)

Chair: Fraser McNeill, Chief Risk Officer

- Provides independent oversight of the management of risk throughout the Society and ensures that risks are identified, assessed, managed, monitored and reported effectively and consistently.

Conduct Risk and Compliance Committee (CRCC)

Chair: Mark Parsons, Chief Executive

- Oversees and monitors the Society's delivery of good customer outcomes consistent with the conduct risk appetite statement approved by the Board.
- Oversees the management of Conduct Risk and the Society's compliance with applicable conduct regulation.

Asset and Liability Committee (ALCO)

Chair: Michele Faull, Chief Financial Officer

- Oversees the balance sheet risks faced by the Society.
- Oversees market risk, treasury credit risk and liquidity and funding risk.
- Ensures the robustness of capital and liquidity stress testing.
- Oversees financial model risk management.
- Oversees Prudential regulatory risk and Treasury conduct risk.

Retail Credit Risk Committee (RCRC)

Chair: Fraser McNeill, Chief Risk Officer

- Monitors the management of retail credit risk across the Society and the performance of the mortgage book to ensure compliance with risk limits approved by the Board.
- Oversees management of model risk through its sub committee, Models and Ratings Committee, which is chaired by Michele Faull.

Operational Risk Committee (ORC)

Chair: Peter Frost, Chief Operating Officer

- Provides primary oversight of all operational risk categories.
- Ensures compliance with limits approved by the Board.

Principal Risk Categories

Credit risk

Credit risk is the risk that borrowers or counterparties will not meet their financial obligations to the Society as they fall due.

Maximum exposure to credit risk

The following table presents the Society's maximum exposure to credit risk for on-balance sheet and off-balance sheet financial exposures. Figures take into account collateral held or other credit enhancement, and allow for impairment where appropriate. The maximum exposure to loss for off-balance sheet financial exposures is considered to be the contractual nominal amounts.

(Audited)	On-balance sheet carrying value 2018 £m	Off-balance sheet exposures[1] 2018 £m	Maximum credit risk exposure 2018 £m	On-balance sheet carrying value 2017 £m	Off-balance sheet exposures[1] 2017 £m	Maximum credit risk exposure 2017 £m
Cash and balances with the Bank of England	5,219.4	–	5,219.4	4,995.2	–	4,995.2
Loans and advances to credit institutions	231.3	–	231.3	202.0	–	202.0
Debt securities	951.2	–	951.2	1,012.3	–	1,012.3
Loans and advances to customers	39,264.6	1,737.5	41,002.1	35,930.9	1,480.7	37,411.6
Hedge accounting adjustments	6.5	–	6.5	17.2	–	17.2
Derivative financial instruments	268.9	–	268.9	306.5	–	306.5
Total	45,941.9	1,737.5	47,679.4	42,464.1	1,480.7	43,944.8

1. Off-balance sheet exposures comprise pipeline loan commitments.

Retail credit risk and treasury credit risk are considered separately below.

Retail credit risk

Retail credit risk profile

The Society continues to focus on low risk, high quality owner-occupier and buy to let mortgages. Non-traditional mortgage lending outside these core segments was discontinued in 2008 and balances on these legacy products, including loans acquired as a result of the merger with Stroud & Swindon Building Society in 2010, comprises just 0.7% (2017: 0.9%) of total gross balances.

During 2018, arrears continued to fall despite Bank of England Base Rate rises, reflecting the benign economic environment and the consistent prudent underwriting principles of the Society. Whilst further Base Rate rises may impact future arrears, we expect the Society and its borrowing members to remain resilient.

Exposure to owner-occupier interest only lending continues to reduce as a result of withdrawing these products in 2012 and only 6.8% of the owner-occupier portfolio was on interest only terms as at 31 December 2018 (2017: 8.6%) with an average loan to value of 39.1% (2017: 39.2%). The Society actively manages contact with customers to help assess their ability to repay the capital when due or, if potential difficulties are identified, to seek suitable solutions. At the end of 2018, there were 268 owner-occupier interest only cases that were past term (2017: 305).

In line with market practice, buy to let lending is largely provided on an interest only basis which reflects the fact that buy to let mortgages fund an investment that can be sold to repay the capital amount.

Loans and advances to customers, gross of impairment provisions, are shown below:

Loans and advances to customers (Audited)	2018 £m	2018 %	2017 £m	2017 %
Residential mortgages: owner-occupier	23,261.5	59.2	21,714.4	60.4
Residential mortgages: buy to let	15,738.0	40.1	13,905.9	38.7
Total traditional residential mortgages	38,999.5	99.3	35,620.3	99.1
Residential near-prime mortgages	66.3	0.2	77.2	0.2
Residential self-certification mortgages	184.2	0.5	215.9	0.6
Commercial mortgages[1]	2.3	–	2.8	–
Total non-traditional mortgages	252.8	0.7	295.9	0.8
Unsecured personal loans[1]	23.9	–	31.8	0.1
Total gross balance	39,276.2	100.0	35,948.0	100.0

1. Legacy books of unsecured personal loans and commercial mortgages. The credit risk for these is immaterial and therefore not considered further in this report.

Geographical concentration

The mortgage portfolio is well diversified and reflects the national coverage of the intermediary and direct channels. The geographical split of mortgages by balance, gross of impairment provisions, is shown below and has remained broadly stable:

Region (Audited)	2018 %	2017 %
London	27.1	26.1
South East England	18.5	18.4
Central England	14.6	15.0
Northern England	13.4	14.0
East of England	11.5	11.3
South West England	9.0	9.1
Scotland	3.5	3.6
Wales and Northern Ireland	2.4	2.5
Total	100.0	100.0

Loan to value and income multiples (Unaudited)

The Society updates the estimated value of the properties securing the mortgage portfolio on a quarterly basis using regional house price indices. The low loan to value profile of the mortgage book, as shown in the following tables, is a reflection of the Society's low risk approach to lending.

The standard maximum income multiple for owner-occupier mortgages is 4.5. The Society lends on multiples of up to 5.0, for very low (50% or lower) loan to value cases. Any lending at or above 4.5 times income is closely monitored and 3.4% (2017: 2.0%) of advances were made at or above this level in 2018, which is well below the maximum limit of 15% set by the Financial Policy Committee (FPC). Maximum income multiples are also reduced if the loan term extends into retirement to ensure it remains affordable.

For owner-occupier mortgages, ensuring a borrower has sufficient net income, both at the time of application and in a future higher interest rate environment, is a cornerstone of the Society's approach to responsible lending.

The Society sets minimum interest coverage ratios to ensure that buy to let loans are affordable. For higher tax rate buy to let customers impacted by restricted tax relief, the Society requires a minimum interest coverage ratio of 145%. A lower minimum interest coverage ratio of 125% is required for basic rate and non-tax payers. The Society's actual average interest coverage ratio at the end of the year using a stressed 5% interest rate was 175.7% (2017: 176.7%).

The loan to value distribution of the mortgage book as at 31 December 2018 has remained broadly stable as shown below. The following tables are by value of loans unless stated otherwise:

Total mortgage book profile by number of accounts (Audited)	2018 %	2017 %
Indexed loan to value:		
< 50%	50.2	51.0
50% to 65%	25.9	26.0
65% to 75%	14.2	13.9
75% to 85%	6.7	6.6
85% to 95%	2.9	2.4
> 95%	0.1	0.1
Total	100.0	100.0
Average indexed loan to value of stock (simple average)	47.6	47.1
Average indexed loan to value of stock (balance weighted)	54.6	53.9

For the London region, the average indexed loan to value of stock (balance weighted) is 52.3% (2017: 50.9%) and for the book excluding London is 55.2% (2017: 55.0%).

The profile of gross lending in the year is shown below. The increase in the proportion of buy to let lending and the focus on remortgaging in this market reflects a continuation of market trends. The average loan to value of the new lending book has increased marginally but remains comfortably within appetite.

Gross lending – new business profile (Audited)	2018 %	2017 %
Owner-occupier purchase	31.6	33.8
Owner-occupier remortgages	24.1	28.2
Owner-occupier further advances	1.7	1.7
Buy to let purchase	9.3	7.0
Buy to let remortgages	32.8	28.8
Buy to let further advances	0.5	0.5
Total	100.0	100.0
Average loan to value (simple average)	59.7	56.9
Average loan to value (balance weighted)	62.6	59.8

Retail credit risk management – mortgages

Credit risk in the Society's mortgage portfolio only materialises if a borrower is unable to repay the mortgage and as a result the property which forms the security for the mortgage has to be repossessed and sold. A loss will be incurred if the proceeds from the sale of a repossessed property are insufficient to pay the mortgage balance in full.

Credit risk is overseen by the Retail Credit Risk Committee (RCRC) and ultimately the Board. A specialist retail credit risk department reporting to the Chief Risk Officer monitors exposure to credit risk and provides information to RCRC on a regular basis.

Prudent risk limits within the context of the Society's overall risk appetite are set by the Board and reflected in the Society's lending policy. The Society ensures appropriate controls are in place to maintain the quality of lending within these limits.

The Society conducts statistical risk assessments of all mortgage applications and confirms that they meet the Society's lending policy criteria. This ensures consistent decision making, and lending that is affordable and within appetite. Assurance that lending decisions are robust and within the Society's policy is provided through the three lines of defence model.

The Society's key lending criteria include:

- Prudent loan to value limits.
- A requirement that buy to let loans are against properties which are readily saleable into the owner-occupier market.
- Restrictions on the maximum number of properties in buy to let portfolios.

In addition, loan applications are assessed using a stressed interest rate to ensure minimum income coverage levels are met even if interest rates rise.

The Society also regularly monitors its mortgage book to ensure that:

- There is no over-exposure to any geographical region or counterparty.
- The portfolio can withstand a range of macroeconomic and specific stress scenarios.

Whilst recent levels of growth mean that a relatively large proportion of the mortgage book is new and therefore may not have had sufficient time for its performance to be established, the quality of the mortgage book remains very high and arrears from new lending are negligible.

Despite the Society's prudent lending approach, customers may sometimes find themselves in financial difficulty. In such cases, the Society places great emphasis on working with each borrower individually, to reach a realistic and fair arrangement to allow the borrower to regularise their account over a sustainable timeframe.

The Society proactively contacts borrowers most at risk of experiencing potential payment difficulties to explain the impacts of rate increases, discuss different product options and provide appropriate advice. This is one example of how the Society seeks to protect its members' interests whilst at the same time mitigating the risk of credit losses.

Repossession of a property is only sought when all reasonable efforts to stabilise matters have failed or where the mortgage is unsustainable in the longer term.

The number of accounts in arrears as a percentage of loans and advances to customers has further improved from the historically low levels and is substantially lower than the sector average as reported by UK Finance data as shown below:

	2018		2017	
(Audited)	Society %	UK Finance[1] %	Society %	UK Finance[1] %
Greater than three months	**0.18**	**0.79**	0.23	0.82
Greater than six months	**0.06**	**0.47**	0.09	0.49
Greater than one year	**0.01**	**0.25**	0.02	0.25
In possession	**0.01**	**0.02**	0.01	0.03

1. UK Finance data as at 31 December 2018 (31 December 2017).

Extent and use of forbearance (Unaudited)

The Society will consider exercising forbearance if it is in the best interests of both the borrower and the Society. The principal forbearance measures provided by the Society are as follows:

- Arrangements, where monthly payments are maintained and the arrears are repaid over a period of time.
- Concessions, where the Society agrees to accept either the normal monthly payment with no contribution towards paying off the outstanding arrears, reduced payments, or in exceptional circumstances no repayments for a short period.
- Mortgage term extensions to reduce the amount of the monthly payment as part of a longer-term solution.

On very rare occasions, capitalisation of the arrears may be considered and arrears were only capitalised twice in 2018 (2017: twice). Even more rarely, the Society may agree to change repayment mortgages to interest only terms for a temporary period as a means of exercising forbearance. This option has not been used since 2016.

Where a loan is not in arrears, the most common means of exercising forbearance is by granting a short-term payment holiday. Where financial difficulties are the reason for a payment holiday request it is treated as a forbearance measure rather than as one where the borrower is using a product feature. Forbearance payment holidays are for a maximum of three months and will only be given where the monthly repayment amount after the holiday is assessed as being affordable and sustainable.

Details of loans subject to forbearance are set out in the table below:

(Unaudited)	2018 No. of accounts	2018 Carrying value £m	2017 No. of accounts	2017 Carrying value £m
Forbearance: Accounts past due				
Arrangements	**656**	**72.9**	950	104.4
Concessions	**38**	**5.8**	44	5.2
Term extensions[1]	**4**	**0.5**	16	3.1
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	**286**	**33.1**	438	52.0
Term extensions[1]	**164**	**28.7**	105	16.8
Capitalisation of arrears[1]	**2**	**0.2**	2	0.5

1. Granted in the last 12 months.

Overall, the number of loans in forbearance has fallen compared to 2017 reflecting the improved economic environment and credit risk profile of the Society's borrowers. The increase of term extensions on customers not past due is a result of proactive engagement with interest only borrowers who do not have sufficient means to pay the outstanding capital balance but can sustainably address any shortfall by extending the term of the loan on a repayment basis.

All accounts subject to forbearance are assessed as either stage 2 or 3 under IFRS 9 and therefore a lifetime expected credit loss has been recognised within the impairment provision. More information on expected credit losses is included below.

Identifying impaired loans (Audited)

The Society adopted IFRS 9 *Financial Instruments* on 1 January 2018. The most significant change for the Society from implementing IFRS 9 relates to the calculation of impairment provisions for its loans and advances to customers. This calculation is now performed on an expected credit loss (ECL) rather than on an incurred loss basis. ECL impairment provisions are based on an assessment of probability of default, loss given default and exposure at default in a range of forward looking scenarios, with future losses discounted back to the balance sheet date to give a net present value.

IFRS 9 requires the Society to categorise its financial assets into one of three stages at the balance sheet date. Assets that are 'performing' are shown in stage 1; assets where there has been a significant increase in credit risk since initial recognition or 'deteriorating' assets are in stage 2; and accounts which are in 'default' are in stage 3. Under IFRS 9, 'default' is defined as accounts which are three or more months in arrears, have been three or more months in arrears in the last 12 months or have other specific unlikeliness to pay indicators. This definition is much wider than for loans which were considered 'impaired' under IAS 39. The Society is required to recognise a 12 month ECL allowance on all stage 1 assets and a lifetime expected credit loss allowance on all stage 2 and 3 assets. At 31 December 2018, 96.6% of the Society's loans and advances to customers were within the stage 1 'performing' category. More information relating to the staging profile of the Society's assets is included below.

The transition to IFRS 9 has not had a significant impact on the Society's overall impairment provision which is broadly consistent under both reporting standards, although it is expected that the IFRS 9 provision will be more volatile in future periods due to the impact of forward looking economic scenarios. The previous IAS 39 impairment provision reflected both incurred losses on individual loans and amounts to reflect the underlying risk of credit losses which existed but had not been observed. Under IFRS 9, an expected credit loss is calculated at an individual account level basis which includes the incorporation of forward looking economic scenarios.

Information on how the Society has applied the requirements of IFRS 9 including the calculation of ECLs is set out in note 1 to the accounts.

The following table explains the movement in the provision for impairment on loans and advances to customers from that reported under IAS 39 (the previous accounting standard) as at 31 December 2017 to IFRS 9 at 1 January 2018:

(Audited)	£m
IAS 39 provision at 31 December 2017[1]	13.6
Removal of IAS 39 collective provision[2]	(5.5)
Increase in provision under IFRS 9:	
12 month ECL	0.6
Lifetime ECL	1.9
Multiple economic scenarios[3]	1.2
Post-model adjustments[4]	1.7
IFRS 9 expected credit loss at 1 January 2018	13.5

1. IAS 39 position is stated after reclassification of impairment of loan notes totalling £3.5 million which were fully provided for under IAS 39 and have been reclassified to fair value through profit and loss on transition to IFRS 9 and included within loans and advances to credit institutions on the balance sheet.
2. This removes the provision held under IAS 39 for losses which had been incurred but not specifically identified at the reporting date.
3. IFRS 9 requires that multiple forward looking macroeconomic scenarios are incorporated into the ECL calculation. Details of these is included in note 13 to the accounts.
4. Modelled ECL provisions may be supplemented by management if it considers that they do not adequately reflect known credit risks. The post-model adjustments are in respect of some small loan portfolios where there is insufficient historical data on which to develop models.

The transition to IFRS 9 has not resulted in any changes to the Society's credit risk management strategy. However, IFRS 9 models now provide the Society with additional insights into both the drivers of credit risks and customers who may be more vulnerable to the threat of arrears in the event of changed economic scenarios.

The table below shows gross loans and advances to customers split by IFRS 9 stage at 31 December 2018. For stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

			Of which			Of which		
2018 (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Not past due £m	Past due £m	Stage 3 'Default' £m	Not past due £m	Past due £m	Total £m
Residential mortgages								
Owner-occupier	22,444.9	685.3	630.9	54.4	131.3	50.0	81.3	23,261.5
Buy to let	15,323.9	375.6	353.0	22.6	38.5	14.6	23.9	15,738.0
Total traditional residential mortgages	37,768.8	1,060.9	983.9	77.0	169.8	64.6	105.2	38,999.5
Non-traditional mortgages								
Residential near-prime	28.7	17.7	14.3	3.4	19.9	5.3	14.6	66.3
Residential self-certified	113.7	51.8	46.4	5.4	18.7	7.9	10.8	184.2
Commercial lending	–	1.9	1.7	0.2	0.4	0.4	–	2.3
Total non-traditional mortgages	142.4	71.4	62.4	9.0	39.0	13.6	25.4	252.8
Unsecured loans	23.5	0.3	–	0.3	0.1	–	0.1	23.9
Total gross loans	37,934.7	1,132.6	1,046.3	86.3	208.9	78.2	130.7	39,276.2
	%	%	%	%	%	%	%	%
Total gross loans	96.6	2.9	2.7	0.2	0.5	0.2	0.3	100.0

At the reporting date, 96.6% of loans are in stage 1 with only 2.9% in stage 2 and 0.5% in stage 3. Cure periods are applied to accounts in stages 2 and 3 that have hit certain quantitative triggers such as arrears which work to delay transition of loans to a lower credit risk classification (i.e. from stage 3 to stage 2 or from stage 2 to stage 1) by requiring 12 months of sustained performance before a loan is reassessed. As a result, loans can be recorded in stage 2 or stage 3 despite otherwise performing at the reporting date.

Of the balances in stage 2 as at the reporting date, only £86.3 million (7.6%) are in arrears by 30 days or more. This demonstrates that the major drivers for stage 2 classification are non-arrears factors.

Loans which are classified as stage 3 under IFRS 9 are currently three or more months in arrears, have been three or more months in arrears in the last 12 months or have other unlikeliness to pay indicators present. This definition is much wider than for loans which were classified as 'impaired' under IAS 39. Of the loans which are classified as stage 3 at the reporting date, 67.6% (or £141.3 million) are less than three months in arrears and 37.4% (£78.2 million) of stage 3 assets were paid up to date.

A total of £67.6 million of loans were more than three months in arrears, subject to litigation or in possession at 31 December 2018, which is a decrease of £11.3 million compared to 31 December 2017; these figures align with loans identified as impaired under IAS 39.

Possession levels have remained low and only £6.7 million of stage 3 loans are in possession. This related to 34 individual cases and represents only 0.02% of the total mortgage book (or 3.2% of the stage 3 book) by balance. These properties are valued at £6.2 million (2017: £5.1 million) against balances net of provisions of £4.7 million (2017: £4.0 million).

The table below shows total impairment provision split by IFRS 9 stage at 31 December 2018. For stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

			Of which			Of which		
Impairment provision as at 31 December 2018 (Audited)	Stage 1 12 month ECL £m	Stage 2 lifetime ECL £m	Not past due £m	Past due £m	Stage 3 lifetime ECL £m	Not past due £m	Past due £m	Total £m
Residential mortgages								
Owner-occupier	0.6	2.1	1.9	0.2	3.3	1.0	2.3	6.0
Buy to let	0.4	1.1	1.0	0.1	2.3	0.6	1.7	3.8
Total traditional residential mortgages	1.0	3.2	2.9	0.3	5.6	1.6	4.0	9.8
Non-traditional mortgages								
Residential near-prime	–	–	–	–	0.2	0.1	0.1	0.2
Residential self-certified	–	0.1	0.1	–	0.1	–	0.1	0.2
Commercial lending	–	0.5	0.5	–	0.3	0.3	–	0.8
Total non-traditional mortgages	–	0.6	0.6	–	0.6	0.4	0.2	1.2
Unsecured loans	0.3	0.1	–	0.1	0.1	–	0.1	0.5
Mortgage pipeline	0.1	–	–	–	–	–	–	0.1
Total impairment provision	1.4	3.9	3.5	0.4	6.3	2.0	4.3	11.6
	%	%	%	%	%	%	%	%
Total impairment provision	12.1	33.6	30.2	3.4	54.3	17.2	37.1	100.0

A reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage from 1 January to 31 December 2018 is as follows:

	Stage 1		Stage 2		Stage 3		Total	
(Audited)	**Gross balance 12 month ECL £m**	Provision 12 month ECL £m	**Gross balance lifetime ECL £m**	Provision lifetime ECL £m	**Gross balance lifetime ECL £m**	Provision lifetime ECL £m	**Gross balance £m**	Provision £m
At 1 January 2018	**34,476.5**	1.3	**1,238.0**	3.9	**233.5**	8.3	**35,948.0**	13.5
Movements with Income Statement impact								
Transfer from stage 1 to stage 2	**(575.4)**	(0.1)	**575.4**	1.1	**–**	–	**–**	1.0
Transfer from stage 1 to stage 3	**(33.7)**	–	**–**	–	**33.7**	0.8	**–**	0.8
Transfer from stage 2 to stage 3	**–**	–	**(46.3)**	(0.2)	**46.3**	0.2	**–**	–
Transfer from stage 3 to stage 2	**–**	–	**40.5**	0.5	**(40.5)**	(0.5)	**–**	–
Transfer from stage 3 to stage 1	**13.6**	–	**–**	–	**(13.6)**	(0.1)	**–**	(0.1)
Transfer from stage 2 to stage 1	**524.2**	0.1	**(524.2)**	(0.5)	**–**	–	**–**	(0.4)
Net movement arising from transfer of stages	**(71.3)**	–	**45.4**	0.9	**25.9**	0.4	**–**	1.3
New loans originated[1]	**9,163.0**	0.6	**26.0**	–	**0.2**	–	**9,189.2**	0.6
Remeasurement of ECL	**–**	(0.1)	**–**	(0.7)	**–**	0.4	**–**	(0.4)
Loans derecognised in the period	**(4,091.1)**	(0.4)	**(131.6)**	(0.2)	**(42.2)**	(1.0)	**(4,264.9)**	(1.6)
Net write offs directly to Income Statement	**–**	0.1	**–**	–	**–**	(0.4)	**–**	(0.3)
Income Statement charge for the period		0.2		–		(0.6)		(0.4)
Repayment and charges	**(1,542.2)**	–	**(45.1)**	–	**(6.3)**	–	**(1,593.6)**	–
Net write offs	**(0.2)**	(0.1)	**(0.1)**	–	**(2.2)**	(1.4)	**(2.5)**	(1.5)
At 31 December 2018	**37,934.7**	1.4	**1,132.6**	3.9	**208.9**	6.3	**39,276.2**	11.6

1. New mortgages originated in stages 2 and 3 relate to further advances on accounts which are performing at the date of origination but are in the 12 month cure period for IFRS 9 staging.

Despite a 9% increase in the mortgage book, there have been decreases in the absolute amount of stage 2 and stage 3 mortgages of around 9% reflecting the continuing improved performance of the portfolio.

The loan to value distribution of the mortgage book has remained stable during 2018. This is shown by IFRS 9 stage below:

As at 31 December 2018 Indexed loan to value (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
< 50%	14,745.5	384.8	78.0	(0.6)	15,207.7
50% to 65%	11,817.2	348.8	62.8	(1.3)	12,227.5
65% to 75%	6,501.7	223.3	26.8	(1.7)	6,750.1
75% to 85%	3,249.0	108.7	20.9	(2.1)	3,376.5
85% to 95%	1,584.5	59.5	12.3	(2.4)	1,653.9
95% to 100%	7.4	4.6	2.0	(0.9)	13.1
> 100%	6.1	2.5	5.8	(2.0)	12.4
Unsecured loans	23.3	0.4	0.3	(0.5)	23.5
Mortgage pipeline	–	–	–	(0.1)	(0.1)
Total	37,934.7	1,132.6	208.9	(11.6)	39,264.6

The credit quality of the mortgage book, shown by lifetime probability of default (PD) by stage, is set out below. This table reflects the PD of a given loan over its life (e.g. PD of less than or equal to 0.25 indicates a 0.25% or lower chance of default). Default includes cases which are three or more months in arrears, have been three or more months in arrears at some point in the last 12 months and cases which have triggered a specified unlikeliness to pay indicator. This shows that the mortgage book has a very low underlying risk of default, with 91.7% of the book having a PD of 0.5% or less.

As at 31 December 2018 Probability of default (%) (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
<=0.25	33,673.0	19.2	–	(0.3)	33,691.9
0.26 to 0.50	2,263.5	41.0	–	(0.2)	2,304.3
0.51 to 1.50	1,395.3	137.3	–	(0.2)	1,532.4
1.51 to 5.00	234.7	330.3	–	(0.3)	564.7
5.01 to 20.00	57.1	405.3	–	(0.7)	461.7
20.01 to 100.00	46.7	192.8	–	(1.0)	238.5
Other[1]	264.4	6.7	3.1	(2.9)	271.3
Default	–	–	205.8	(5.9)	199.9
Mortgage pipeline	–	–	–	(0.1)	(0.1)
Total	37,934.7	1,132.6	208.9	(11.6)	39,264.6

1. Including mortgage portfolios and other loans where the probability of default is not assessed.

Comparative period disclosures under IAS 39

The Society has not restated comparative information on transition to IFRS 9 and disclosures that were presented in the previous period are presented below.

Under IAS 39 loans were categorised by arrears status, being either not past due, past due or in possession. The table below shows the 2017 position split by product. The corresponding 2018 arrears position is also presented and this shows that there has been no significant change in the distribution.

	Not impaired		Impaired				
As at 31 December 2017 (Audited)	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Residential mortgages							
Owner-occupier	21,491.6	172.0	29.4	18.9	2.5	(3.8)	21,710.6
Buy to let	13,831.2	62.3	5.4	4.7	2.3	(6.9)	13,899.0
Total traditional residential mortgages	35,322.8	234.3	34.8	23.6	4.8	(10.7)	35,609.6
Non-traditional mortgages							
Residential near-prime	51.5	17.6	4.3	3.4	0.4	(0.4)	76.8
Residential self-certified	189.2	19.5	3.7	3.5	–	(1.4)	214.5
Commercial lending	2.6	0.2	–	–	–	(0.8)	2.0
Total non-traditional mortgages	243.3	37.3	8.0	6.9	0.4	(2.6)	293.3
Unsecured	28.9	2.5	0.3	0.1	–	(3.8)	28.0
2017 Total	35,595.0	274.1	43.1	30.6	5.2	(17.1)	35,930.9
2018 Total	**38,960.2**	**248.4**	**39.4**	**21.5**	**6.7**	**(11.6)**	**39,264.6**

In 2017 the analysis of past due and impaired loans by loan to value was as presented in the table below:

	Not impaired		Impaired				
As at 31 December 2017 (Audited) Indexed loan to value:	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
< 50%	14,144.3	106.2	13.2	6.9	1.1	(2.7)	14,269.0
50% to 65%	11,244.9	85.1	12.2	9.9	0.2	(4.1)	11,348.2
65% to 75%	6,062.8	41.3	7.5	4.6	0.3	(1.5)	6,115.0
75% to 85%	2,935.5	23.6	5.0	4.3	0.2	(1.4)	2,967.2
85% to 95%	1,147.6	11.7	3.5	3.3	0.4	(1.1)	1,165.4
95% to 100%	17.7	2.1	0.5	0.9	0.2	(0.5)	20.9
> 100%	13.3	1.6	0.9	0.6	2.8	(2.0)	17.2
Unsecured	28.9	2.5	0.3	0.1	–	(3.8)	28.0
2017 Total	35,595.0	274.1	43.1	30.6	5.2	(17.1)	35,930.9
2018 Total	**38,960.2**	**248.4**	**39.4**	**21.5**	**6.7**	**(11.6)**	**39,264.6**

Credit risk outlook

The Society will continue to focus its lending on high credit quality, low risk business and will only take on risks that it understands when considering which segments of the mortgage market it intends to operate in. The Society's mortgage book is geographically spread throughout the UK, which protects the Society from any further fall in London house prices. We expect to continue to be resilient to economic challenges, which is particularly important given the uncertainties regarding Brexit and the performance of the wider global economy.

Treasury credit risk

Treasury credit risk is the risk that the Society is unable to recover the principal or interest due from a wholesale creditor, or that the liquidity or value of a wholesale asset or instrument suffers materially due to changes in the creditworthiness of the counterparty.

Management of treasury credit risk

The Society has a low appetite for treasury credit risk. As such, exposures are restricted to good quality counterparties with a low risk of failure.

Treasury investment limits are focused on highly rated UK institutions, with additional limits extended to a small number of highly rated and systemically important banks in Europe, Australia, Canada and the United States. The limits reflect internal analysis, external credit ratings and any other relevant factors. The framework for limit setting is reviewed annually by BRC and the Board. Limit setting within the framework is delegated to the Asset and Liability Committee (ALCO) and the Risk function.

Exposures are reviewed continuously to ensure that they remain within the approved limits and developments with treasury counterparties are closely monitored and reviewed. Limits are reduced or suspended where there are adverse changes in the creditworthiness of counterparties, markets or local developments.

The Society has no exposure to emerging markets, hedge funds, non-UK Residential Mortgage Backed Securities (RMBS), non-UK covered bonds or credit default swaps.

Treasury liquid assets profile (Audited)

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities. All of the Society's treasury assets have an investment grade as set out below:

	Exposure value by Moody's rating				
2018 (Audited)	**Aaa-Aa3 £m**	**A1-A3 £m**	**Baa1-Baa3 £m**	**Unrated £m**	**Total £m**
Central banks and sovereigns	**5,886.0**	**–**	**–**	**–**	**5,886.0**
Multilateral development banks (supranational bonds)	**75.1**	**–**	**–**	**–**	**75.1**
Financial institutions	**108.4**	**276.0**	**48.2**[1]	**–**	**432.6**
Mortgage backed securities	**8.2**	**–**	**–**	**–**	**8.2**
Total	**6,077.7**	**276.0**	**48.2**	**–**	**6,401.9**

	Exposure value by Moody's rating				
2017 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated £m	Total £m
Central banks and sovereigns	5,733.0	–	–	–	5,733.0
Financial institutions	192.7	271.2	0.3[1]	1.6[2]	465.8
Mortgage backed securities	10.7	–	–	–	10.7
Total	5,936.4	271.2	0.3	1.6	6,209.5

1. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities. The Baa1-Baa3 exposure in 2018 relates to a single counterparty that was downgraded during the year.
2. Unrated financial exposure comprises a single exposure to a building society. This was called during 2018.

The following table summarises the Society's treasury assets split by geographical domicile. The substantial majority of treasury assets continue to be held within the UK.

2018 (Audited)	Liquid assets					Of which, debt securities		
	Sovereign £m	Supranationals £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	5,886.0	–	372.6	8.2	6,266.8	844.9	31.2	876.1
Supranationals	–	75.1[1]	–	–	75.1	75.2	(0.1)	75.1
France	–	–	59.1[2]	–	59.1	–	–	–
Switzerland	–	–	0.5[2]	–	0.5	–	–	–
Canada	–	–	0.4[2]	–	0.4	–	–	–
Total	5,886.0	75.1	432.6	8.2	6,401.9	920.1	31.1	951.2

2017 (Audited)	Liquid assets					Of which, debt securities		
	Sovereign £m	Supranationals £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	5,733.0	–	432.0	10.7	6,175.7	943.0	69.3	1,012.3
Germany	–	–	0.3[2]	–	0.3	–	–	–
France	–	–	33.1[2]	–	33.1	–	–	–
Canada	–	–	0.4[2]	–	0.4	–	–	–
Total	5,733.0	–	465.8	10.7	6,209.5	943.0	69.3	1,012.3

1. Supranationals relate to amounts held with the European Investment Bank (guaranteed by a number of European sovereigns) and the International Bank for Reconstruction and Development (guaranteed by a number of global sovereigns).
2. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities.

Counterparty credit risk mitigation

In managing its liquidity the Society enters into derivative transactions for risk management purposes and sale and repurchase (repo) transactions, where highly rated assets such as gilts are sold with an agreement to repurchase at an agreed price on a later date. Counterparty credit risk includes the risk of default by the derivative counterparty or the risk that cash received in a repo transaction is less than the market value of the asset.

All counterparties are subject to credit assessments and the regular exchange of collateral to mitigate any exposure. Daily collateralisation of repo transactions takes place in accordance with the Global Master Repurchase Agreements to mitigate net exposure arising from changes in market value. Similarly, all derivatives have Credit Support Annexes (CSAs) in place to ensure they are collateralised to mitigate net mark to market credit exposures.

The Society has entered into International Swaps and Derivatives Association (ISDA) master netting agreements for all of its derivatives (other than swaps undertaken by Coventry Building Society Covered Bonds LLP), which allow the Society to settle exposures 'net' in the event of a default or other predetermined event.

The Society is subject to mandatory clearing of derivatives through a third party regulated central clearing counterparty to reduce systemic and operating risk. Under central clearing, collateral is exchanged on a daily basis. The Society enters into a number of amortising swaps that are not currently cleared by any of the central clearing houses; these are all subject to daily exchange of collateral to better manage counterparty risk.

Coventry Building Society Covered Bonds LLP undertakes swaps under a separate ISDA agreement. Each agreement includes a CSA which provides for collateralisation of the swap exposure. The £17.4 million derivative net asset exposure in note 32 (Offsetting financial assets and liabilities) includes £12.9 million in respect of an arrangement which will only be fully collateralised if the counterparty is downgraded to below specified credit ratings.

The derivative exposure can only be settled net following a default or other predetermined event, and therefore exposures are presented gross in the balance sheet.

Analysis of treasury assets by IFRS 9 stage and impairment

As already noted, the Society adopted IFRS 9 on 1 January 2018 and the calculation of impairment on treasury assets is now also performed on an ECL rather than on an incurred loss basis.

The Society determines whether there has been a significant increase in credit risk for treasury assets using a range of factors including counterparty credit ratings, internal monitoring processes and, for mortgage backed securities, quarterly stress testing. Exposures are monitored by the Treasury Risk Committee.

Given their low risk nature, all of the Society's treasury assets are stage 1 'performing' assets at both 1 January and 31 December 2018. In accordance with IFRS 9, impairment is calculated taking the treasury exposure value and applying an externally published probability of default for the credit risk rating applicable to the exposure. The resulting ECL is immaterial at both dates. Under IAS 39, at 31 December 2017 no treasury assets were either past due or impaired and as such no impairment provision was held.

More information on the impact of IFRS 9 on classification and measurement of the Society's treasury assets is included in note 1 to the accounts.

Treasury credit risk outlook

Whilst there are global economic uncertainties, the Society's consistently cautious approach to treasury credit risk protects the Society and its members from credit risk.

Market risk

Market risk is the risk of a reduction in earnings and/or value resulting from adverse movements in financial markets. It arises in the banking book and includes interest rate, basis, swap spread, reset, currency and product option risks.

Management of market risk

The Society has limited potential for a loss of income or changes in economic value through market risk. The main sources of market risk are mismatches between the re-pricing profiles of mortgages and savings products, and certain characteristics embedded within these products.

The Chief Financial Officer and Treasurer are responsible for managing current and emerging market risks. The Society's risk appetite is to manage risk to earnings over the strategic planning horizon by:

- Managing within prudent limits.
- Matching assets and liabilities.
- Using of derivative financial instruments such as interest rate swaps where possible to remove inherent risk.

Market risk exposure is overseen by the ALCO and ultimately the Board.

Interest rate risk

The Society's business model means it is exposed to a risk that its margin narrows as a result of changes in interest rate.

Where the Society has advanced fixed rate mortgages, there is a risk that an increase in the interest rates it pays on deposits or wholesale funding would leave the Society facing a higher interest expense on its funding, but without a compensating increase in interest income from fixed rate mortgages. The Society manages this risk by natural offset where available or by entering into interest rate swaps.

Interest rate risk lasts for the fixed term of the mortgage, it is particularly relevant for the equity release mortgages held by the Society due to their long term. At 31 December 2018, £130.4 million of the £248.4 million equity release mortgage balance is hedged with interest rate swaps (2017: £134.7 million, of £264.5 million).

In addition, the Society ensures that it has a significant proportion of discretionary variable rate savings and mortgages on its balance sheet to give it flexibility to manage different interest rate environments.

The Society operates within a series of Board approved limits which manage the impact of a change in interest rates on both net interest income and the present value of the balance sheet. From 2018, the limits reflect the maximum acceptable impact of a 100 basis point parallel shock to interest rates throughout the reporting period. An additional assessment against a 200 basis point shock is used for assessing capital requirements. In 2017, the limits were against a 200 basis point shock only.

The impact of a 100 and 200 basis point shock on both the present value of assets and liabilities and on net interest income is set out below. The balance sheet is positioned so that net interest income benefits from rising interest rates, as shown by the impact of an upward rate shock on the net interest income measure. It is broadly balanced for market value changes, as shown by the relatively small PV100 and PV200 measure when viewed in relation to the overall balance sheet size.

In these calculations, interest rates and yields are floored at zero. Given current low interest rates the shock from a fall in rates is limited. If this constraint was removed the impact of the falling rate shock would be similar but opposite to that of the rising rate shock.

Shock applied (Unaudited)	+100bps 2018 £m	-100bps 2018 £m	+100bps 2017 £m	-100bps 2017 £m
PV100 results (impact on present value of assets and liabilities at year end)	(2.9)	6.1	(5.0)	3.5
Impact on net interest income for the year	34.3	(25.0)	28.6	(14.0)

Shock applied (Unaudited)	+200bps 2018 £m	-200bps 2018 £m	+200bps 2017 £m	-200bps 2017 £m
PV200 results (impact on present value of assets and liabilities at year end)	(6.6)	5.0	(11.7)[1]	(0.5)[1]
Impact on net interest income for the year	61.6	(25.0)	58.1	(14.6)

1. The PV200 disclosures for 2017 have been restated and were previously reported as +200bps shock (£22.0) million and -200bps shock £5.2 million.

Product option risk

The Society's products include options which can create interest rate risks for the Society.

Mortgage pipeline risk is the risk that between the point of mortgage application and completion, customers choose not to complete on a mortgage. If this occurs during a period in which interest rate expectations have changed, this could leave the Society with a funding imbalance. This risk is managed by limiting the size of the pipeline in total and by individual product, and by hedging a proportion of the pipeline.

Mortgage prepayment and savings access risks arise when customers reduce either their mortgage or fixed rate savings balance more quickly than the contract term. These risks are managed through a combination of:

- Appropriate redemption or early withdrawal charges.
- Offering products which encourage more predictable behaviour under anticipated future interest rate outcomes.
- Monitoring past trends and stress testing future forecasts to better understand possible customer behaviour.
- Matching swaps to the expected attrition profile.

Basis risk

Basis risk arises mainly as a result of executing swaps at a market rate (for example LIBOR, SONIA) which does not exactly match the Society's administered variable rate.

The risk is managed through regular assessment of potential basis shock to ensure that the Society's exposure remains within these Board defined limits.

The implications of replacing LIBOR in the UK are still not clear but the Society is well placed to manage through this change.

Swap spread risk

In order to diversify its liquidity holdings the Society maintains part of its liquidity portfolio in gilts, which are issued with long-term fixed rates. These gilts have associated derivatives (swaps) that turn the fixed income into a variable rate. However, there remains a residual risk associated with a change in perception of sovereign credit quality. This risk is only realised if the gilt is sold and the swap cancelled ahead of maturity. The potential swap spread risk is monitored against a Board limit.

Reset risk

Reset risk is the risk of retail or wholesale assets or liabilities re-pricing within a concentrated timeframe to materially different rates. In order to mitigate this risk, the Society manages maturity concentrations and limits both the size and time period for exposures resetting at money market rates.

Foreign currency risk (Audited)

The Society raises non-sterling funding to ensure wholesale funds are obtained cost effectively across a wide pool of potential providers. However, this exposes the Society to the risk of an appreciation in the value of foreign currency denominated liabilities.

The Society has a very low risk appetite for foreign currency risk and manages this by the use of cross currency swaps entered into to match the maturity profile of the debt instruments. Further information is in note 24 to the accounts.

Market risk outlook

The outlook for interest rates is currently uncertain. In the event of a protracted low rate environment, the Society is comfortable that it is able to continue to generate additional capital to support growth. The balance sheet is positioned to benefit the Society's net interest margin should interest rates rise further in future.

Liquidity and Funding risk

Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as they fall due. Funding risk is the risk of the inability to access funding markets or to do so only at excessive cost.

Management of funding risk

Funding risk is managed by ensuring that reliance on any single source or funding provider is minimised.

The Society has a strong and diversified funding base reflecting its long-term strategy and traditional building society model. Retail funding consists of a mix of variable rate products, fixed rate bonds and ISAs. The Society has a strong record of attracting and retaining savings balances and continues to organically grow its savings book. Diversifying the source of retail deposits is achieved by having a broad customer base spread throughout the UK and by offering a range of retail savings products.

Wholesale funding is used to diversify funding risk by both source and term, and to increase value to members through lowering the overall cost of funding. To support this, the Society continues to retain access to a number of wholesale funding markets. Bank of England programmes such as the Term Funding Scheme (TFS) have been used to reduce funding costs and further diversify exposures. As at 31 December 2018, the Society has accessed £4.25 billion of TFS (2017: £3.0 billion).

The Board ensures no over-reliance on wholesale funding by setting limits which comply with the Building Societies Act 1986 and which follow the Prudential Regulation Authority's (PRA) supervisory guidance.

Funding is managed on a Group basis (including all subsidiary entities) with day-to-day responsibility delegated to the Chief Financial Officer and Treasurer with oversight by the Asset and Liability Committee (ALCO), Board Risk Committee (BRC) and the Board.

Management of liquidity risk

The Society's approach to liquidity risk management is to hold sufficient quality and quantity of liquidity to remain a going concern after a severe but plausible stress and to ensure that it meets regulatory requirements set by the PRA.

The Society's business inherently involves 'maturity transformation' as the Society borrows for relatively short terms and lends on mortgages for much longer periods. This mismatch generates liquidity risk which could manifest in an inability to raise new funding or replace existing funding as it matures. This could be as a result of a severe liquidity crisis in the capital markets, or a loss of member confidence that causes a 'run' on retail funds.

Determining the appropriate mix and amount of liquidity to hold is a key decision for the Board. An annual Internal Liquidity Adequacy Assessment Process (ILAAP) is completed to ensure that the Society holds sufficient liquidity and to confirm the Society's liquidity risk appetite: this is complemented by reverse stress testing and a Recovery Plan (all outlined below) which identify actions that could be taken to manage liquidity risk in the event of an extreme stress.

The Society regularly tests both the current balance sheet and the latest projections to ensure that actual and forecast liquidity remain within appetite.

Liquidity risk is managed on a Group basis by the Chief Financial Officer and Treasurer. Day-to-day liquidity management is the responsibility of the treasury department and is overseen by the Risk function. Liquidity positions are monitored by ALCO, BRC and ultimately overseen by the Board.

Liquidity resources

Liquidity resources comprise assets such as funds in cash accounts and other easily realisable liquid assets together with contingent liquidity.

Liquidity resources are managed across distinct parameters, principally the time taken to convert resources into cash. Separate limits or requirements for each timeframe ensure that the Society meets its prescribed risk appetite.

Liquidity resources are subject to regulatory requirements. The Liquidity Coverage Ratio (LCR) is a 30 day short-term liquidity measure. The regulatory minimum LCR at 31 December 2018 was 100%. The Society monitors compliance against this measure on a daily basis and as at 31 December 2018, the Society's LCR remains significantly above regulatory requirements at 202% (2017: 208%).

Net Stable Funding Ratio (NSFR) is a measure of stable funding which is expected to be implemented. Based on its current interpretation, the Society holds sufficient stable funding to meet the anticipated requirement of 100% NSFR.

The Society's liquidity resources at 31 December 2018 are set out in the following table. The amounts differ from those in the accounting balance sheet as this analysis excludes any encumbered assets such as cash held in the Society's covered bonds and Residential Mortgage Backed Securities (RMBS) programmes, and balances posted with counterparties as collateral under swap agreements. The amount of high quality liquid assets has remained broadly stable.

(Audited)	2018 £m	2017 £m
Cash balances with the Bank of England	4,948.7	4,708.0
UK Government securities and other qualifying securities	313.7	669.6
Sub-total high quality liquid assets	5,262.4	5,377.6
Other securities – on-balance sheet	8.2	10.7
Contingent liquidity	3,301.4	2,183.2
Total	8,572.0	7,571.5

Contingent liquidity includes Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS. These are approved portfolios of mortgage collateral that could be used to access Bank of England liquidity facilities or sold to and repurchased from third parties under repo agreements to realise contingent liquidity. Contingent liquidity increased by £1.0 billion primarily due to an increase in the amount of Bank of England approved mortgage portfolios.

Liquidity adequacy and stress testing

The ILAAP ensures compliance with regulatory minimum requirements such as the LCR and with the ILAA Rules, including the need to meet the Overall Liquidity Adequacy Rule.

An integral component of this assessment is stress testing which tests whether the Society remains a going concern under a severe but plausible stress. The stress tests consider each of the principal drivers of liquidity risk with the main risks to the Society being large unexpected withdrawals of retail deposits, the impact of a credit risk downgrade and lack of access to wholesale funding markets when wholesale funding matures. The ILAAP considers management actions that may be taken in a stress.

The stress tests are complemented by alternative stress tests and reverse stress testing, which goes beyond standard tests by considering very extreme events that have the capacity to 'break' the Society. These additional tests help to identify risks and possible controls which might ordinarily be missed when using standardised risk assessments.

The ILAAP is reviewed by the PRA. Following this, the PRA provides Individual Liquidity Guidance which sets out the eligible liquidity that the PRA requires the Society to hold, including any add-ons for liquidity risks that are not captured by the LCR. No PRA add-ons are required at this time.

Throughout the year the Society has continued to meet all regulatory liquidity requirements.

Recovery Plan

The Society is required to maintain a Recovery Plan which outlines a menu of actions that can be undertaken to stop the Society from failing in extreme stress situations. Additionally, information is held to support the Resolution Authority to affect stabilisation powers should the recovery options fail. The Recovery Plan covers liquidity risk issues and capital.

Following its review of regulatory requirements which ensure operational continuity in resolution, the Society has put in place a number of actions to ensure the Society has no barriers to resolution.

Wholesale funding

The Society's wholesale funding at 31 December 2018 has increased by £1.2 billion to £10.3 billion. The increase is driven by an increase in the amount drawn down under the TFS (included on the balance sheet in deposits from banks) to £4.25 billion (2017: £3.0 billion). During the year the Society repaid a £750.0 million covered bond and issued a new £500.0 million five year bond maturing in November 2023, the first SONIA linked five year covered bond issued in the UK.

(Audited)	Notes to the accounts	2018 £m	2018 %	2017 £m	2017 %
Deposits from banks, including repo agreements	22	1,195.8	11.6	496.7	5.4
Amounts drawn under the Term Funding Scheme	22	4,258.0	41.3	3,002.3	32.9
Other deposits and amounts owed to other customers		506.0	4.9	739.5	8.1
Debt securities in issue					
Certificates of deposit	23	–	–	251.3	2.8
Medium-term notes	23	2,144.2	20.8	2,135.2	23.4
Covered bonds	23	2,047.3	19.8	2,309.4	25.3
Residential Mortgage Backed Securities	23	162.4	1.6	192.9	2.1
Total		10,313.7	100.0	9,127.3	100.0

Wholesale funding outstanding at 31 December 2018 remains primarily denominated in sterling as shown below:

(Audited)	GBP £m	EUR £m	Total £m
Deposits from banks, including repo agreements	1,122.6	73.2	1,195.8
Amounts drawn under the Term Funding Scheme	4,258.0	–	4,258.0
Other deposits and amounts owed to other customers	506.0	–	506.0
Debt securities in issue			
Medium-term notes	1,559.0	585.2	2,144.2
Covered bonds	1,149.8	897.5	2,047.3
Residential Mortgage Backed Securities	162.4	–	162.4
Total as at 31 December 2018	8,757.8	1,555.9	10,313.7
Total as at 31 December 2017	7,605.1	1,522.2	9,127.3

All of the euro denominated medium-term notes and covered bonds have been swapped back into sterling.

The expected maturity analysis for wholesale funding is shown below, based on the earlier of first call date or contractual maturity. This shows that the overall maturity of funding has not significantly changed. The absolute increase in the two to five year banding is driven by the increase in TFS drawdown and the covered bond issuance noted above.

(Audited)	2018 £m	2018 %	2017 £m	2017 %
Less than one year	2,077.9	20.2	2,281.4	25.0
One to two years	1,582.3	15.3	349.4	3.8
Two to five years	6,205.9	60.2	5,606.7	61.4
More than five years	447.6	4.3	889.8	9.8
Total	10,313.7	100.0	9,127.3	100.0

Contractual maturity profile of financial assets and liabilities

The table below analyses the carrying value of financial assets and financial liabilities based on the remaining contractual life to the maturity date. In practice, the contractual maturity will differ to actual repayments; 'on demand' customer deposits will be repaid later than the earliest date on which repayment can be requested and mortgages may be repaid ahead of their contractual maturity.

At 31 December 2018 (Audited)	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1- 5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England[1]	5,219.4	–	–	–	–	5,219.4
Loans and advances to credit institutions	231.3	–	–	–	–	231.3
Debt securities	–	108.3	0.5	389.0	453.4	951.2
Loans and advances to customers	41.4	730.2	2,081.3	10,042.2	26,369.5	39,264.6
Derivative financial instruments	–	0.8	18.9	220.2	29.0	268.9
Other financial assets	–	0.1	(5.0)	(26.9)	41.4	9.6
Total financial assets	5,492.1	839.4	2,095.7	10,624.5	26,893.3	45,945.0
Liabilities						
Shares	30,770.9	7.9	1,290.8	1,212.0	–	33,281.6
Sale and repurchase agreements[2]	–	1,025.2	–	–	–	1,025.2
Amounts drawn under TFS[2]	–	8.0	–	4,250.0	–	4,258.0
Deposits from banks – other	168.5	2.1	–	–	–	170.6
Other deposits	–	4.0	5.5	–	–	9.5
Amounts owed to other customers	–	413.4	83.1	–	–	496.5
Secured debt securities in issue – RMBS and covered bonds	–	3.5	0.4	1,758.1	447.6	2,209.6
Senior unsecured debt funding	–	6.2	358.0	1,780.1	–	2,144.3
Derivative financial instruments	–	3.3	5.1	52.2	106.8	167.4
Other financial liabilities	–	–	6.7	29.8	–	36.5
Subordinated liabilities	–	0.6	–	10.0	14.9	25.5
Subscribed capital	–	1.6	–	–	40.0	41.6
Total financial liabilities	30,939.4	1,475.8	1,749.6	9,092.2	609.3	43,866.3
Net liquidity gap (contractual)	(25,447.3)	(636.4)	346.1	1,532.3	26,284.0	2,078.7

1. Includes £97.1 million mandatory reserve with the Bank of England.
2. Included in Deposits from banks on the balance sheet.

At 31 December 2017 (Audited)	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England[1]	4,995.2	–	–	–	–	4,995.2
Loans and advances to credit institutions	202.0	–	–	–	–	202.0
Debt securities	–	40.7	102.2	662.6	206.8	1,012.3
Loans and advances to customers	45.4	689.4	1,934.4	9,273.6	23,988.1	35,930.9
Derivative financial instruments	–	–	42.1	244.4	20.0	306.5
Other financial assets	–	0.6	5.8	(13.9)	27.2	19.7
Total financial assets	5,242.6	730.7	2,084.5	10,166.7	24,242.1	42,466.6
Liabilities						
Shares	28,356.2	–	2,088.7	590.8	–	31,035.7
Sale and repurchase agreements[2]	–	300.1	–	–	–	300.1
Amounts drawn under TFS[2]	–	2.3	–	3,000.0	–	3,002.3
Deposits from banks – other	170.7	25.9	–	–	–	196.6
Other deposits	–	2.0	2.0	–	–	4.0
Amounts owed to other customers	–	487.9	247.6	–	–	735.5
Secured debt securities in issue – RMBS and covered bonds	–	2.5	774.7	1,283.2	441.9	2,502.3
Senior unsecured debt funding	–	120.6	145.1	1,672.9	447.9	2,386.5
Derivative financial instruments	–	1.3	10.8	96.4	105.5	214.0
Other financial liabilities	–	–	8.1	68.4	–	76.5
Subordinated liabilities	–	0.6	–	10.0	14.9	25.5
Subscribed capital	–	1.6	–	–	40.0	41.6
Total financial liabilities	28,526.9	944.8	3,277.0	6,721.7	1,050.2	40,520.6
Net liquidity gap (contractual)	(23,284.3)	(214.1)	(1,192.5)	3,445.0	23,191.9	1,946.0

1. Includes £52.5 million mandatory reserve with the Bank of England.
2. Included in Deposits from banks on the balance sheet.

Gross contractual cash flows payable under financial liabilities are analysed further below.

This analysis differs from the analysis of residual maturity as it includes interest accrued for the period to maturity on the balance outstanding at the balance sheet date. The principal amount on the undated subscribed capital is included in the 'More than 5 years' column but with no accrued interest after this date.

At 31 December 2018 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	30,747.8	1,310.8	1,260.6	–	33,319.2
Deposits, amounts owed to other customers and debt securities in issue	1,528.6	669.0	8,075.5	476.7	10,749.8
Other liabilities and adjustments	47.1	80.9	84.1	46.7	258.8
Subordinated liabilities	0.9	0.9	15.8	19.5	37.1
Subscribed capital	2.4	2.4	19.4	40.0	64.2
Total liabilities	32,326.8	2,064.0	9,455.4	582.9	44,429.1
Undrawn loan facilities	43.3	–	–	–	43.3
Leasing commitments	0.9	2.6	12.1	4.4	20.0

At 31 December 2017 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	28,314.3	2,123.1	616.7	–	31,054.1
Deposits, amounts owed to other customers and debt securities in issue	1,014.6	1,417.1	6,217.0	925.1	9,573.8
Other liabilities and adjustments	59.1	96.9	142.7	75.8	374.5
Subordinated liabilities	0.9	0.9	16.4	20.7	38.9
Subscribed capital	2.4	2.4	19.4	40.0	64.2
Total liabilities	29,391.3	3,640.4	7,012.2	1,061.6	41,105.5
Undrawn loan facilities	55.4	–	–	–	55.4
Leasing commitments	0.9	2.4	10.5	5.2	19.0

Asset encumbrance

Some of the Society's mortgages or treasury assets are used to support collateral requirements for secured funding, central bank operations or third party repo transactions. Mortgages or treasury assets used in this way are referred to as encumbered. Encumbrance provides cheaper and more stable funding; however, it creates the risk that savings members and other senior unsecured creditors may be unable to benefit from the liquidation of encumbered assets in the event of insolvency of the Society, and may risk bearing losses from a forced sale of the encumbered assets if the Society defaulted. Whilst these risks are very remote, limits on encumbrance by type are set by the Board and encumbrance levels are managed within these limits.

Asset encumbrance at 31 December 2018 is set out in the table below. Encumbered assets pledged as collateral have increased due to an increase in repos and TFS drawings. Unencumbered assets available as collateral have also increased as part of the Society's liquidity risk management strategy.

	Encumbered		Unencumbered		
(Unaudited)	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total £m
Cash and balances with the Bank of England	–	262.2	4,957.2	–	5,219.4
Loans and advances to credit institutions	231.3	–	–	–	231.3
Debt securities	629.4	–	321.8	–	951.2
Loans and advances to customers	9,933.5	–	3,641.5	25,689.6	39,264.6
Derivative financial instruments	–	–	–	268.9	268.9
Hedge accounting adjustments	–	–	–	6.5	6.5
Other assets	–	–	–	129.0	129.0
Total as at 31 December 2018	10,794.2	262.2	8,920.5	26,094.0	46,070.9
Total as at 31 December 2017	8,190.2	312.8	7,588.8	26,480.7	42,572.5

1. Assets that have been used to support interest rate swap collateralisation agreements, third party secured funding operations, central bank operations or third party repo transactions and cannot be used for any other purpose.
2. Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. This includes cash and assets supporting secured funding vehicles.
3. These assets are readily available as collateral to secure funding. Loans and advances to customers in this category comprise Bank of England approved portfolios, and those that although technically encumbered are held in respect of retained self-issued notes in the Society's covered bond and securitisation programmes.
4. Unencumbered other assets are therefore conservatively defined as not readily available for use as collateral. The loans and advances in this category include £18.9 billion at 31 December 2018 which would be eligible for use to support future external or self-issuance under the Society's covered bond and securitisation programmes. A proportion of the remaining balance would also be suitable for such purpose subject to amending the programme structures.

External credit ratings

The Society's long-term and short-term credit ratings were unchanged by Moody's in the year. During the year Fitch affirmed the Society's 'A' rating.

Short and long-term credit ratings as at 28 February 2019 are set out below:

(Audited)	Long-term	Short-term	Subordinated	Outlook	Date of last credit opinion
Moody's	A2	P-1	Baa1	Stable	September 2018
Fitch	A	F1	n/a	Stable	April 2018

Liquidity and Funding risk outlook

The availability of funding through central bank schemes (e.g. TFS) has led to a sustained benign funding environment for UK banks and building societies which continued through 2018. The TFS drawdown availability ended on 28 February 2018 and TFS drawings are due to be repaid by February 2022. The Society expects this to be preceded by a rebalancing of funding markets with potential for increased volatility, particularly in pricing. Market-wide funding requirements arising from regulatory requirements under the Minimum Requirement for own funds and Eligible Liabilities (MREL) could further impact the wholesale markets.

Since the end of 2018, the continuing uncertainty resulting from the Brexit negotiations has impacted both the availability and cost of wholesale funding and the outlook in the short term is likely to be volatile. There is the potential that this uncertainty, together with any squeeze in household budgets, inflation or other factors, may impact the retail savings market.

The Society is satisfied that it can accommodate any funding uncertainty that arises; in particular it has a strong track record of being able to attract retail funds; strong credit ratings; and the underlying strength of its business model continues to support access to wholesale markets for funding.

Conduct risk

Conduct risk is the risk that the Society's behaviour and decision making fail to deliver good customer outcomes. The Society is committed to making a positive difference and delivering good outcomes for customers. More information is included in the Corporate Responsibility Report.

Conduct risk profile

The Society's mutual ethos and culture, focused on Putting Members First, has delivering good customer outcomes at its heart. This means it is well placed to meet its conduct risk responsibilities and ensure the fair treatment of members.

The principle of Putting Members First informs strategy, day-to-day decision making, and operations across the Society and is embedded in the Society's people and communication strategies. The extremely high level of employee engagement is evidence that employees understand and share this commitment.

All colleagues receive relevant training for their role which covers key systems and processes in addition to how Putting Members First shapes all our activities. All colleagues therefore play an important part in delivering good customer outcomes.

When we design products and services, we focus on making sure that products are fair and that their features are explained simply and clearly. This is a key part of Putting Members First. All major new product developments must first receive approval from our Conduct Risk and Compliance Committee, chaired by our Chief Executive, before they can be launched.

Management of conduct risk

Day-to-day management of conduct risk is the responsibility of all of the Society's senior management. Oversight is provided by the Conduct Risk and Compliance Committee and overseen by BRC and the Board.

The Society identifies the potential conduct risks arising from the products, services and documentation it provides to its members and the control measures to manage, mitigate and monitor such risks.

Second line monitoring programmes provide assurance that regulatory standards and conduct risk expectations are met.

During 2018, the Society continued to have a much lower number of customer complaints upheld by the Financial Ombudsman Service than the industry as a whole. Only 6% of complaints were upheld against the Society against an industry average of 34%. The Financial Ombudsman Service asked for the outcome of referred Society customer complaints to be changed on just six occasions. This demonstrates that poor outcomes are a rarity.

Customer redress is not a significant issue for the Society as a consequence of the design of its products and the member-focused approach in distributing them. An additional provision of £1.5 million has been raised during the year for expected Payment Protection Insurance redress ahead of the claims deadline in 2019.

Sales incentive schemes have frequently been cited as a major reason for customer detriment. None of the Society's employees have any sales-based targets or individual incentive schemes, and this has been the case since 2008.

Conduct risk outlook

The Society anticipates that redress payments and fines will continue to be a feature of the financial services sector. In parallel, the FCA will continue to develop the regulatory regime around culture and conduct risk.

The Society's focus on Putting Members First means that it will continue to place good customer outcomes at the heart of its decision making, reducing conduct risk.

Operational risk

Operational risk profile

Operational risk is the risk of a loss arising from inadequate or failed internal processes, people and systems, or from external events.

Operational risk in the Society is managed across a number of sub-categories, the most significant of which relate to operational resilience, IT and change management, Information security and financial crime. These are considered further below.

The Society is focused both on maintaining operational resilience and reducing the risk that the Society will fail to deliver critical functions and services after a shock event.

Management of operational risk

Operational risk is managed as an integral part of the Society's operations.

Day-to-day management of operational risk is the responsibility of the functional executive who is responsible for identifying potential risks and for putting in place controls or mitigating activities. The Operational Risk Committee provides primary oversight of all operational risk categories and issues are reported to and ultimately overseen by BRC and the Board.

The Society maintains a Risk and Control Self-Assessment process to identify and assess the risks it is exposed to and to evaluate controls to ensure risks are managed within the Society's risk appetite.

Regulatory environment

The regulatory landscape is rapidly evolving and it is challenging for financial institutions to implement the necessary changes well and on a timely basis.

There is significant regulation relevant to financial crime, fraud, money laundering, terrorist financing and the facilitation of tax evasion. The Society complies with all such regulation and continues to evolve its capability to manage such risks. In 2018, it implemented a new transaction monitoring and case management system to support its anti-money laundering and financial crime processes.

The General Data Protection Regulation (GDPR) came into force in May 2018, extending the rights of consumers in respect of their personal data. The Society completed its review of GDPR requirements and established a programme to deliver compliance.

The regulation of payment services changed significantly in 2018, requiring new disclosures which the Society has met.

New regulatory compliance requirements come into effect in 2019, including further requirements arising from the Payment Services Directive 2 (PSD2), Mortgage Credit Directive and extension of the Senior Managers Regime to the Society's subsidiary companies. Of particular significance is the PSD2 requirement for Strong Customer Authentication which will require changes to the authentication of online payment services by September 2019. The Fifth Money Laundering Directive comes into force in June 2019, which requires further measures to be taken to prevent money laundering and terrorist financing. The Society has dedicated programmes and initiatives in place to meet these requirements as they are introduced.

Operational resilience

The Society is focused on protecting and maintaining operations, so that it can deliver critical services even after an operational risk event has occurred, and minimise customer impact.

The Society has built its business continuity capability, investing in skills and physical continuity capacity and enhancing governance arrangements. Critical processes are regularly tested to ensure they can be adequately recovered in the event of a number of different scenarios and simulated risk events. The Society's investment in new data centres will further enhance resilience and security when completed.

These actions are designed to ensure that resilience and continuity capability meets the Society's risk appetite and is in line with industry standards.

IT and change management

The Society recognises that not keeping pace with technology could introduce risk to the stability, security and resilience of technology systems. IT outages have been seen increasingly across the industry and have had significant customer and reputational impact. As a result the Society continues to invest in upgrading its IT estate and enhancing IT governance and monitoring systems. The Society will utilise cloud services to augment its IT capabilities where appropriate, having fully assessed the risks and regulatory implications of adoption.

Undertaking any change programme carries risk, as new systems and processes are introduced and integrated with existing ones. In 2018, having undertaken detailed design and analysis for the work to upgrade our core technology platform, we have identified that this programme is likely to be a bigger endeavour for the Society than originally indicated and we are currently reviewing options to deliver on our objectives whilst reducing the cost and risk of the upgrade. We have recorded the replanning of the upgrade of our core technology platform as an operational risk event underlining the conservative risk tolerance and prudence of the Society. We will strengthen our risk management processes for change programmes to ensure they are delivered both safely and without disruption to our core operations, and in line with expectations.

The increasing pace of change may raise obsolescence risk with the result that services become less stable or resultant costs increase. The IT investment that the Society is undertaking will mitigate the business resilience risk and is affordable given the Society's inherent cost advantage and capital strength.

Information security and financial crime

The threat from cybercrime is well publicised and whilst the Society considers it is well protected it recognises the need to continue to enhance protection for the Society and its members.

Risk management activity focuses on detecting and preventing unauthorised use of information or access to the Society's systems. Where information is shared with third parties, the Society ensures that they provide a similar level of security as the Society itself does.

The Society monitors developments in technology, cybercrime and social media, and pays close attention to the source, likelihood and impact of financial crime and the various ways in which this risk could manifest itself.

As well as enhancing threat intelligence, the Society continues to strengthen its control environment to protect those who are most vulnerable to financial abuse. It continues to work collaboratively with industry partners to further improve controls and enhance customer awareness to ensure risks for the Society and its members are mitigated.

Operational risk outlook

The pace of regulatory change is expected to continue for the foreseeable future. In common with the wider sector, the Society will be particularly impacted by PSD2 and the broader industry developments such as Open Banking will also impact the Society.

The Society expects to focus on improving business resilience and business continuity capability, together with continued effective management of information security and financial crime risks. The Society expects regulators to have a similar focus. In addition, the significant change agenda means that managing execution risk effectively will become even more important for the Society.

The Society expects to extend its use of third parties to provide services and expertise going forward. This is an area of increasing interest for regulators who are seeking to ensure that outsourcing does not give rise to increased risk, for example increased information security risk.

In response, we are enhancing our procurement and supplier management controls to make sure we work with the right partners and have controls in places which mitigate risks from use of third parties.

Model risk

Model risk is defined as the risk that an ineffective model or incorrect interpretation of a model output leads to a loss, opportunity cost, accounting restatement, reputational damage or regulatory censure. If model risk materialises it would impact the other principal risk categories which have been discussed in this report, such as credit risk.

Model risk is managed by the Chief Financial Officer, with oversight provided by the Chief Risk Officer and governance through the RCRC and ALCO. The Society's Model Risk Framework, approved by BRC, sets out standards across a variety of techniques used to mitigate model risk which conform to the Prudential Regulation Authority's principles on Model Risk Management. This includes sensitivity analysis of key assumptions, comprehensive documentation, independent validation, robust development processes and strong governance.

The Society categorises its models against the potential risks and has identified its most critical models. Additional controls and governance are required dependent upon the level of model criticality.

Model risk outlook

Internal Ratings Based (IRB) models are undergoing significant regulatory reform with new regulations published by UK and global bodies. The Society is in the process of updating its models in response to the new requirements.

The Society recognises the benefits from model use and anticipates that usage will increase over time. It will therefore continue to expand its expertise in both model development and model governance.

Strategic risk

Strategic risk is the risk that changes to the business model or macroeconomic, geopolitical, regulatory or other factors may lead to the business model, strategy or Strategic Plan becoming inappropriate. This includes the risk of an overly ambitious Strategic Plan as well as unforeseen market, consumer, competitor or regulatory changes.

Managing strategic risk

Strategic risk is managed by the Board, supported by senior management. ERC, BRC and the Board review the Strategic Plan assumptions and focus on risks that could become a material threat to the viability of the Society's business over the medium or long term.

The Society's Strategic Plan is based on a continuation of its simple business model, the risks of which are well understood and which the Society has significant experience in managing effectively. The main drivers of strategic risk are concentration of the business model, margin compression, regulatory change and reputational risk, in addition to delivery of far reaching investment programmes.

Concentration of business model

The Society's business model is focused exclusively on UK mortgages and savings. There is a risk that this results in lower capital generation than more diversified firms, particularly in a period of persistently low interest rates.

Similarly, the Society's distribution of mortgages concentrates on intermediaries. This is highly cost efficient and delivers a geographical spread of mortgages, thereby reducing regional concentration risk. Whilst there is little evidence that this channel will not continue to be a key feature of the UK mortgage market, the Society's business model would need to evolve should this prove not to be the case.

The Society's deep experience in UK mortgages and savings means that it can operate efficiently in these markets and respond to changes. The Society is well placed to continue to offer products through intermediaries as they evolve.

Market and margin compression

The Society's Strategic Plan, particularly its plans to grow, may be impacted if economic factors result in less margin and lower capital creation.

Pricing pressure in the mortgage market remains strong potentially exacerbated by UK ring-fenced banks focusing on the mortgage market and new entrants.

The ongoing uncertainty created by the Brexit negotiations could lead to pressure on both the availability and cost of wholesale funding in the market, which in turn could result in more competitive savings rates, both of which would reduce net interest margins. Margins could be put under further pressure if the outcome of current macroeconomic factors results in a prolonged period of low interest rates or even a fall in rates.

In the event that either uncertainty or a slowdown in the global economy causes a significant increase in UK unemployment, this could have a knock-on effect on the housing market, reducing the demand for mortgages and impacting the Society's plans.

The Society has a proven track record of managing effectively in a low margin, low interest rate environment and its low cost, low risk business model means it is well placed to continue to do so.

Regulatory change

Emerging capital regulations have the potential to threaten the viability of the Society's low risk model through increased capital requirements such as those arising from the MREL and revisions to the Basel III capital rules for credit risk.

The Board believes the increase in capital measures that do not take account of the low risk nature of the Society's business are likely to result in disproportionately high capital requirements. Maintaining focus on low risk lending is core to the Society's plans and consequently the new regulatory requirements have the potential to moderate the rate of growth targeted, or to lower the returns currently paid to savings members.

In addition, the volume and complexity of regulatory changes, often with short delivery timeframes, has continued. This represents a strategic risk through increased costs, execution risk and continuing compliance effort.

Reputational risk

In recent years, there have been a number of material risk events impacting the reputation of the financial services industry. The Society manages its reputational risk carefully and will continue to invest significant resources in enhancing the robustness of its systems and controls, governance, product set and ongoing monitoring.

Investment programme delivery

The Society has ambitious and far reaching investment programmes in addition to needing to deliver on significant levels of regulatory driven change. This will involve the Society in both a level of change and complexity which it has so far not experienced. In turn, this could lead to increased execution risk which could damage services delivered to members and negatively impact the Society's reputation.

The Society is improving its risk management processes in this area by undertaking robust design analysis before commencing change build and ensuring that there is thorough testing of any new platforms and systems before they are used. Similarly the new branch layout and change approach were prototyped and tested by branch staff before being commissioned and the initial roll out programme was planned to ensure that layouts and transition approach could be well tested before wider roll out.

This approach has led to the Society identifying that the change activity needed to deliver its core platform upgrade would be significantly more complex and carry more risks than previously identified. As a result activity is currently under way to deliver on the Society's objectives whilst reducing cost and execution risks.

Strategic risk outlook

The focus for strategic risk mitigation going forward is likely to be management of execution and delivery risks associated with the significant change programmes and managing the risks of compressed margins.

The Board considers that the Society's strategic advantages of a simple business model, mutual ownership and low cost, low risk profile mean it will be able to manage these risks such that the Society will continue to fulfil its purpose of delivering long-term value savings and mortgage products and great service whilst generating sufficient capital to support its growth and invest in the Society's future.

Capital

Management of capital

Capital is held to protect depositors, ensuring that the Society has sufficient resources to repay liabilities even in the event of unexpected losses.

Day-to-day capital management is delegated to the Chief Financial Officer and Treasurer and overseen by the Risk function, ALCO, BRC and ultimately the Board.

The ICAAP is the Society's evaluation of its capital position and requirements. This is assessed under the Capital Requirements Regulation (CRR) and Capital Requirements Directive IV (CRD IV) framework. The ICAAP assesses capital requirements both against the Society's current and planned position and during severe but plausible stresses.

The Society bases its capital stress tests on severe but plausible stress scenarios specified by the regulator which reflect both low and high Bank of England Base Rates. These are overlaid with additional adverse effects to provide a Society-specific stress. In addition, a range of more severe stresses are considered in support of the overall capital assessment.

Reverse stress testing is also undertaken and considers extreme events that have the capacity to 'break' the Society. This helps to identify risks and possible controls which might otherwise be missed.

The Recovery Plan, described more fully in the Liquidity and Funding risk section, contains a menu of options that may be used to address any shortage of capital resulting from an extreme stress.

Capital adequacy

When assessing the adequacy of available capital the Society considers the material inherent risks which it is exposed to and the need for capital to support the business growth.

The Society has a binding regulatory requirement in relation to its risk weighted Common Equity Tier 1 capital (CET 1). It also has regard to the following regulatory capital requirements which may become binding in future:

- A leverage ratio set in proportion to exposures regardless of their relative risk (CRR and UK leverage).
- A Minimum Requirement for own funds and Eligible Liabilities (MREL).

Each of these is discussed further below. Further information on capital management is also included in the Society's 2018 Pillar 3 Disclosures (www.coventrybuildingsociety.co.uk/2018pillar3).

Risk weighted capital requirements

The Society has permission from the Prudential Regulation Authority (PRA) to use an Internal Ratings Based (IRB) approach to retail credit risk and capital management. The Society therefore calculates capital requirements for prime owner-occupier and buy to let mortgage exposures using internally developed models that reflect the credit quality of the Society's mortgage book. IRB models were used for around 99% of lending exposures throughout 2018, with the remaining exposures relating to legacy non-core products modelled using the standardised approach.

For other lending exposures and other risk areas, such as operational risk, the Society follows the standardised approach, which uses capital risk weighting percentages set by CRD IV. CRD IV sets the following minimum capital requirements: a CET 1 ratio of 4.5%; a Tier 1 capital ratio of 6%; and a total minimum capital ratio of 8%. These ratios apply principally to credit and operational risk and are known as the Pillar 1 requirement.

The Pillar 2 capital requirement reflects the Society's ICAAP assessment and any capital add-ons arising from the supervisory review of those assessments. The Pillar 2 requirement is divided into capital held against risks not captured or not fully captured by Pillar 1 (Pillar 2A), and risks to which a firm may become exposed under a severe but plausible stress (Pillar 2B).

Both the Pillar 1 and Pillar 2A capital requirements must be covered with at least 56% CET 1 capital. Additional Tier 1 capital (AT 1) and Tier 2 capital (up to a maximum of 25% of the requirement) can be used to fulfil requirements above CET 1 capital.

CRD IV requires lenders to hold supplementary capital buffers. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB). At 31 December 2018 the CCoB was set at 1.875% (increasing to 2.5% from 1 January 2019) and the CCyB was 1.0%. The SRB, which came into force from 1 January 2019, does not impact the Society as it has total assets of less than £175 billion.

The PRA provides the Society with a Total Capital Requirement (TCR). In 2018, the Society was issued with a TCR equating to 11.2% of risk weighted assets or £511.2 million. This sets the minimum capital which the Society must hold under Pillar 1 and Pillar 2A requirements and is driven by both balance sheet growth and risk factors determined by the PRA. The Society comfortably meets this requirement using CET 1 capital alone.

Leverage ratio

The leverage ratio is a non-risk based measure that reflects the relationship between Tier 1 capital and total exposures, including off-balance sheet items. The leverage ratio does not distinguish between unsecured and secured loans, or recognise risk factors such as the value of low loan to value mortgage lending.

The requirement for leverage to be legally binding is likely to be introduced at the EU level in 2019.

In advance of this, the PRA has implemented the Financial Policy Committee's (FPC) direction to introduce a UK leverage ratio framework. This currently only applies to banks and building societies with retail deposits of £50 billion or more. The Society is not currently within the scope of this requirement but could be subject to the leverage ratio regime in line with EU regulations from 2019. The Society's focus on low risk assets means that the leverage requirement will be the most onerous and become the most binding capital requirement on the Society.

Following the launch of the TFS the FPC recommended that the leverage ratio exposures were modified to exclude central bank reserves.

The UK leverage ratio requires a minimum ratio of 3.25% calculated on the basis that exposures exclude central bank reserves. Of the UK leverage requirement, a maximum of 25% may be met using high quality AT 1 capital. Neither of these modifications exists in the CRR leverage measure.

There are two additional buffers: these are a Supplementary Leverage Ratio Buffer (SLRB), which does not impact the Society, and a macro-prudential Countercyclical Leverage Buffer (CCLB). The levels of these buffers are set at 35% of the corresponding CET 1 buffers as described above.

Whilst the current UK leverage requirement for firms with total assets of less than £175 billion is 3.6%, the maximum theoretical leverage ratio requirement under UK leverage is 4.125% (3.0% under CRR leverage). The Board is confident that the Society will continue to meet both UK and CRR leverage requirements.

Minimum Requirement for own funds and Eligible Liabilities (MREL)

MREL capital requirements are based on a loss absorption amount to cover losses up to and in resolution and a recapitalisation amount, to enable continuation after resolution.

The Society is required to meet an interim MREL requirement of 18% of risk weighted assets by 1 January 2020. The indicative end-state MREL requirement for all firms will be twice the binding capital requirement; for the Society this is currently 21.5% of risk weighted assets[1]. The new Basel IV rules on risk weighted asset output floors will result in increased MREL requirements from 2022, as would be the case if leverage became binding on the Society. This will result in the need to raise MREL eligible debt.

Regulatory capital analysis

The Society is required to calculate and maintain regulatory capital ratios on both a Group consolidated (including all subsidiary entities) and Individual consolidated (or solo) basis. The Individual basis includes only those subsidiaries meeting particular criteria contained within CRD IV. For the Society there are no significant differences between the Group and Individual bases and the capital disclosures in this report are provided on a Group consolidated basis only.

The Society implemented IFRS 9 *Financial Instruments* on 1 January 2018 and information on the transition impact is in note 1 to the accounts. The transition did not have a material impact on the balance sheet and the impact on regulatory capital was negligible. To coincide with IFRS 9 implementation, CRD IV introduced transitional capital arrangements which reduce the impact of IFRS 9 expected credit losses on a phased basis over five years. The impact of these transitional arrangements on the Society's regulatory capital ratios is not material and the CET 1 and leverage ratios disclosed in this report therefore do not include the transitional reliefs.

1. Two times Pillar 1 and Pillar 2A.

Risk weighted capital (Unaudited)

The Society's capital position on a CRD IV end-point basis is set out below based on all CRD IV requirements that were in force during 2018 excluding transitional provisions. Further information on CRD IV disclosures on a transitional basis is included in the Society's 2018 Pillar 3 Disclosures (www.coventrybuildingsociety.co.uk/2018pillar3).

Capital position	End-point 31 Dec 2018 £m	End-point 31 Dec 2017 £m
Common Equity Tier 1 (CET 1)		
General reserve	1,693.5	1,553.1
Fair value through other comprehensive income reserve	5.6	5.7
Cash flow hedge reserve	24.4	20.3
Common Equity Tier 1 prior to regulatory adjustments	1,723.5	1,579.1
Common Equity Tier 1 regulatory adjustments		
Prudent additional valuation adjustment[1]	(0.9)	(1.0)
Intangible assets[2]	(33.1)	(40.8)
Cash flow hedge reserve[2]	(24.4)	(20.3)
Pension fund surplus adjustment[2]	(17.5)	(14.2)
Excess of expected loss over impairment[3]	(23.5)	(21.9)
Foreseeable distributions[4]	(9.3)	(9.3)
Common Equity Tier 1 capital	1,614.8	1,471.6
Additional Tier 1 (AT 1) capital		
Additional Tier 1 – Perpetual Capital Securities	396.9	396.9
Total Additional Tier 1 capital	396.9	396.9
Total Tier 1 capital	2,011.7	1,868.5
Tier 2		
Collective provisions for impairment	–	1.5
Permanent Interest Bearing Shares (PIBS)[5]	–	40.0
Total Tier 2 capital	–	41.5
Total capital	2,011.7	1,910.0
Risk weighted assets		
IRB approach		
Credit risk – retail exposures	3,592.4	3,270.8
Standardised approach		
Credit risk – retail exposures	140.7	159.5
Credit risk – liquidity book	86.4	99.0
Credit risk – other	68.3	50.0
Credit valuation adjustment risk	48.7	46.8
Operational risk	612.0	587.0
Total risk weighted assets	4,548.5	4,213.1
Common Equity Tier 1 ratio	35.5%	34.9%

1. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
2. Items do not form part of regulatory capital, net of associated deferred tax.
3. The expected loss over accounting provisions is deducted, gross of tax.
4. Foreseeable distributions in respect of AT 1 securities are deducted, net of tax.
5. During 2018, the Society concluded that its PIBS are not eligible to be classified as Tier 2 capital on an end-point basis following discussion with the regulator and further internal review.

At 31 December 2018, and throughout the year, the Society complied in full with the capital requirements that were in force.

The CET 1 ratio has been maintained at 35.5% (2017: 34.9%). Total risk weighted assets have increased by 8.0% primarily reflecting growth in the mortgage book of 9.3% offset by book quality improvements from an increase in house prices and lower arrears.

The Individual consolidated CET 1 ratio on an end-point basis at 31 December 2018 was 0.8% higher than the Group ratio due to assets held by entities that sit outside of the Individual consolidation.

Leverage ratio analysis (Unaudited)

The Society's leverage ratio position on an end-point basis is set out below on both a UK and CRR basis.

The UK ratio differs from the CRR basis in that it includes a restriction on the amount of AT 1 capital that can be included in leverage capital and excludes central bank reserves from leverage exposures.

Both the UK and CRR leverage ratios have remained broadly static at 4.6% and 4.2% respectively (2017: 4.6% and 4.3% respectively) as the increase in eligible Tier 1 capital was matched by an increase in leverage ratio exposures, largely driven by the growth in the mortgage book. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Leverage ratio	End-point 31 Dec 2018 £m	End-point 31 Dec 2017 £m
Total Tier 1 capital – used in CRR calculation	2,011.7	1,868.5
Adjustment for AT 1 restriction	(47.4)	(67.7)
Total Tier 1 capital – used in UK calculation	1,964.3	1,800.8
Leverage ratio exposures		
Total balance sheet assets	46,070.9	42,572.5
Mortgage pipeline[1]	338.9	714.1
Other committed facilities (undrawn lending)[1]	20.0	22.7
Repurchase agreements[2]	1,711.1	869.3
Netted derivative adjustments[3]	(39.8)	(94.4)
Other adjustments[4]	(155.1)	(192.6)
Total leverage ratio exposures – used in CRR calculation	47,946.0	43,891.6
Adjustment to exclude central bank reserves	(4,930.2)	(4,688.1)
Total leverage ratio exposure – used in UK calculation	43,015.8	39,203.5
CRR leverage ratio[5]	4.2%	4.3%
UK leverage ratio[6]	4.6%	4.6%

1. Mortgage pipeline and other commitments are assessed at 20% (2017: 50%) as per the delegated regulation amending CRD IV.
2. Repurchase agreements represent the extent to which collateral provided on repurchase agreements exceeds the amount borrowed.
3. The netted derivative adjustment figure converts the accounting value of derivatives to an exposure measure.
4. Other adjustments predominantly relate to asset balances that have already been included in the capital calculation and these are therefore removed from the total balance sheet assets figure.
5. The CRR leverage ratio is calculated in accordance with the definition of CRD IV as amended by the European Commission delegated regulations. The CRR disclosure replaces the disclosure made in previous years (2017: 4.1%) that included the AT 1 restriction on capital and central bank reserves in exposures.
6. In previous years the UK leverage ratio has been reported as 'Leverage ratio (modified)'.

Additional capital disclosures including the European Banking Authority Templates are available in the Society's 2018 Pillar 3 Disclosures (www.coventrybuildingsociety.co.uk/2018pillar3).

Capital outlook

The Society continues to monitor regulatory developments that could lead to increased capital requirements including any changes to leverage requirements.

Whilst there will be no changes to our risk position, these regulatory changes disproportionately impact institutions with lower risk assets such as the Society. This will mean that reported capital ratios for the Society will reduce, not reflecting its low risk profile. The Society is still considering the impact of these reforms on its capital position, including local regulatory interpretations. The Society expects its risk based capital ratios assessed against these reporting requirements to show a significant reduction as they are phased in. However, the Society is confident that it will continue to have a substantial capital surplus above regulatory minima, remaining safe and secure.

Governance

In this section you will find details of how Coventry Building Society is managed in the interests of its members, the role and constitution of the Board and its various committees. These committees ensure that the Society's operations are effectively governed.

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Board of Directors

The Board places the highest priority on effective corporate governance as part of its commitment to Putting Members First.

Appointed to the Board

Gary Hoffman
Chair of the Board

Committee membership
Nominations and Governance Committee (Chair)
Remuneration Committee
Non-executive Director Remuneration Committee

Experience
Gary joined Coventry Building Society in April 2018 as Chair of the Board. Prior to joining the Society, he was Chief Executive of Hastings Insurance Group, which he established as a key player in the UK insurance market and led through flotation on the London Stock Exchange. He was also Chair of Visa Europe having served on the boards of Visa for 17 years until 2018. Gary has extensive experience in the field of retail financial services, including lending, deposit taking, credit cards and insurance. He had a 26 year career with Barclays Bank, during which he undertook roles as varied as Group Vice Chairman, Chief Executive for UK retail banking, Chairman of UK Banking and Group CEO of Barclaycard. After leaving Barclays, he served as Chief Executive of Northern Rock following its nationalisation.

External appointments
Gary is Chairman for Hastings Group, the Football Foundation and Monzo Bank.

Appointed to the Board

Mark Parsons
Chief Executive Officer

Committee membership
Non-executive Director
Remuneration Committee (Chair)

Experience
Mark has been Chief Executive Officer since July 2014. He previously served as Chief Financial Officer for Retail and Business Banking at Barclays Bank. Mark worked at Barclays for eight years, having joined as Managing Director of the home finance division of the UK retail bank. He later served as deputy chief executive of the UK retail bank.

Mark is a Chartered Global Management Accountant. His career spans more than 30 years in retail financial services, having worked at Abbey National and PwC in leadership roles covering finance, products, branches and personnel. He has previously served as deputy chairman of the Council of Mortgage Lenders.

External appointments
Mark is a Board member of the trade association, UK Finance Limited.

Appointed to the Board

Iraj Amiri

Independent Non-executive Director

Committee membership

Board Audit Committee (Chair)
Board Risk Committee

Experience

Iraj was a partner with Deloitte for over 20 years, leading its national internal audit group and serving clients in the financial, retail and public sectors. Iraj was also Global Head of Internal Audit for Schroders Plc for more than 10 years.

As a specialist in the financial sector he carried out numerous reviews of major financial institutions including banks, building societies and insurance companies. Iraj is a Fellow of the Institute of Chartered Accountants in England and Wales, a past Fellow of the Royal Statistical Society, and was a member of the Internal Audit Task Force of the Institute of Chartered Accountants in England and Wales for a number of years.

External appointments

Iraj is a Trustee and Chair of the Audit Committee at National Employment Savings Trust, where he also serves as a member of the Risk Committee. He is Chair of the Audit Committee at Development Bank of Wales plc. He is also a member of the Regulatory Decisions Committee at the Financial Conduct Authority.

Appointed to the Board

Peter Ayliffe

Deputy Chair of the Board

Committee membership

Board Risk Committee
Nominations and Governance Committee
Remuneration Committee

Joined the Board in May 2013 as a Non-executive Director and served as Interim Chair of the Board from October 2017 to April 2018, after the unexpected death of Ian Pickering.

Experience

Peter has over 40 years' experience of working in retail banking and payments. Peter served as President and Chief Executive Officer at Visa Europe Limited from March 2006 to September 2013. He was responsible for Visa's European business in 36 countries. Prior to joining Visa Europe in 2006, he worked for more than 20 years with Lloyds TSB, where he held a number of executive posts in the bank's retail business. This included serving as Group Executive Director of UK Retail Banking on the Lloyds Group plc Board from 2003 to 2005. In relation to other roles, Peter has served as Director of Investors in People UK and President of The Chartered Management Institute.

External appointments

Peter is a trustee of Pennies Foundation Charity and Chairman of TruRating Limited.

Appointed to the Board

Roger Burnell
Senior Independent Director

Committee membership
Board Audit Committee
Board Risk Committee
Nominations and Governance Committee

Joined the Board in September 2008 and became Senior Independent Director in April 2016.

Experience
Roger is a Chartered Accountant with 40 years' senior executive and non-executive experience. He worked for several businesses within the Thomson Travel Group before becoming group chief operating officer and has also been chairman of a number of businesses and senior independent director of the Thomas Cook Group.

Roger is an advocate of simplicity and organic growth, and believes that our straightforward business model, with low costs and excellent service, is the best way to protect the long-term interests of members.

External appointments
None

Appointed to the Board

Andy Deeks
Executive Director

Committee membership
None.

Experience
Andy is the Society's Product, Marketing & Strategy Director. He has over 10 years of experience with Coventry Building Society and plays a key role in both the commercial delivery and strategic development of the Society for its members. He graduated with a first class degree from the University of Nottingham and holds an MBA from Warwick Business School, University of Warwick. Before joining the Society, Andy was a management consultant, advising UK retail banks, building societies and insurers.

External appointments
None

Appointed to the Board

Catherine Doran
Independent Non-executive Director

Committee membership
Board Risk Committee
Remuneration Committee

Experience
Prior to joining Coventry Building Society as Non-executive Director in August 2016, Catherine served as the Chief Information Officer of Royal Mail plc until May 2016. She was responsible for devising and delivering the IT strategy to support the business transformation agenda. Prior to Royal Mail plc, Catherine was Director, Corporate Development at Network Rail Limited where she led a company-wide transformation programme. Throughout her career, she has held progressively responsible IT leadership roles in a number of blue chip companies – BT, NatWest, Capital One, Logica and Altergo.

External appointments
None

Appointed to the Board

Michele Faull

Executive Director

Committee membership

Non-executive Director Remuneration Committee

Experience

Michele is the Society's Chief Financial Officer, a position she has held since April 2017. Before joining the Society, Michele had over 10 years' experience in senior finance and risk roles in the financial services sector both in the UK and Europe, including positions at Nationwide Building Society and Aviva. Michele is a fellow of the Association of Chartered Certified Accountants and was previously a Tax Partner at PwC.

External appointments

Michele is a trustee and treasurer of Bow Arts Trust where she is Chair of the Core Services Committee. She is also a member of Coventry Cathedral's Finance Committee.

Appointed to the Board

Peter Frost

Executive Director

Committee membership

None

Experience

Peter is the Society's Chief Operating Officer and has responsibility for all aspects of the Society's operations, including IT and Change.

Peter has over 25 years' experience in financial services. Prior to joining the Society, Peter worked at Barclays Bank where he served as Operations Director of UK Retail Operations. He was responsible for managing a number of different operational and change functions including secured and unsecured collections, fraud operations, debit card services and unsecured underwriting. Before this, Peter also held a number of roles across retail banking, including Woolwich Building Society and Woolwich plc. Peter has also held a number of non-executive directorships including roles at Vaultex and Intelligent Processing Solutions Limited.

External appointments

Peter serves the local community by acting as Governor and Chair of the Resources Committee of Little Heath Primary, Coventry.

Appointed to the Board

Jo Kenrick

Independent Non-executive Director

Committee membership

Remuneration Committee (Chair)
Nominations and Governance Committee
Board Audit Committee

Experience

Jo joined the Society in November 2017 as Non-executive Director. She is an experienced director with a commercial and marketing background. She has held a number of directorships including Marketing Director at Homebase Limited, B&Q plc and Wilson Connolly Holdings plc.

She has also served as Chief Executive Officer of Start, a Prince of Wales charitable initiative.

Jo brings building society and payments experience through her previous non-executive role at Principality Building Society and her role as Chair of the Current Account Switch Service as non-executive director for Pay.uk.

External appointments

Jo is a non-executive director of both Dŵr Cymru Welsh Water and Safestore Holdings plc and is Chair of the Current Account Switch Service as non-executive director for Pay.uk.

Appointed to the Board

Martin Stewart

Independent Non-executive Director

Committee membership

Board Risk Committee (Chair)
Board Audit Committee

Experience

Prior to joining the Society in September 2018, Martin served as Director of Banks, Building Societies and Credit Unions at the Bank of England from April 2013. From 2010, he was Head of UK Banks and Mutuals at the Financial Services Authority (now Financial Conduct Authority). He has wide-ranging experience within financial services from a career that includes over 20 years at board level as an executive and non-executive director, as well as senior roles in the building society and consultancy sectors.

External appointments

Martin is an Advisory Board Member of OakNorth Bank plc and a visiting professor at the London Institute of Banking & Finance.

Directors' Report on Corporate Governance

Dear Member

I report to you on the Society's corporate governance arrangements in my capacity as Chair of the Board, a role I have held since 26 April 2018. I assumed the role from Peter Ayliffe, who was interim Chair of the Board from October 2017. The Board and I would like to thank Peter for taking up the role after the sudden and sad passing of Ian Pickering. Peter continues to play a prominent role on the Board in his role as Deputy Chair of the Board.

Effective corporate governance remains a high priority for the Board. The Financial Reporting Council (FRC) published its new UK Corporate Governance Code (the Code) in 2018. The new Code represents a major change in corporate governance and sets higher standards in order to promote transparency and integrity in business. This includes a need to foster positive relationships with wider stakeholders as well as having a clear purpose and strategy aligned with a healthy corporate culture. The Society's governance arrangements will evolve in 2019 to ensure compliance with the new Code from 1 January 2019 and we will report on this in the 2019 Annual Report & Accounts.

We are focused on the Society's mission and our role: leading and managing the Society in a safe, secure and sustainable way. Our 'CARES' values and commitment to Putting Members First inform the Board's decisions and are at the heart of everything we do. Our strategy in 2018 reflects changing technology, market and customer behavioural trends including the Society's change programmes as well as planning for economic uncertainty including the impact of Brexit. The Society will continue to focus on these areas in 2019.

The Board's efforts to secure a pipeline of non-executive talent to enable the progressive refreshing of the Board will continue. This recognises the importance of having a blend of skills, experience and knowledge on the Board. More information on the Society's succession planning for non-executive roles is in the report of the Nominations and Governance Committee.

This year, the Board welcomed Iraj Amiri and Martin Stewart as non-executive directors as well as myself. We will stand for election at the 2019 Annual General Meeting (AGM). In 2018, Ian Geden stepped down from the Board and Roger Burnell will retire with effect from the 2019 AGM, both after many years of service. The Board and I would like to thank them for their dedication and support.

The Board believes diverse leadership is a recipe for balanced decision making. All Society recruitment, including Board appointments, is carried out in line with the Society's approach to diversity and inclusion. Improving gender balance is an important part of this. Today, women represent 27% of the Board's membership and 36% of the executive. The target, by the end of 2019, is for one third of the roles on the Board to be occupied by women.

The Board is supportive of increasing the proportion of female directors and, in line with the Hampton-Alexander Review, intend to increase female representation on the Board to 50% over time.

Gary Hoffman
Chair of the Board

28 February 2019

Report on Corporate Governance

This report describes the role of the Board of Directors and its Committees, and the Society's governance arrangements. It also provides disclosures required under the Code.

UK Corporate Governance Code

The Society is committed to effective corporate governance and seeks to apply the Principles and Provisions of the Code to the extent that it is appropriate given the Society's legal form and mutual ownership structure. It was not, for instance, possible to comply with provisions relating to dialogue with 'major shareholders' due to the Society's mutual status and 'one member, one vote' principle. The Society is committed to maintaining a dialogue with its members and details of engagement activities are included in the Member relations section below.

The Board

The Board sets the overall direction and management of the Society. It is responsible for the long-term success of the Society and the directors collectively have a general duty to ensure that the Society acts in accordance with its Rules and all applicable laws and regulations.

The Board's responsibilities

- Setting the culture and values of the Society.
- Approving the Strategic Plan of the Society and its subsidiaries, monitoring performance, and assessing progress against the Strategic Plan.
- Setting the Society's risk appetite, and agreeing the principal risks faced by the Society.
- Ensuring the Society has adequate capital, liquidity and funding.
- Ensuring adequate Board and executive succession planning and approving key appointments.
- Approving significant projects and contracts.
- Approving the Society's Remuneration Policy.
- Approving significant member communications, such as the Annual Report & Accounts, and overseeing member engagement.

Activities during 2018

Notably, the Board:

- Reviewed and agreed the Society's long-term strategy.
- Received and constructively challenged Assurance Reports from the Chief Executive and other executive directors on the Society's performance, including financial performance, external developments relevant to the Society and other significant matters.
- Approved the Society's internal capital and liquidity assessments after critical reviews by the Board Risk Committee.
- Reviewed and set its risk appetite, considered the principal risks faced by the Society and approved the Society's Enterprise Risk Management Framework.
- Approved the Society's Recovery Plan after review by the Board Risk Committee.
- Approved the publication of the Annual Report & Accounts and risk disclosures, and the Interim Financial Report.
- Considered the Society's culture, member experience and service, and how this aligned with the Strategic Plan.
- Approved and monitored the progress of programmes to upgrade the Society's IT infrastructure.
- Reviewed the Society's compliance with regulatory and legal provisions relevant to moving services to the cloud.
- Monitored progress towards the delivery of the People Vision, including diversity, wellbeing and employee engagement.
- Considered feedback from the Employee Opinion Survey and the Employee Forum.
- Reviewed and approved a number of policies including the Board's lending, health and safety and treasury credit limits.
- Received a report by and updates from the Money Laundering Reporting Officer.
- Considered a report on whistleblowing and determined that the Society's arrangements for enabling employees to speak up had worked effectively, after review by the Board Audit Committee.
- Critically reviewed reverse stress testing scenarios which could adversely affect viability and received assurance on the effectiveness of risk management arrangements.
- Considered recommendations from the Board Audit Committee on appointment of the next external auditor and approved the appointment of PricewaterhouseCoopers LLP as auditor from 2019, subject to member approval at the Society's AGM.

Delegation of authority

The Board spends its time on the most significant matters and delegates other matters to its Committees or to the Chief Executive. This allocation of responsibility makes best use of the knowledge, skills and experience on the Board. The Board has documented this arrangement and reviews it annually.

The Board has five Committees: Board Audit Committee, Board Risk Committee, Nominations and Governance Committee, Non-executive Directors' Remuneration Committee and Remuneration Committee. They are chaired by and comprise members who are non-executive, except the Non-executive Directors' Remuneration Committee which is chaired by the Chief Executive and includes the Chief Financial Officer.

The Board ensures oversight of its Committees by receiving a report detailing key matters discussed from the Committee Chairs following each meeting. Each Committee carries out a review of its own effectiveness annually, including an assessment of its compliance with its terms of reference, published guidance and best practice. All Board Committees were confirmed as effective during 2018.

Terms of reference for all the Board Committees are reviewed annually and can be found on the Society's website, and are available from the General Counsel and Secretary.

Board of Directors

Brief biographies of the directors are included in the Board of Directors section. Details of those seeking election/re-election can be found in the Notice of the 2019 AGM.

The Society's Rules require that the Board comprises between six and 12 directors. There are currently 11 directors: the Chair of the Board, six independent non-executive directors and four executive directors. Under the Code at least half of the directors, excluding the Chair of the Board, should be non-executive.

Changes to the Board during 2018 are as follows:

Gary Hoffman	Chair of Board	Appointment
Martin Stewart	Non-executive Director	Appointment
Iraj Amiri	Non-executive Director	Appointment
Ian Geden	Non-executive Director	Resignation

Independence

The Board has reviewed the independence of its non-executive directors. In line with the Code, it considered whether there were any relationships or circumstances that were likely to affect, or could appear to affect, a director's independence. Under the Code, one of the factors to be considered is length of service longer than nine years and, in April 2019, Roger Burnell will have served more than nine years since he was first appointed to the Board in September 2008. Roger continued in his role as Senior Independent Director in order to facilitate the succession planning process but will retire at the 2019 AGM.

In the opinion of the Board, Peter Ayliffe, Roger Burnell, Catherine Doran, Jo Kenrick, Iraj Amiri and Martin Stewart satisfy the requirements for independence and have demonstrated this in their character and judgement. The Board considered Gary Hoffman was independent when appointed as Chair of the Board on 26 April 2018. Letters of appointment for the non-executive directors are available from the General Counsel and Secretary on request. Details of the directors' external appointments are in the Annual Business Statement.

Time commitment

Non-executive directors are not required to devote the whole of their time to the Society's affairs but must devote sufficient time to properly discharge their duties and regulatory obligations.

Independent advice and insurance

All directors have access to the advice and support of the General Counsel and Secretary. The Access to Independent Advice Policy enables the directors to seek external professional advice at the Society's expense. The Society's Rules indemnify directors against wrongful or negligent acts and insurance has been arranged for directors and officers as permitted under the Building Societies Act 1986.

Chair of the Board and Chief Executive

The positions of Chair of the Board and Chief Executive are held by different directors and are distinct in their purpose. This meets with accepted good practice, including the Code, and the requirements of the Bank of England's Senior Managers Regime. The Chair is responsible for leading the Board and ensuring that it is effective. The Chief Executive has overall responsibility for managing the Society and implementing the strategies and policies agreed by the Board.

Deputy Chair

The principal role of the Deputy Chair is to deputise for the Chair of the Board at meetings of the Board and to support the Chair of the Board in his role. Peter Ayliffe has served as Deputy Chair of the Board since the appointment of Gary Hoffman. In addition, the Deputy Chair has specific responsibility to represent the interests of the Society's employees to the Board.

Senior Independent Director

The role of the Senior Independent Director is to provide a sounding board for the Chair of the Board and a means for the other directors to voice any concerns to the Chair of the Board and oversee the induction of the Chair of the Board.

In conjunction with the other directors, the Senior Independent Director evaluates the performance of the Chair of the Board and leads succession planning for the role of the Chair of the Board. Roger Burnell has been the Senior Independent Director since April 2016 and will step down from this role when he retires from the Board at the 2019 AGM. A member of the current Board will be appointed as Senior Independent Director in April 2019.

Training and development

New directors receive formal induction training on joining the Board. The training is tailored to the needs of each director given their existing knowledge and experience, and any Committees on which they will serve. Training covers key aspects of the Society's business. Established directors must continue their professional development and maintain their knowledge of the Society's operations, including branch and department visits.

During the year the directors received training on subjects structured around Board and Board Committee meetings, to ensure current awareness and informed decision making including:

- Cyber security.
- Cloud computing.
- Regulatory updates.
- Model risk.
- Operational resilience.
- Financial control risks arising from technological change.

The Board's ongoing training and development needs are reviewed by the Nominations and Governance Committee in line with the Board Training Policy.

Board and Board Committee attendance 2018

The attendance record for Board members is shown in the table below. The table shows the actual number of meetings attended with the number of meetings for which the directors were eligible to attend.

Name	Title	Board	Board Risk Committee	Board Audit Committee	Remuneration Committee	Non-executive Director Remuneration Committee	Nominations and Governance Committee
Gary Hoffman[1]	Chair of the Board	7/7			3/3		3/3
Peter Ayliffe[2]	Deputy Chair	11/11	8/8		6/6	1/1	5/5
Iraj Amiri[3]	Non-executive Director	4/4	3/3	3/3			
Roger Burnell[4]	Senior Independent Director	11/11	8/8	6/6			5/5
Andy Deeks	Product, Marketing and Strategy Director	11/11					
Catherine Doran	Non-executive Director	10/11	7/8		6/6		
Michele Faull	Chief Financial Officer	11/11				1/1	
Peter Frost	Chief Operating Officer	10/11					
Ian Geden[5]	Non-executive Director	6/6		2/3	2/2		2/3
Jo Kenrick[6]	Non-executive Director	9/11		6/6	6/6		2/2
Mark Parsons	Chief Executive	11/11				1/1	
Martin Stewart[7]	Non-executive Director	3/4	2/3	2/2			

1. Chair of the Board from 26.04.18 and Chair of Nominations and Governance Committee from 26.06.18.
2. Deputy Chair of the Board from 27.04.18 and Chair of the Board until 26.04.18.
3. Non-executive Director from 28.06.18 and Chair of the Board Audit Committee from 18.09.18.
4. Chair of the Board Risk Committee until 25.09.18 and Chair of the Board Audit Committee until 18.09.18.
5. Served on the Board until 27.06.18. Chair of the Remuneration Committee until 25.04.18 and Deputy Chair of the Board until 26.04.18.
6. Chair of the Remuneration Committee from 26.04.18.
7. Non-executive Director from 01.09.18. Chair of the Board Risk Committee from 25.09.18.

The Board held 11 meetings during 2018. One of these was a specially formed Committee of the Board to sign the Annual Report & Accounts. In addition, the Board held two off-site strategy days, to contribute to the Society's strategic planning process.

Board effectiveness

The Board reviews its performance and that of its Committees annually. The Board's last internal review was in December 2018. Each Board member considered the effectiveness of the Board and its Committees by reference to its terms of reference. The Corporate Governance Code requires boards to undertake an externally facilitated review of effectiveness every three years. The Nominations and Governance Committee chose Independent Audit Limited to undertake this work during December 2018. Independent Audit Limited has no connection with the Society or individual directors of the Society.

The Board and its Committees were determined as operating effectively.

The Chair of the Board appraised the directors' performance. The Chair of the Board's performance review was led by the Senior Independent Director and took into account the views of the rest of the Board. The Board concluded that all directors were fulfilling their duties and responsibilities effectively.

Member relations

A key responsibility of the Board is to ensure it remains accountable to the Society's members. In practice this means ensuring the views of members are understood and taken into account when decisions are made. In 2017, the Society launched the Member Panel, an online community established for sharing feedback with the Society. The Board received regular dedicated updates on the views and experiences of members during the year. These included customer survey results presentations, complaint analysis and Member Panel blogs, together with detailed presentations from the Customer Experience Director. The Board also has regular opportunities to hear customer feedback directly through interaction with research groups, communications with the Member Panel and listening to calls with customers in our contact centres.

All directors attended and were available to answer questions at the Society's 2018 AGM.

All members who are eligible to vote at the 2019 AGM are encouraged to do so by one of the following means:

- Attending in person.
- Sending a proxy to the meeting.
- Voting by post.
- Voting online, or in any branch.

Voting by proxy means members do not vote in person. All resolutions are taken on a poll to enable proxy votes to be counted and the Chair of the Board indicates the level of proxies lodged on each resolution by announcing the numbers for and against the resolution and the number withheld. The proxy voting form explains the status of votes withheld. A separate resolution is proposed on each item, including a resolution to receive the Annual Report & Accounts. The Society employs Electoral Reform Services, a Civica Group company, to act as independent scrutineers and ensure the votes are properly received and recorded.

Culture

One of the main responsibilities of the Board is to set the right culture and values for the Society. The Society's mission, Putting Members First, is as relevant today as it was when the Board endorsed it in 2003.

The Society continues to perform strongly in a range of areas relevant to culture, including customer satisfaction and employee engagement. The Board is confident that the Society's culture delivers good outcomes for members.

Putting Members First is a key principle which underpins the Board's approach to members, its desire for the Society to remain independent and its commitment to mutuality. It is regularly discussed at the Board. The Board has a responsibility to ensure that the culture it considers appropriate for the Society is achieved in practice. It discharges this obligation through various activities, including receiving regular management information which provides insight into culture, consideration of specific agenda items with relevance to culture, and undertaking various activities outside formal Board meetings such as branch and departmental visits, to enhance its understanding of the Society's culture.

Internal controls and risk management

The Society's risks are explained in the Risk Management Report. The Report explains each principal risk category, and provides information on specific risks faced by the Society and what is done to mitigate each risk.

The Board is responsible for the system of internal control, designed to enable the Society to achieve its strategic objectives in a safe, secure and sustainable way. The Board and senior management are committed to maintaining a robust control framework and reviewing its effectiveness at regular intervals. The Board assures itself that its internal control and risk management arrangements are effective through a combination of the following:

- Receiving reports, which are scrutinised by the Board Risk Committee, from the Risk function on the principal risks facing the Society and the adequacy of the controls in place to mitigate such risks. The Chief Risk Officer has an independent reporting line to the Chair of the Board Risk Committee.
- Receiving reports, which are scrutinised by the Board Audit Committee, from the Internal Audit function. The reports outline the results of independent audits of risk management processes and the effectiveness of internal controls across the Society. More information is included in the Board Audit Committee Report. The Chief Internal Auditor reports directly to the Board Audit Committee Chair.
- The Chief Risk Officer carrying out a review of the effectiveness of the Enterprise Risk Management Framework. The conclusions are reported to the Board Risk Committee and subject to review by the Internal Audit function. The Board Audit Committee receives the Internal Audit report.
- The Chief Risk Officer prepares and presents at each meeting of the Board a consolidated risk report. The report comments on current and emerging risks and how they are being managed or mitigated.

The Board confirms that a robust assessment of the principal risks facing the Society has been carried out, including those that would threaten the Society's business model, future performance, solvency or liquidity.

The Board has carried out a review and is satisfied that during 2018, the Society maintained adequate risk management arrangements and systems of internal control given the Society's size and scale, strategy and risk profile.

Nominations and Governance Committee Report

Dear Member

I present to you the report of the Nominations and Governance Committee (the Committee) for the year ended 31 December 2018.

Current membership[1]	Member since
Gary Hoffman[2]	2018
Jo Kenrick	2018
Roger Burnell	2016
Peter Ayliffe[3]	2014

1. Ian Geden was a member until June 2018.
2. Chair from 26.06.2018.
3. Chair until 26.06.2018.

Succession planning and policy

One of the Committee's main roles is to review and make recommendations to the Board on matters relating to the structure, size, composition and ways of working of the Board. This includes Board succession planning, overseeing the appointment of new directors and the appointment of non-executive and executive directors to Board Committees.

The Committee gave particular focus during the year to succession planning and contingency planning. There was continued emphasis on the search for non-executives to fill key Board roles.

For all Board vacancies, the Committee considers the skills, knowledge, experience and diversity of existing members of the Board and the capabilities needed on each occasion. All candidates must have enough time available to devote to the position if appointed.

Diversity

The Society values and promotes diversity and inclusion. The Nominations and Governance Committee and the Board are active sponsors of the Society's inclusion agenda. All recruitment, including Board appointments, is carried out in line with the Society's approach to diversity and inclusion.

The Society works with specialist search advisors in relation to executive and non-executive director appointments, and diversity and inclusion credentials are a key factor in selecting advisors. Active management of shortlisting by the Committee, and the willingness to extend a search in order to find suitably diverse talent, has been important to improving diversity on the Board. In 2018, the Committee used the services of specialist external search advisors, selected for their market expertise as well as their track record of making placements of diverse candidates as follows:

Director		Search firm
Gary Hoffman	Chair of the Board	Zygos
Iraj Amiri	Chair of Board Audit Committee	Zygos
Martin Stewart	Chair of Board Risk Committee	Zygos

Zygos has no connection with the Society or individual directors of the Society.

Governance

The Committee takes an active role in reviewing the effectiveness of the Board and its Committees, reviewing the matters reserved to the Board, considering conflicts of interest, and reviewing governance related policies, including those relating to the Senior Managers Regime (SMR). The Committee oversees the application of the Fit and Proper Policy and other SMR related policies to ensure compliance with this area of regulation.

Key activities in 2018

The Committee:

- Reviewed the Society's Board Succession Plan with particular reference to executive succession and securing a pipeline of non-executive directors.
- Oversaw changes to the Chairs and membership of the Board's Committees, and reviewed the Society's Management Responsibilities Map, before submission to the Board for approval.
- Oversaw the search for a new Chair of the Board and two further non-executive directors to succeed the previous Chair of the Board Risk Committee and Chair of the Board Audit Committee.
- Oversaw the application of the various policies designed to ensure the Society's Board is effective.
- Reviewed the matters reserved for the Board and the Board timetable to ensure matters were considered or delegated appropriately.
- Reviewed directors' proposed external appointments to ensure they did not represent a conflict of interest or exceed the number of permitted directorships or prevent directors devoting sufficient time to the Society.
- Reviewed the roles of the Chair of the Board and Chief Executive.
- Oversaw actions to improve the effectiveness of the Board and its Committees, including coordinating the 2018 effectiveness review, and agreed follow-up actions.
- Received updates on corporate governance developments.
- Reviewed and approved changes to the Society's corporate governance arrangements to take account of the 2018 Code.

Annual election/re-election

Gary Hoffman, Iraj Amiri and Martin Stewart were appointed to the Board during the year and will, for the first time, stand for election at the 2019 AGM.

The Board has considered the provisions of the Code relating to re-election of directors, and considers that it is in the best interests of members to submit the entire Board for annual re-election. This means all directors who were re-elected at the 2018 AGM have voluntarily submitted themselves for re-election, with the exceptions of Ian Geden who resigned during 2018 and Roger Burnell who will retire at the 2019 AGM.

Time commitment

The Committee considers that the directors currently comply with Article 91 of the Capital Requirements Directive, since all directors are able to commit sufficient time to perform their duties at the Society and none of the directors has more than the maximum number of directorships when taking into account the provisions relating to group directorships and non-commercial organisations.

Gary Hoffman
Chair of the Nominations and Governance Committee

28 February 2019

Board Risk Committee

Dear Member

I am pleased to present the Board Risk Committee (the Committee) report, having taken up the position as Chair of the Committee in September 2018. I would like to thank Roger Burnell for his valued contribution as the previous Chair, and for his continued support as a member of the Committee.

The Board Risk Committee is the senior risk committee in the Society. It has delegated authority from the Board and assists the Board in fulfilling its responsibilities for risk management across the Society. Its remit includes the following:

- Reviewing the Society's risk strategy, culture and principles, challenging constructively to ensure a risk culture that is aligned with Putting Members First.
- Evaluating the effectiveness of both the design and completeness of the Society's internal control and assurance framework, including the Enterprise Risk Management Framework.
- Reviewing key risk policies and frameworks, including principal risk appetite statements, and recommending them to the Board for approval.
- Overseeing the management of current and potential risk exposures.
- Overseeing the performance of the Risk and Compliance functions, including their independence.

A summary of the key matters considered by the Committee is set out in this report.

Martin Stewart
Chair of the Board Risk Committee

28 February 2019

Committee membership

The members of the Committee are detailed below.

Current membership	Member since
Martin Stewart[1]	2018
Iraj Amiri	2018
Catherine Doran	2017
Peter Ayliffe	2016
Roger Burnell[2]	2010

1. Chair from 25 September 2018.
2. Chair until 25 September 2018.

At each meeting the Committee considered a detailed consolidated risk report from the Chief Risk Officer. In addition, during 2018 the Committee:

- Reviewed the strategic and emerging risks within the Society's 2019–2023 Strategic Plan.
- Critically reviewed the Society's plan for meeting future capital requirements prior to submission to the Board.
- Reviewed and approved the Society's Recovery Plan.
- Scrutinised internal assessments of capital and liquidity resources, including a range of stress testing scenarios, prior to the Board providing its approval.
- Reviewed risk matters relevant to the Society's IT capabilities.
- Reviewed the Society's Enterprise Risk Management Framework and recommended it for approval by the Board.
- Reviewed the Society's operational resilience and sought assurance as to the effectiveness of IT systems and business continuity arrangements.
- Received reports on changes to lending policy and processes in general to meet with regulatory expectations surrounding portfolio landlords and buy to let mortgages.
- Reviewed the Society's overall risk appetite and the risk appetites for each of the principal risks faced by the Society, including risk limits and tolerances.
- Agreed an integrated risk assurance plan, and monitored second line risk oversight and progress in delivering a programme of thematic reviews.
- Reviewed the Conduct Risk Framework and received assurance from the Chief Risk Officer that employees are risk aware and encouraged to contribute to identifying and managing risks faced by the Society.
- Agreed the approach to evaluating the risks and benefits of data storage options as part of a project to upgrade the Society's IT infrastructure.
- Reviewed assurance reports relating to the Society's strategic investment programmes.
- Critically reviewed treasury credit limits and recommended changes to the Board for approval.
- Reviewed the Financial Crime Policy and received a report from the Money Laundering Reporting Officer.

Please refer to the Risk Management Report for information relating to the Society's principal risk categories and top and emerging risks.

Board Audit Committee Report

Board Audit Committee

Dear Member

I report to you as Chair of the Board Audit Committee (the Committee), a role I was delighted to take up in September 2018. I would like to thank Roger Burnell for his strong leadership as the previous Chair, and for his ongoing contribution as a member of the Committee.

In 2018, we have continued to focus on reviewing and challenging the external financial reporting, scrutinising the effectiveness of internal controls and overseeing the work of Internal Audit.

We have also provided oversight of the tender for a new external auditor during the year. This has resulted in the proposal to appoint PricewaterhouseCoopers LLP as auditor for the 2019 year end, subject to approval at the AGM. More information about the audit tender is included in this report.

The main function of the Committee is to assist the Board in fulfilling its responsibilities with specific regard to:

- Monitoring the integrity of the interim and annual financial statements, summary financial statements and Pillar 3 disclosures, focusing particularly on significant financial reporting judgements, and ensuring the financial statements overall are fair, balanced and understandable.
- Reviewing the adequacy of systems of internal control and the risk management systems.
- Monitoring the external auditor's independence and objectivity, and the effectiveness of the external audit process.
- Overseeing the Society's whistleblowing procedures and policies, assessing their effectiveness and reviewing a report on the effectiveness of whistleblowing procedures on an annual basis prior to submission to the Board.
- Reviewing the activities, findings and performance of Internal Audit.
- Approving the appointment of the Chief Internal Auditor.
- Recommending the appointment and approving the remuneration and terms of engagement of the external auditor.

A summary of the key matters considered by the Committee during the year is set out in this report.

Iraj Amiri
Chair of the Board Audit Committee

28 February 2019

Committee membership

The members of the Committee are detailed below.

Current membership[1]	Member since
Iraj Amiri[2]	2018
Roger Burnell[3]	2013
Jo Kenrick	2017
Martin Stewart	2018

1. Ian Geden was a member of the Committee until 15 May 2018.
2. Chair from 18 September 2018.
3. Chair until 18 September 2018.

The Committee met six times during the year.

The Committee invites the Chief Executive, Chief Financial Officer, Chief Risk Officer, General Counsel and Secretary, Deputy Secretary, Chief Internal Auditor and the external auditor to attend every meeting. Other senior managers are invited to attend meetings as required. Private meetings are held at least twice a year with both the external auditor and, separately, with the Chief Internal Auditor without management present to enable issues to be raised privately if necessary. The Committee Chair also meets privately with the Chief Internal Auditor and the external auditor on a regular basis.

The Board is satisfied that Iraj Amiri has recent and relevant financial services sector experience. He is a professionally qualified accountant.

During 2018, the Committee reviewed its terms of reference, validated its roles and responsibilities and ensured that they comply with the Financial Reporting Council's (FRC) Guidance on Audit Committees. This exercise did not result in any significant changes to the Committee's responsibilities.

Change of external auditor

Audit tender timing

In the 2017 Annual Report & Accounts, the Society confirmed that an external audit tender process would commence during 2018. This has been completed and has resulted in the proposal, subject to member approval at the 2019 AGM, to appoint PricewaterhouseCoopers LLP (PwC) as auditor. This appointment will take effect for the 2019 financial statements.

Due to audit rotation regulations, Ernst & Young LLP (EY) was not invited to tender but will continue as external auditor until the audit of the 2018 financial statements is complete for the Society and its subsidiaries. EY and its predecessor firms have been the Society's auditors since 1930 when first appointed to audit the Coventry Permanent Economic Building Society's accounts, with the last audit re-tender taking place in 2014.

Governance

The overall objective of the audit tender was to select the best auditor across a range of critical success factors which were determined by the Society. The Committee retained responsibility for the tender process and made a recommendation to the Board following evaluation of the tendering firms.

The Committee was supported in the process by an External Audit Tender team which was led by the Chief Financial Officer and included the Chief Internal Auditor and Chief Risk Officer in addition to other senior managers.

Tender process

The tender process was conducted in line with the FRC best practice guidance. Following a market assessment, three firms were invited and submitted tenders. Following initial evaluation by the External Audit Tender team, the Committee endorsed the recommendation that two of these firms be shortlisted. Presentations were made by these two firms to the Committee which was able to recommend both firms to the Board, with PwC identified as the preferred firm. Throughout the process, PwC demonstrated that they would offer effective challenge, insight and also added value. They showed alignment with the Society's values and evidenced in-depth thinking about the transition and management of the audit.

The following critical success factors were used in the evaluation process:

- Industry experience.
- Audit team composition and experience, and access to specialists.
- Audit quality record of the lead partner and firm, including findings by the FRC's Audit Quality Review team.
- Experience of transitioning similar audits and planned transition approach.
- Alignment of values and culture between the firm and the Society.
- Continuity of the audit team, including succession planning for key team members.

A number of other secondary factors were considered, including whether the proposed audit fees provided value for money.

Audit firm and auditor independence was assessed for each firm and, as no independence conflicts were identified, this was not considered as a determining factor.

Transition

The Committee and the Society's management team are working closely with both EY and PwC to ensure a smooth transition during 2019. There are no services which are currently provided to the Society by PwC and any future services will be considered in accordance with the Society's policy for engagement of its auditor for non-audit services.

Key areas of focus during 2018

Significant matters which were considered by the Committee during the year are set out in the following sections.

Preparation of financial statements and key areas of judgement

When assessing both the interim and full year 2018 financial statements, the Committee considered in detail areas subject to management judgement. The areas reviewed included:

Effective Interest Rate (EIR) methodology

The Society recognises interest and fee income using a rate of return that reflects a constant income yield over the expected life of the mortgage loan based on expectations of interest rates at the time of loan origination. This is known as the Effective Interest Rate (EIR). This approach recognises the impact of different interest rates charged over the life of the loan, such as an initial period of fixed interest rates followed by a period of the Society's Standard Variable Rate (SVR). This methodology generally gives rise to an asset on the balance sheet in the early life of a loan that is subsequently amortised. The EIR calculation is most sensitive to assumptions about loan redemption and the difference between fixed rates and SVR in the future.

The Committee reviewed updated assumptions used for 2018, reflecting the latest experience, together with the impact on the EIR asset of higher levels of redemptions and expectations of future SVR rates. The Committee concluded that the basis of calculation and value of the asset was appropriate. Further information can be found in note 3 to the accounts.

Implementation of IFRS 9

The Society implemented IFRS 9 on 1 January 2018. This required changes to its accounting policies for the classification and measurement of financial assets and for the recognition of impairment.

The Committee has reviewed the key judgements regarding classification and measurement, determining a significant increase in credit risk and using alternative economic scenarios to calculate expected losses. It has reviewed the governance and oversight arrangements which have been adopted by management and reviewed the work performed by the external auditor and Internal Audit in relation to IFRS 9 implementation. The Committee has also considered the disclosures made in both the interim and year end financial statements in respect of adopting IFRS 9. The Committee was satisfied that the new reporting standard has been implemented appropriately.

Impairment

The Committee reviewed the impairment provision for loans and advances to customers which has been recognised in the financial statements and the basis for calculating expected credit losses under IFRS 9. This included the method for determining a significant increase in credit risk, and the application of management judgement relating to specific provisions. The sensitivity of the provision calculation to various assumptions was considered, including the impact of forward looking economic scenarios. The Committee was satisfied with the adequacy of the provisions recorded within the financial statements. Further information can be found in the Retail credit risk section of the Risk Management Report and note 13 to the accounts.

Capitalisation of intangible assets

The Committee considered the capitalisation of costs in relation to the Society's ongoing strategic investment programmes and was satisfied that appropriate judgements had been taken in relation to recognition of project costs as intangible assets. More information is included in note 18 to the accounts.

Derivatives and hedge accounting

The Committee reviewed the Society's use of derivatives and its approach to hedge accounting. Derivatives are used solely for risk management purposes, to manage either interest rate risk or foreign exchange risk, and are economically effective. The Committee noted that the Society's application of hedging and hedge accounting strategies had remained unchanged during 2018 and was satisfied that the approach adopted was appropriate. Further information can be found in notes 8 and 24 to the accounts.

Other matters relevant to the accounts

The Committee considered the accounting treatment for the sale of a £351 million buy to let loan portfolio, including the gain on sale and removal of the loans from the Society's balance sheet. Further information on these matters can be found in notes 3 and 11 to the accounts.

Going concern and long-term viability

The Committee evaluated whether adopting the going concern basis of accounting was appropriate and separately considered the Society's longer-term viability, taking account of the principal risks facing the Society, including those that could threaten the Society's business model, future performance, solvency and liquidity.

In particular, the Committee considered the periods over which the Society's prospects and long-term viability should be assessed, along with the basis of these assessments. The Committee concluded that the going concern and long-term viability assessment were appropriate and statements on these matters are included in the Director's Report.

Fair, balanced and understandable

The Committee considered whether the 2018 Annual Report & Accounts were fair, balanced and understandable. The Committee did this by satisfying itself that there was a robust process of review and challenge at different levels within the Society to ensure balance and consistency, which included:

- Issuing guidance to those involved in drafting or reviewing the Annual Report & Accounts.
- Ensuring all key messages are included within the Strategic Report, and that they are communicated in a simple and straightforward manner.
- A thorough internal verification process of the factual content of the reports.
- Central coordination ensuring a sufficient cycle of review and adequate review time at each level within the Society.
- Independent review by a non-specialist.
- Comprehensive review by senior management, executives and the Committee Chair, prior to a meeting of the Committee held to review and consider the Annual Report & Accounts, in advance of the Board's approval.

The Committee also considered other information regarding the Society's performance presented to the Board during the year. After consideration of relevant information, the Committee concluded that it could recommend to the Board that the 2018 Annual Report & Accounts are fair, balanced and understandable.

New accounting standards

Regular updates and training on financial reporting developments were presented to the Committee during the year.

The Committee was updated on the progress of the implementation of IFRS 16 *Leases* accounting standard, which is applicable for reporting periods beginning on or after 1 January 2019. The Committee was satisfied that the new reporting standard is being implemented appropriately.

Further information with respect to financial reporting developments can be found in note 1 to the accounts.

The Society's internal control and risk management arrangements

The Committee reviewed the effectiveness of internal control and risk management arrangements through regular reporting from Internal Audit, the Risk function and the external auditor.

Further information on the Society's approach to internal control and risk management is included in the Risk Management Report.

The Committee received regular reports during 2018 on the application of the Whistleblowing Policy. The Committee also considered an annual report on the operation of these arrangements and a thematic summary of concerns raised during 2018, and concluded that the arrangements were operating effectively and there were no material matters of concern.

The activities of Internal Audit

The role and responsibilities of Internal Audit are set out in Internal Audit's Charter. These were reviewed and revalidated by the Committee during the year and a copy is available on the Society's website (www.coventrybuildingsociety.co.uk/InternalAudit).

The Committee received regular reports from the Chief Internal Auditor setting out the results of assurance activity related to Society operations and strategic change initiatives, progress in delivery of the Internal Audit plan and the adequacy of resources available. Significant findings and thematic issues identified were considered by the Committee, as well as management's response and the tracking and completion of remedial action commitments made in respect of previously issued audit reports.

In addition to approving the Internal Audit annual plan and budget, the Committee reviewed and approved amendments to the plan and resources throughout the year.

During the year, the Committee received a report from the Chief Internal Auditor detailing the results of a self-assessment of Internal Audit effectiveness. The report considered conclusions drawn from an evaluation against Internal Audit professional standards, internal quality assurance processes and stakeholder surveys. The Committee was satisfied that the Internal Audit function remains effective.

In accordance with Chartered Institute of Internal Auditors guidance, an external assessment of the effectiveness of the Internal Audit function is required at least every five years. This review was last performed during 2014. An appropriate independent assessor has been selected and the effectiveness assessment is expected to be completed during 2019 in line with the guidelines.

External auditor

As well as discussing the views of the external audit firm on the results of its audit work, the Committee is responsible for oversight of the relationship with the firm and the quality of the audit process. During the year this included the following:

Audit plan

Prior to the annual audit commencing, the Committee considered a report presented by the external auditor, Ernst & Young LLP (EY), which set out the audit plan, planning materiality, areas of audit focus, terms of engagement and fees payable for the audit. Following the review of the 2018 Interim Financial Report and audit of the annual financial statements, the Committee received a report setting out: the work performed in areas of significant risk and management judgement and conclusions for each area; a summary of adjustments identified; and internal control related issues. In recommending for approval the interim and annual financial statements the Committee considered the matters set out in these reports.

Audit quality

The Committee maintains oversight of external audit quality. Consideration at all Committee meetings is given to factors which impact on external audit quality, with conclusions on external audit effectiveness being formalised as part of the year end reporting process. The factors considered included, but were not limited to:

- The technical skills and industry experience of the audit engagement partner and wider audit team.
- The appropriateness of the proposed audit plan, the identification of significant risk areas and the effective performance of the audit in line with the agreed plan.
- The quality of communication between the external auditor and the Committee, and the effectiveness of interaction between management and the external auditor.
- The quality of reports to the Committee on accounting matters, governance and internal control.
- The reputation and standing of the external auditor.
- The independence and objectivity of the external auditor.

The review also considered the FRC's June 2018 Audit Quality Inspection Report on EY. The Committee concluded that the external audit process was effective, and it was satisfied that there were no matters of concern with respect to the external auditor's independence or objectivity. The results of the assessment were shared with the lead audit partner so that areas for improvement could be addressed.

The appointment of the external audit firm to undertake non-audit services

The Committee regularly reviews and monitors the Society's relationship with the external auditor to ensure that auditor independence and objectivity is maintained at all times. The Committee has developed a policy and framework which defines the approach to non-audit engagements. At no time does the external auditor audit its own work, make management decisions for the Society, create a conflict of interest or find itself in the role of advocate for the Society. The Committee keeps non-audit engagements under review and receives regular reports from the external audit partner confirming that adequate safeguards for independence remain in place.

During 2018, the Society engaged the external audit firm to provide certain non-audit services including a review of the Society's Pillar 3 disclosures, and assurance work in relation to the Society's debt issuances. All engagements complied with the Society's policy. The Committee received regular updates on the nature and cost of the engagements.

Details of the fees paid to the external auditor for audit and non-audit services are set out in note 9 to the accounts.

The effectiveness of the Committee

The Committee carried out a review of its effectiveness during 2018, including an assessment of its work against its terms of reference, published guidance and best practice. The review was facilitated by the General Counsel and Secretary and considered questionnaires which were completed by both Committee members and regular attendees. The review concluded that the Committee had operated effectively throughout the year.

Governance

Directors' Remuneration Report

Dear Member

I am pleased to present the Remuneration Committee's annual report for 2018. I would like to start by thanking Ian Geden, who Chaired the Remuneration Committee from January 2016 to April 2018 and always brought his passion for Mutual values to this role. I am delighted to take over as Chair.

The Committee's work

The Remuneration Committee assists the Board in fulfilling its responsibilities to the Society's members by ensuring that remuneration policy and practices are appropriate. The Committee recognises the importance of aligning the approach taken to remuneration with the Society's mission, purpose and values. All decisions are therefore taken in this context. This means that reward needs to be fair, balancing the need to run a cost-effective Society with the need to attract and retain necessary expertise. There is also a clear link to corporate and individual performance and ensuring we meet statutory and regulatory requirements.

The Committee considers the remuneration policy and its application to all employees, with particular scrutiny given to the remuneration of executive directors and executive managers.

The Committee consists of three independent non-executive directors (Jo Kenrick, Peter Ayliffe and Catherine Doran) and the Chair of the Board (Gary Hoffman).

During 2018, the Committee:

- Considered the outturn of the 2017 balanced scorecard and approved the measures for the 2018 scorecard.
- Approved variable pay awards under the 2017 Executive Variable Pay Plan (ExVPP), ensuring awards were in line with the Society's remuneration policy.
- Approved the 2017 Success Share scheme payment to all employees.
- Endorsed the Society's remuneration policy, including a restatement of the principles that ensure the same pay approach for executive directors and employees.
- Approved the Society' salary review approach.
- Received a report from the Chief Risk Officer that gave assurance that the Society's remuneration framework had not encouraged excessive risk taking.
- Considered the Chief Risk Officer's annual review of whether there had been grounds to recover or withhold variable pay awards.
- Oversaw an assessment of employees whose responsibilities could impact the Society's risk profile.
- Reviewed and approved the Society's Prudential Regulation Authority (PRA) Remuneration Policy Statement.
- Reviewed and approved the Directors' Remuneration Report.

The Committee also undertook the following activities in 2018:

- Developed a dashboard to provide an overview of remuneration and its alignment with culture and values.
- Agreed the principles and provided oversight for a review of the Society's reward strategy affecting all employees.
- Received a regulatory update from the Committee's advisors.
- Considered the Society's gender pay ratios, committed to future diversity and inclusion actions and determined to sign up to the Women in Finance Charter.
- Considered the impacts of the UK Corporate Governance Code, effective from 1 January 2019, and the Companies (Miscellaneous Reporting) Regulations 2018 which include CEO pay ratios.
- Revised the Committee's terms of reference to ensure compliance with the UK Corporate Governance Code (the Code).

Content of this report

In line with our policy of transparency and openness, the Society has prepared this report which is in line with legislation applicable to quoted companies even though it is not required by regulation to do so. The report presents a summary of the Society's Remuneration Policy, and explains how the Committee intends to apply the Policy in relation to the 2018 and 2019 performance years.

Involving members

The Annual Remuneration Report is submitted to a vote of you, the members, annually at the Annual General Meeting. In addition, the Remuneration Policy is submitted to an advisory vote by members every three years, with the next vote in 2020. These voting arrangements are advisory and the directors' remuneration is not conditional upon them. Regardless of this the Committee intends to take account of members' feedback.

I am confident the Committee is well placed to continue to fulfil its responsibilities to members, regulators and to the Society's employees.

Jo Kenrick
Chair of the Remuneration Committee

28 February 2019

Remuneration Policy Summary

The Remuneration Policy approved by members at the 2017 AGM remains in force and is summarised below. The full Policy can be found at www.coventrybuildingsociety.co.uk and applies to all employees. This report deals with the Policy specifically as it applies to executive directors and executive managers.

The Society's Remuneration Policy is designed to ensure remuneration rewards executive directors for their responsibilities, performance and experience, whilst recognising that cost-efficiency is a key part of the Society's strategy. The Policy aids the recruitment, retention and motivation of high calibre individuals to lead and direct the Society to deliver improved performance and long-term sustainability for the benefit of our members.

The Remuneration Policy is aligned with the mission, purpose, strategy, objectives, values and long-term interests of the Society and with the PRA's Remuneration Code. The Remuneration Policy is consistent with the overall financial stability of the Society, promotes sound and effective risk management and does not encourage excessive risk taking. The key components of the Policy and how they are applied to executive directors and executive managers are summarised below:

	Element	Operation	Potential value
Fixed remuneration	Base salary	Reviewed annually, taking into account market data, individual experience and performance and the Society's performance.	Salary increases are assessed in exactly the same way as for employees.
	Benefits	Company car or a cash alternative, private fuel, private medical insurance and life insurance, subject to eligibility.	Benefits are provided in line with the market.
	Pension	Eligible to participate in the Society's defined contribution pension plan. Where contributions exceed the annual or lifetime allowance, executive directors are permitted to take a cash alternative in place of contributions.	Pension contribution or cash supplement of 15% of base salary for executive directors and 20% for the Chief Executive.
Variable remuneration	Annual Success Share bonus	Awards reflect the Society's performance across a balanced scorecard of measures. The annual Success Share bonus scheme applies to all Society employees. Awards are made in cash and, for executive directors and executive managers, are subject to deferral and retention as outlined in the Remuneration Report. The scheme is reviewed each year in light of business plans and changes in regulation. The Committee has absolute discretion to adjust or recover awards made to executive directors and executive managers if necessary, as described below for the ExVPP.	If the Society performs in line with its plans, the scheme provides for an award of 10% of base salary. The maximum award of 20% of base salary can only be achieved by exceeding stretching upper targets for all measures. The scheme is assessed in exactly the same way as for employees.
	Executive Variable Pay Plan (ExVPP)	A consistent set of balanced scorecard measures is used to assess performance for both the Success Share and ExVPP. Awards to executive directors and executive managers are made in cash, and are subject to deferral and retention in an equivalent share-like instrument, outlined in the Remuneration Report. The scheme is reviewed each year in light of business plans and changes in regulation. The Committee has absolute discretion to adjust or recover awards if necessary, including withholding vested awards under malus arrangements and recovering payments made under clawback arrangements.	If the Society performs in line with its plans, the ExVPP scheme provides for an award of 30% of salary for executive directors (15% for executive managers). The maximum award (60% of base salary at the date of grant for executive directors and 30% for executive managers) can only be achieved by exceeding stretching upper targets for all measures.

Annual Remuneration Report

This report informs members of the remuneration awarded to both executive and non-executive directors relating to 2018. All remuneration is in accordance with the Remuneration Policy approved by an advisory vote at the AGM in 2017.

The total pay package earned by each executive director in respect of the years ended 31 December 2018 and 2017 are shown below.

Total remuneration earned by each executive director

	Fixed remuneration			Variable remuneration		
Audited information	Base salary £000	Taxable benefit £000	Pension allowance[1] £000	Annual Success Share bonus £000	ExVPP £000	Total
2018						
Mark Parsons	**524**	**18**	**105**	**58**	**158**	**863**
Andy Deeks[2]	**221**	**10**	**33**	**25**	**68**	**357**
Michele Faull	**350**	**10**	**53**	**39**	**106**	**558**
Peter Frost	**285**	**28**	**43**	**32**	**86**	**474**
Total	**1,380**	**66**	**234**	**154**	**418**	**2,252**

	Fixed remuneration			Variable remuneration			
Audited information	Base salary £000	Taxable benefit £000	Pension allowance[1] £000	Annual Success Share bonus £000	ExVPP £000	Legacy LTIP[3] £000	Total £000
2017							
Mark Parsons	509	19	102	62	185	116	993
Andy Deeks[2]	140	7	21	25	76	18	287
Michele Faull[4]	230	7	34	31	93	n/a	395
Peter Frost	276	26	41	33	100	60	536
John Lowe[5]	108	13	16	n/a	n/a	n/a	137
Total	1,263	72	214	151	454	194	2,348

1. Pension allowance includes both contributions to the Group's defined contributory pension scheme and cash payments in lieu of contributions.
2. Andy Deeks' 2017 remuneration comprises base salary and benefits from his appointment to the Board on 27 April 2017 and not for a full year. The Remuneration Committee determined that his salary would move to market rate over time, rather than award a significant increase on appointment. The variable remuneration shown for 2017 is for a full performance year and therefore includes some pre-Board service.
3. The Long Term Incentive Plan (LTIP) is a legacy arrangement which concluded in 2017. The LTIP figure for 2017 is the amount earned in respect of the LTIP award granted in 2015 and based on performance for the three years ended 31 December 2017. The legacy LTIP does not contribute towards the regulatory deferral threshold of £500,000.
4. Michele Faull's 2017 remuneration comprises base salary and benefits from her appointment to the Board on 27 April 2017. The variable remuneration shown for 2017 is from the date of joining the Society (1 April 2017).
5. John Lowe's remuneration comprises all payments made to him in respect of service until 27 April 2017.

The impact of deferral

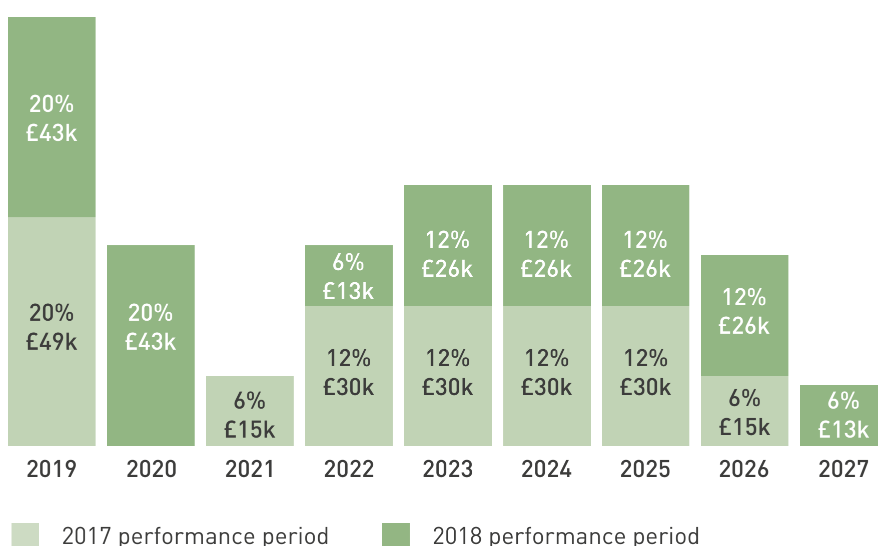
The variable remuneration shown above is subject to regulatory deferral arrangements as described below. For executive directors whose total remuneration is above the regulatory deferral threshold of £500,000, 60% of their total variable pay (annual Success Share bonus and ExVPP) is paid over nine years following the performance period, with 60% of this being paid in the last seven years or the 'extended deferral period'. The percentage which is paid in each year is set out in the table below. For each annual payment, half is made in cash with the other half retained in an equivalent share-like instrument for a further 12 months. The valuation of the equivalent share-like instrument is determined in relation to inflation. The payment is reduced if there has been a material reduction in profit performance or capital strength during the retention period.

Impact of deferral in relation to the 2017 and 2018 performance periods

In 2018, Mark Parsons and Michele Faull are above the regulatory deferral threshold and therefore their variable remuneration will be paid in instalments as set out below. The table shows the percentage of variable remuneration which will be paid in each year.

Variable pay received		2019	2020	2021	2022	2023	2024	2025	2026	2027
2018 performance period	%	20	20	–	6	12	12	12	12	6
2017 performance period	%	20	–	6	12	12	12	12	6	–

The impact of deferral is further illustrated by reference to Mark Parsons' variable pay in the diagram below.



For executive directors below the regulatory deferral threshold only the ExVPP payments are subject to deferral, with 40% of this being paid two years after the performance period. For the annual Success Share bonus and the ExVPP payments, half of the awards are made in cash with the other half retained in an equivalent share-like instrument for a further period of six months.

In 2018, Peter Frost and Andy Deeks are below the regulatory deferral threshold and therefore will be paid 100% of the annual Success Share bonus in 2019 and 60% of the ExVPP amount. The remaining 40% of the ExVPP will be paid in 2021. These payments are also reduced if there has been a material reduction in profit performance or capital strength during the retention period.

Further information on individual remuneration elements: executive directors

Base salary 2018

The annual review of salaries conducted in April 2018 saw a 2% basic increase for all employees and an additional 1.5% of salaries primarily used to progress towards market levels, where appropriate. The executive directors received increases in line with this approach. The table below sets out the current base salary for the executive directors compared with the previous year:

Executive director	2018 £	2017 £	% increase
Mark Parsons	**528,000**	512,946	2.9%
Andy Deeks[1]	**225,000**	210,000	7.1%
Michele Faull	**351,900**	345,000	2.0%
Peter Frost	**287,570**	277,846	3.5%

1. Andy Deeks was appointed to the Board on 27 April 2017. The Remuneration Committee determined that salary would move to market rate over time, rather than award a significant increase on appointment.

Variable pay 2018

The Society delivered a robust performance, given challenging market conditions in 2018. This is reflected in the balanced scorecard of measures which determine variable pay. The Society outperformed against three of the twelve strategic measures, performed in line with seven measures and performed below target in two measures.

Performance against the balanced scorecard measures, which are equally weighted, is summarised below:

Performance measure	Performance relative to target range
Financial:	
Mortgage balance growth	In line
Savings balance growth	In line
Cost to mean asset ratio	Below
Capital ratios:	
Leverage ratio	In line
Common Equity Tier 1 ratio	In line
Risks and projects:	
Mortgage balances in arrears (%)	Above
Liquidity Coverage Ratio	Above
Investment programme delivery	Below
Members:	
Experience Net Promoter Score®[1]	Above
Relationship Net Promoter Score®[1]	In line
People:	
Employee engagement	In line
Community involvement	In line

1. Net Promoter®, Net Promoter Score®, and NPS® are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc. and Fred Reichheld.

Further information on the Society's performance can be found in the Strategic Report. Given the performance outlined, the Committee considered the level of variable awards and determined:

- An annual Success Share bonus for all 2,566 eligible employees, including executive directors, equivalent to 11% of base salary from a potential maximum of 20%.
- An ExVPP award to executive directors equivalent to 30% of base salary from a potential maximum of 60% and to executive managers of 15% of base salary from a potential maximum of 30%. In determining this award, the Committee applied a degree of downward discretion.

This assessment reflects the core technology platform project not progressing as planned and the impact this had on investment programme delivery and costs.

For executive directors and executive managers these awards will be deferred as described on page 85.

The maximum award levels under the variable plans awarded in 2018 are unchanged from 2017.

Benefits and pension 2018

Executive directors received benefits including a fully expensed car or a cash alternative, with private fuel (legacy arrangement not offered to new or recent appointments), personal membership of a private medical insurance scheme and life assurance.

Executive directors were eligible to participate in the Society's defined contribution pension plan which is offered to all employees. The Product, Marketing and Strategy Director is an active member of the defined contribution pension plan and received a pension contribution of 15% of base salary.

The Chief Executive, Chief Financial Officer and Chief Operating Officer received cash alternatives in lieu of pension contributions equivalent to 20% (CEO) and 15% of base salary respectively as they have exceeded the Lifetime Allowance cap.

Remuneration elements in 2019

Base salary 2019

The base salaries for executive directors will be revised from April 2019 in line with the approach outlined in the Remuneration Policy.

Benefits and pension 2019

The Society is currently reviewing benefit and pensions provision for all employees and will consider whether any changes are required to provisions for executive directors following the conclusion of this review.

Variable pay 2019

The 2019 annual Success Share bonus scheme and ExVPP will be reviewed in line with business strategy and the impact of changes to relevant regulation. It is anticipated that there will be no significant changes to variable pay arrangements for 2019. Details of the performance metrics for both variable pay plans will be provided in the 2019 Directors' Remuneration Report.

Change in remuneration of director undertaking the role of Chief Executive

The historical levels of the Chief Executive's variable pay awards as a percentage of the maximum payable are shown below:

	2018 %	2017 %	2016 %	2015 %	2014 %	2013 %	2012 %	2011 %	2010 %	2009 %
Current Chief Executive										
Annual Success Share bonus as a percentage of maximum	**55**	60	70	60	60	–	–	–	–	–
LTIP as a percentage of maximum	**n/a**	63	63	–	–	–	–	–	–	–
ExVPP as a percentage of maximum	**50**	60	65	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Former Chief Executive										
Annual Success Share bonus as a percentage of maximum	**–**	–	–	–	60	70	60	65	55	0
LTIP as a percentage of maximum	**–**	–	–	–	100	100	97	38	38	0

CEO pay ratio

The Companies (Miscellaneous Reporting) Regulations 2018 came into force for accounting periods starting from 1 January 2019 as part of the Government's package of corporate governance reforms. It requires UK quoted companies with more than 250 UK employees to publish their CEO pay ratio figures and supporting information in their annual reports. The regulation requires that the pay ratio figures be calculated using the single total figure of remuneration methodology used above which includes total salary, variable pay, pension benefits and taxable benefits.

The Society has voluntarily elected to publish its CEO pay ratios in advance of the regulations coming into force using the Government's preferred methodology (Option A) which is based on actual full time equivalent pay and benefit values for all employees for the financial year. It is calculated by identifying the median total remuneration as well as the total remuneration at the 25th percentile and 75th percentile points. For 31 December 2018, these were as set out in the table below. In calculating these figures, leavers were excluded but all other employees who started partway through the year or who were on leave for some or all of the year have been included on the basis of a full year's salary.

Remuneration element	25th percentile £	Median £	75th percentile £
Total pay and benefits	24,372	31,591	45,114
Salary	21,509	25,468	37,725

On the basis of these numbers the ratio of CEO pay to employee pay at the median and 25th and 75th percentiles is as follows:

Year	Method	25th percentile	Median	75th percentile
2018	Option A	36:1	27:1	19:1

If the figures were calculated on a pro rata basis for all employees who started partway through the year, or who were on leave for some or all of the year, the median CEO pay ratio would be 29:1.

Relative importance of spend on pay

The following table sets out the changes in profit after tax in 2018 and 2017 and compares these with the overall spend on remuneration over the two years. As a mutual organisation the Society only seeks to retain sufficient profit to maintain capital ratios and allow for investment in the business, returning any surplus above this to members through superior returns on savings accounts. A better measure of the Society's activity is the level of growth in mortgages and savings balances and so the percentage change in total assets has been included to give an appropriate indication of this.

	2018 £m	2017 £m	Percentage change %
Total assets	**46,070.9**	42,572.5	8.2%
Employee remuneration costs	**95.6**	86.2	10.9%
Profit after tax	**156.1**	184.8	(15.5)%

The increase in employee remuneration costs reflects the 3.5% increase in salaries following the annual salary review and a further 7.4% increase from additional headcount to support the growth of the business and investment in our technology and infrastructure.

Material Risk Takers

The disclosures required under the Capital Requirements Regulations (CRR) Part Eight Article 450 in respect of the Society's Material Risk Takers for the performance year ended 31 December 2018 are included in this report. The Society's remuneration policies, practice and governance comply with the Remuneration part of the Prudential Regulation Authority (PRA) Rulebook and the Financial Conduct Authority (FCA) Remuneration Code for dual-regulated firms (SYSC 19D 'the Remuneration Code'). Material Risk Takers are those individuals whose actions have a material impact on the risk profile of the Society, based on criteria set by the European Banking Authority (EBA) and those individuals identified outside the EBA criteria, that the Society has determined have a material impact on the risk profile of the Society.

During the year there were a total of 46 Material Risk Takers. Of these, 19 fall within the senior management category (being the executive and non-executive directors of the Board and executive managers).

The following table shows the remuneration of the Society's Material Risk Takers for the performance year ended 31 December 2018.

Analysis of remuneration by fixed and variable elements

	Senior management	Other Material Risk Takers	Total
Number of Material Risk Takers	19	27	46
Fixed pay (£000)[1]	3,699	2,873	6,572
Variable pay (£000)[2]	921	290	1,211
Total (£000)	4,620	3,163	7,783

1. Fixed pay includes base salary, benefits, pension and severance pay and fees for non-executive directors.
2. Variable pay includes the 2018 annual Success Share bonus and 2018 ExVPP awards.

Total remuneration earned by each non-executive director

Audited information	Base fees 2018 £000	Base fees 2017 £000	Committee Chair and other fees 2018 £000	Committee Chair and other fees 2017 £000	Expense payments 2018 £000	Expense payments 2017 £000	Total fees and expense payments 2018 £000	Total fees and expense payments 2017 £000
Non-executive directors:								
Gary Hoffman Chair of the Board – from 26.04.18	119	–	–	–	–	–	119	–
Ian Pickering Chair of the Board – until 28.09.17	–	109	–	–	–	6	–	115
Peter Ayliffe Deputy Chair of the Board – until 30.09.17 and from 27.04.18 Chair of the Board – from 01.10.17 until 26.04.18	83	73	4	5	3	5	90	83
Janet Ashdown retired 27.04.17	–	16	–	–	–	2	–	18
Iraj Amiri from 28.06.18 Chair of the Board Audit Committee – from 18.09.18	26	–	5	–	5	–	36	–
Roger Burnell Senior Independent Director Chair of the Board Risk Committee – until 25.09.18 Chair of the Board Audit Committee – until 09.05.17 and from 12.12.17 until 18.09.18	50	49	25	28	–	–	75	77
Catherine Doran from 01.08.16	50	49	–	–	4	6	54	55
Ian Geden until 27.06.18 Chair of the Remuneration Committee – until 25.04.18 Deputy Chair of the Board – from 21.11.17 until 26.04.18	24	49	6	12	–	2	30	63
Jo Kenrick from 06.11.17 Chair of the Remuneration Committee – from 26.04.18	50	8	8	–	3	1	61	9
Alasdair Lenman from 01.11.2016 until 28.09.17 Chair of the Board Audit Committee – from 09.05.17 until 28.09.17	–	45	–	8	–	–	–	53
Martin Stewart from 01.09.18 Chair of the Board Risk Committee – from 25.09.18	17	–	5	–	6	–	28	–
Total	419	398	53	53	21	22	493	473

Further information on individual remuneration elements: Non-executive directors' fees

A Non-executive Directors' Remuneration Committee reviews the fees of the non-executive directors annually in light of their responsibilities and with reference to market competitive ranges and recommends to the Board for approval the remuneration of the non-executive directors, other than the Chair of the Board. Recommendations for the remuneration of the Chair of the Board are made by the Remuneration Committee and approved by the full Board without the participation of the Chair. No director takes part in the discussion of his or her own remuneration. The fees for non-executive directors were increased from April 2018 in line with increases applied to all employees. The table below sets out the full year fee levels for non-executive director roles which were in effect during the year. Non-executive director fees are made up of a base fee, plus a Committee Chair fee as appropriate. The Chair of the Board does not receive additional fees for roles carried out other than that of Chair.

Non-executive director fees	2018 £000	2017 £000
Chair of the Board[1]	175	145
Base fee	51	49
Deputy Chair of the Board	7	7
Senior Independent Director (if different from Deputy Chair of the Board)	7	7
Chair of the Remuneration Committee	11	11
Chair of the Board Audit Committee	14	13
Chair of the Board Risk Committee	14	13

1. The increase in fees for the Chair of the Board in 2018 reflects the appointment of a new Chair of the Board and current market rates.

Expense payments

Expense payments are amounts relating to the reimbursement of travel and accommodation expenses in relation to attendance at meetings. Non-executive directors do not participate in any performance related pay or bonus schemes, pension arrangements or other benefits.

Details of the Remuneration Committee

The Remuneration Committee consists of independent non-executive directors and the Chair of the Board. The members of the Committee are:

Current membership	Member since
Jo Kenrick[1]	2017
Gary Hoffman	2018
Peter Ayliffe	2017
Catherine Doran	2016

1. Chair of the Committee since April 2018, replacing Ian Geden who was Chair from January 2016.

The Committee considers regulatory compliance, best practice for remuneration (for example, deferral) and market practice. The Remuneration Committee also considers external data from independent national surveys of the financial services sector and a comparator group of financial institutions to ensure remuneration remains competitive. Any decisions about remuneration reflect the Society's values and align with the approach taken for all employees.

The Committee met six times during the year to consider matters within its remit. The outcomes of the Committee's work are set out in this report.

Remuneration Committee advisors and fees

Deloitte LLP (Deloitte) was appointed by the Committee and is retained to provide independent advice to the Committee as required. Deloitte is a founding member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The Committee is satisfied that the advice received is objective and independent and services provided by Deloitte are reviewed annually to ensure this continues to be the case. Deloitte's fees for providing advice to the Committee amounted to £23,400 (including VAT) for the year ended 31 December 2018.

The CEO, HR Director and Head of Reward attended meetings and provided advice to the Committee as required.

Details of the Non-executive Director Remuneration Committee

The members of the Committee are:

Current membership	Member since
Mark Parsons[1]	2014
Michele Faull	2017
Gary Hoffman	2018

1. Chair of the Committee.

The Committee is responsible for reviewing and recommending to the Board for approval the remuneration of the non-executive directors, other than the Chair of the Board. The Committee met once during the year to conduct the annual remuneration review and carry out other activities within its remit.

Statement of member vote at AGM

At the 2018 AGM, an ordinary resolution (advisory vote) was proposed to members to approve the Annual Remuneration Report for the year ended 31 December 2017 for which the following votes were received:

Annual Remuneration Report	Number of votes	% votes cast
Votes cast for	121,357	92.7%
Votes cast against	9,560	7.3%
Total votes cast	130,917	100%
Votes withheld	2,259	–

Directors' Report

The directors have pleasure in presenting their Annual Report & Accounts for the year ended 31 December 2018.

Business objectives, future developments and key performance indicators

The Society's objectives and future plans are set out in the Strategic Report, together with the Society's principal key performance indicators. The Strategic Report is included by reference within this Directors' Report.

Profit and capital

Profit before tax for the year ended 31 December 2018 was £202 million (2017: £243 million). The profit after tax transferred to the general reserve was £156 million (2017: £185 million).

Total Group reserves and equity at 31 December 2018 were £2,120 million (2017: £1,976 million). Further details on the movements on reserves and equity are given in the Group Statement of Changes in Members' Interests and Equity.

Gross capital at 31 December 2018 was £2,188 million (2017: £2,043 million), including £26 million (2017: £26 million) of subordinated debt, £42 million (2017: £42 million) of subscribed capital and £397 million (2017: £397 million) of Perpetual Capital Securities. The ratio of gross capital as a percentage of savings and borrowings at 31 December 2018 was 5.02% (2017: 5.09%) and the free capital ratio was 4.82% (2017: 4.91%). The Annual Business Statement gives an explanation of these ratios.

Non-financial reporting

Non-financial information relating to the Society's business model and principal risks is set out in Our Business Model. Information relating to engagement with members, colleagues and partners, the environment and our communities is set out in the Corporate Responsibility Report. This includes statements on Human Rights and Modern Slavery and Anti-bribery.

Mortgage arrears

At 31 December 2018, there were 72 mortgage accounts more than 12 months in arrears (including those in possession) (2017: 84). The balance on these accounts totalled £11.7 million (2017: £13.1 million) and the value of these arrears was £0.8 million (2017: £0.8 million) or 0.002% (2017: 0.002%) of total mortgage balances. The mortgage arrears methodology is based on the UK Finance definition, which calculates months in arrears by dividing the arrears balance outstanding by the latest contractual payment.

Charitable and political donations

The Board approved donations of £1.5 million (2017: £1.6 million) to charitable organisations during the year. This included an amount of £1.4 million (2017: £1.5 million) to The Royal British Legion's Poppy Appeal and £70,000 (2017: £70,000) to the Coventry Building Society Charitable Foundation.

No contributions were made for political purposes. However, time allowed for employees to carry out civic duties and political activity can amount to a political donation. The Society supports a small number of employees in this way.

Employees are also supported in volunteering and fundraising in the local community; more information in relation to this is included in the Corporate Responsibility Report.

Creditor payment policy

The Society's policy is to agree the terms of payment at the start of trading with suppliers and to pay in accordance with its contractual and other legal obligations. The Society's creditor days were nine days as at 31 December 2018 (2017: nine days).

Country-by-country reporting

The nature of activities of the Society is set out in the Strategic Report and for each of the Society's subsidiaries in note 17 to the accounts. All of the activities of the Society and its subsidiaries are conducted in the United Kingdom, and therefore 100% of the total income, profit before tax and tax shown in the Income Statement, as well as employee figures disclosed in note 10 to the accounts, are related to the United Kingdom. The Society and its subsidiaries have not received any public subsidies.

Risk management

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market, liquidity and funding, conduct, operational, model and strategic risk. The Group seeks to manage all the risks that arise from its activities and has established a number of Committees and policies to do so. Details of these are set out in the Risk Management Report and the Directors' Report on Corporate Governance.

Employees

Information on employee engagement, development, equality, diversity and inclusion is in the Corporate Responsibility Report and is incorporated by reference into this Directors' Report.

The Society embraces the spirit of the UK Equality Act 2010 and has processes in place to help train, develop and promote employees with disabilities. If someone has a disability the Society makes appropriate adjustments during the recruitment process. Similarly, if someone becomes disabled during their employment, the Society provides support relevant to individual needs. This may include retraining and redeployment within the workforce. Partnerships are also in place with specialist organisations in order to make our workplace more accessible to people with a disability.

Directors' responsibilities in respect of the preparation of the Annual Report & Accounts

The following statement, which should be read in conjunction with the statement of the auditor's responsibilities on page 100, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' Remuneration Report, the Annual Business Statement and this Directors' Report.

The Building Societies Act 1986 (the Act) requires the directors to prepare Group and Society Annual Accounts for each financial year. Under that law, they are required to prepare the Group Annual Accounts in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and applicable law and have elected to prepare the Society Accounts on the same basis.

The Group and Society Annual Accounts are required by law and by accounting standards to present fairly the financial position and the performance of the Group and the Society; the Act provides in relation to such Annual Accounts that references in the relevant part of that Act to Annual Accounts giving a true and fair view are references to their achieving a fair presentation. The Act also requires the Annual Accounts to provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made thereunder.

In preparing each of the Group and Society Annual Accounts, the directors are required to:

- Select suitable accounting policies and apply them consistently.
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- State whether applicable accounting standards have been followed.
- Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Group and Society will continue in business.

In addition to the Annual Accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group.

Directors' responsibilities in respect of accounting records and internal control

The directors are responsible for ensuring that the Group:

- Keeps proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and Society.
- Establishes and maintains systems for control of its business, records, inspection and reports.

The directors have responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors who held office at the date of approval of this Directors' Report confirm that, so far as each of them is aware, there is no relevant audit information of which the Group'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 information and to establish that the Group's auditor is aware of that information.

Directors' statement pursuant to the Disclosure and Transparency Rules

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority, the directors have included a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group. This information is contained principally in the Strategic Report and the Risk Management Report.

The directors confirm that, to the best of each of their knowledge and belief:

- The financial statements, prepared in accordance with IFRS as adopted by the EU, present fairly the assets, liabilities, financial position and profit of the Group and Society.
- The management report contained in the Strategic Report includes a fair review of the development and performance of the business and the position of the Group and Society, and the Risk Management Report includes a description of the principal risks and uncertainties that they face.

Directors' statement pursuant to the UK Corporate Governance Code

As required by the UK Corporate Governance Code, the directors confirm their opinion that the 2018 Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for members to assess the performance, strategy and business model of the Society.

Details of the governance procedures which have been implemented to support this can be found in the Board Audit Committee Report.

Going concern and long-term viability

The directors' responsibilities in respect of going concern are set out below. In addition, compliance with the UK Corporate Governance Code requires the directors to state in a long-term viability statement whether there is a reasonable expectation that the Society will be able to continue in operation and meet its liabilities as they fall due. The period assessed under the long-term viability statement is required to be significantly longer than the minimum period of 12 months over which going concern is assessed.

Directors' responsibilities in respect of going concern

In preparing the financial statements the directors are required to satisfy themselves that it is reasonable for them to conclude that it is appropriate to adopt the going concern basis in accordance with the Financial Reporting Council's 2014 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' and 'Guidance for Directors of Banks on Solvency and Liquidity Risk Management and the Going Concern Basis of Accounting' and IAS 1 *Presentation of Financial Statements*.

The Society's business activities, together with the factors likely to affect its future development, performance, position, liquidity and capital structure, are set out in the Strategic Report. In addition, the Risk Management Report includes further information on the Society's objectives, policies and processes for managing its exposure to credit, market, liquidity and funding, conduct, operational, model and strategic risks, along with details of its financial instruments and hedging activities.

The Group's forecasts and projections, taking account of possible changes in trading performance and funding retention, and including stress testing and scenario analysis, show that the Society will be able to operate at adequate levels of both liquidity and capital for at least the next 12 months with no material uncertainties and that all regulatory requests will be met with an appropriate buffer.

After making enquiries, the directors are therefore satisfied that the Society has adequate resources to continue in business for at least the next 12 months with no material uncertainties and therefore it is appropriate to adopt the going concern basis of accounting in preparing these financial statements.

Long-term viability statement

In addition to the going concern statement, Provision C.2.2 of the UK Corporate Governance Code requires the directors to explain how, taking account of the Society's current position and principal risks, they have assessed the prospects of the Society, over what period they have done so and why they consider the period to be appropriate. The Code also requires the directors to confirm that they believe the Society will be able to continue in operation and meet its liabilities as they fall due over a specified period determined by the directors.

Assessment of prospects

In making this assessment, the directors used a wide range of sources including the Strategic Plan, the Society's business model, principal risks and the risk management framework described within the Risk Management Report to assess the Society's future prospects.

The directors considered the Society's strategy and the key threats to its delivery, including a review of the risk of a disorderly Brexit, which the directors consider has increased in the short-term. The most significant impact is considered to be the potential impact on wholesale funding markets. Mitigating plans are in place and therefore the directors are comfortable this will not have a material impact on the prospects of the Society.

The directors also considered broader risks to the prospects of the Society, including the adequacy of risk management arrangements, performance of the Society against the Board's risk appetite and the risk outlook for the Society.

The directors consider this to be a suitable process to enable them to form a reasonable expectation of the Society's prospects over a five year period. This period was chosen as it aligns with the Society's Strategic Plan and capital and liquidity stress testing exercises.

Viability assessment

The directors have assessed the viability of the Society over the three year period to December 2021. The directors consider a three year period appropriate as it is within the period covered by the Strategic Plan and the stress testing activities undertaken by the Society. In addition, using a period of three years eliminates the inherent uncertainties in the assumptions underpinning the outer years of the Society's Strategic Plan and is in line with market practice.

In making the assessment, the directors considered the financial projections of the Society, including profitability, capital and funding positions and the wide range of stress testing of those projections, to ensure the viability of the Society even in times of severe stress.

The review considered emerging regulation where there is sufficient clarity over future standards to inform the analysis. For example, the assessment of the Society's capital position reflects current understanding of capital buffer and leverage requirements likely to be imposed on the Society, together with the consequences of MREL.

Based upon the assessment set out above, the directors have a reasonable expectation that the Society will continue in operation and meet its liabilities as they fall due over the period to December 2021.

Directors

The directors who served during the year are set out in the Directors' Report on Corporate Governance.

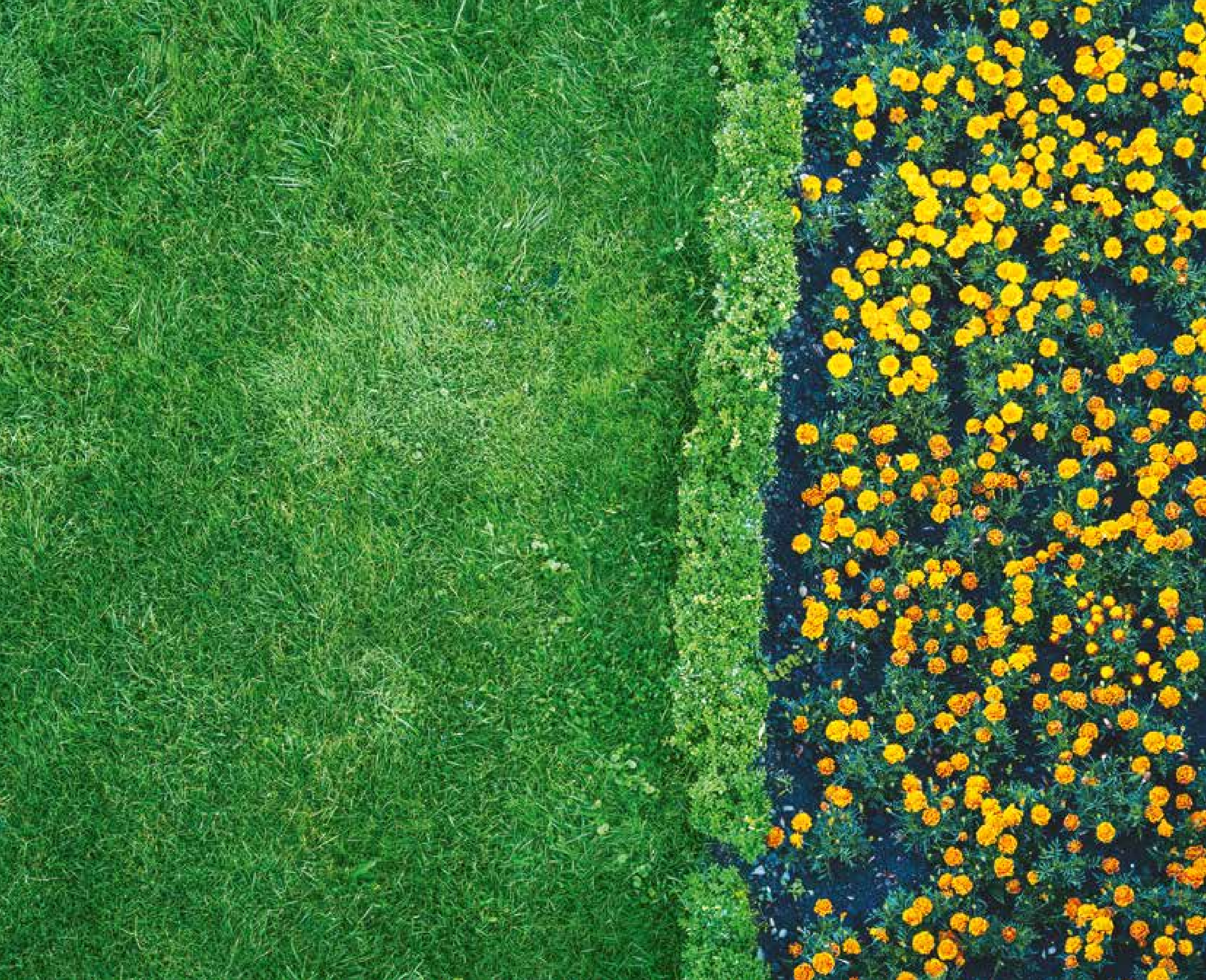
The auditor

A resolution to appoint PricewaterhouseCoopers LLP to replace Ernst & Young LLP as auditor of the Society will be proposed at the 2019 AGM. More information on the audit tender process which has been completed during 2018 is included in the Board Audit Committee Report.

Approved by the Board of directors and signed on its behalf by

Gary Hoffman
Chair of the Board

28 February 2019



Financial Statements

In this section you will find our primary statements and related notes.

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Independent Auditor's Report to the Members of Coventry Building Society

Opinion

In our opinion, the financial statements:

- give a true and fair view, in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2018 and of the Group's and the Society's income and expenditure and for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Coventry Building Society which comprise:

Group	Society
Consolidated Balance Sheet as at 31 December 2018	Balance Sheet as at 31 December 2018
Consolidated Income Statement for the year then ended	Income Statement for the year then ended
Consolidated Statement of Comprehensive Income for the year then ended	Statement of Comprehensive Income for the year then ended
Consolidated Statement of Changes in Members' Interests and Equity for the year then ended	Statement of Changes in Members' Interests and Equity for the year then ended
Consolidated Statement of Cash Flows for the year then ended	Statement of Cash Flows for the year then ended
Related notes 1 to 34 to the financial statements, including a summary of significant accounting policies	Related notes 1 to 34 to the financial statements, including a summary of significant accounting policies
Information in the Risk Management Report, identified as 'audited' on pages 26 to 61	Information in the Risk Management Report, identified as 'audited' on pages 26 to 61

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (FRC) Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to principal risks, going concern and viability statement

The directors have voluntarily complied with the UK Corporate Governance Code (the Code) and Listing Rule 9.8.6(R)(3)(a) of the Financial Conduct Authority (FCA) and provided a statement in relation to going concern, required for companies with a premium listing on the London Stock Exchange.

As a result, we have nothing to report in respect of the following information in the Annual Report, in relation to which the ISAs (UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the Annual Report set out on page 26 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 73 in the Annual Report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 93 in the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;

- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 93 in the Annual Report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Risk of fraud in the revenue recognition relating to Effective Interest Rate (EIR) method. • Measurement of loan impairments relating to retail mortgages.
Audit scope	• We performed an audit of the complete financial information of the Group and Society.
Materiality	• Overall Group materiality of £11.7 million which represents 5% of profit before tax adjusted for one off costs.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters	Our response to the risk	Key observations communicated to the Board Audit Committee
Risk of fraud in the revenue recognition relating to Effective Interest Rate (EIR) method		
Please refer to the Board Audit Committee Report (page 77); Accounting policies (page 110); and Note 3 of the Consolidated Financial Statements (page 118). The EIR method of revenue recognition involves significant Management judgement and complex calculations in both determining the initial EIR and recording the present value of adjustments arising in subsequent periods when cash flows are reforecast. As such, it represents a risk of fraud in revenue recognition and through management override of internal controls. The Society's EIR models are most sensitive to changes in the behavioural life and future interest rate assumptions. Modelled forecast cash flows may be measured incorrectly due to the use of inaccurate or incomplete data, erroneous formulae or inappropriate assumptions being used. Due to the degree of judgement that needs to be exercised by Management around forecast future cash flows; the number of different products the Society has across its loan portfolio and the complexity of calculation, this remains a key audit matter.	After assessing the design effectiveness of key controls for setting and updating EIR assumptions and methodologies, we adopted a substantive audit approach. We validated and challenged assumptions used in the EIR models, including the behavioural lives of assets and the forecasting of future interest rates. We compared customer redemption assumptions with recent customer behaviours observable in the Society's portfolios, and assessed the consistency of forecast interest rates with market derived base rate forecasts and the Society's expectations of future interest margins. We tested the completeness and accuracy of data within these models through agreeing the model data to the Society's source systems and underlying evidence. We tested the accuracy of the EIR calculations by engaging our valuations specialists in the review of model methodology and by recalculating the EIR for a sample of mortgages.	We concluded that the approach taken results in a reasonable estimate in the context of the Society's data, current observable market behaviours and economic conditions. We highlighted that there is subjectivity in the behavioural life and future assumptions. We were satisfied that the assumptions deployed in the EIR model are reasonable in the context of the Society's mortgage portfolios and current market conditions.

Key audit matters	Our response to the risk	Key observations communicated to the Board Audit Committee
Measurement of loan impairments relating to retail mortgages		
From 1 January 2018, IFRS 9 '*Financial Instruments*' replaced IAS 39 '*Financial Instruments: Recognition and Measurement*' and contains new requirements for the classification and measurement of financial assets and liabilities and the recognition of impairment of financial assets. The measurement of the loan impairment provision under IFRS 9 is subjective and requires Management to exercise judgement with regards to estimating future losses that the Society may incur within the retail mortgage book. This includes the application of multiple economic scenarios and key assumptions when calculating expected credit losses. There is also judgement involved in identifying assets that have experienced a significant increase in credit risk since origination (stage 2) and those that are credit impaired (stage 3). Furthermore, there is a risk that financial disclosures do not comply with the requirements of the International Financial Reporting Standards.	We have understood and evaluated the design effectiveness of key controls over the impairment process and adopted a substantive audit approach. For a sample of stage 3 provisions we independently challenged the provision adequacy by assessing the valuation of collateral and verifying assumptions to source documentation. Our substantive audit procedures over the collective IFRS 9 provision models included assessing, challenging and substantiating the key assumptions, such as: definition of default, probability of default (PD), loss given default, significant increases in credit risk and the staging applied, forward looking assumptions and the determination of lifetime PD curves. In order to assess the Society's modelled provisions, we used credit modelling specialists to perform substantive procedures over the model build, perform sensitivity analysis and determine whether any indications of model weakness exist which could reasonably give rise to a material misstatement. We engaged our economic specialists to assess the macro-economic factors considered in the forward-looking assumptions, including the probability weighting applied to each scenario. We also assessed the completeness of model overlays using our knowledge and experience across the banking sector and tested material overlays for reasonableness of estimation. We have assessed whether the financial disclosures are in compliance with the requirements of both IFRS 9 and IFRS 7.	We concluded that the provision levels held in relation to credit impairment were reasonably estimated and in line with the new requirements of IFRS 9. We also concluded that the disclosures relating to retail mortgage loan impairment are in compliance with the requirements of International Financial Reporting Standards. We highlighted the following matters: Based on our validation of the transitional impact of IFRS 9, we concluded that the opening balance sheet position is materially correct. Following our assessment of specifically provided stage 3 provisions we concluded that the estimates of impairment were reasonably estimated. We consider the multiple economic scenarios incorporated in the IFRS 9 models to be reasonable. The IFRS 9 provision models reasonably estimated expected credit losses with immaterial limitations.

In the prior year, our auditor's report included a key audit matter in relation to the fair value and hedge accounting of cross currency swaps. In the current year, we have considered that this has a lower likelihood of material misstatement and as a result had a lesser effect on our audit strategy and on directing the efforts of the engagement team. Our assessment is based on our observations and our understanding that there are a small number of cross currency swaps which are incepted on an infrequent basis. Therefore this area has been addressed in the context of our audit of the financial statements as a whole.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £11.7 million (2017: £16.0 million), which is 5% of profit before tax adjusted for one off costs (2017: 1% of members' interests and equity excluding other equity instruments).

We determined materiality for the Society to be £7.8 million (2017: £11.5 million), which is 5% of profit before tax adjusted for one off costs (2017: 1% of members' interests and equity excluding other equity instruments).

In the current year we challenged our previous measurement basis (being 1% members' reserves, excluding AT 1 capital) and determined that it would be appropriate to adopt an adjusted pre-tax profit basis for the 2018 audit. We consider profit before tax adjusted for one off costs to be an appropriate basis for materiality given the users of the financial statements, including the Society's members and regulators, focus on pre-tax profit in assessing the Society's performance. Pre-tax profit is a consistent basis for calculating materiality across the industry and is considered to be the most appropriate basis for profit making banks and building societies.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2017: 75%) of our planning materiality, namely £8.8 million (2017: £12.0 million). We have set performance materiality at this percentage due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate.

We used a proportion of this value for performing the audit work on the subsidiaries, taking into consideration account size, risk profile, the organisation of the Group and effectiveness of Group-wide controls, changes in the business environment and other factors such as recent Internal Audit results when assessing the level of work to be performed at each entity. The performance materiality set for each subsidiary is based on the relative scale and risk of the subsidiary to the Group as a whole and our assessment of the risk of misstatement at that subsidiary. Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in the financial statements did not exceed our materiality level. Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Board Audit Committee that we would report to them all uncorrected audit differences in excess of £0.6 million (2017: £0.8 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the Annual Report set out on pages 6 to 94, including Performance Highlights, Statement from our Chair, Chief Executive's Review, Our Business Model, Chief Financial Officer's Review, Corporate Responsibility Report, Risk Management Report, Board of Directors, Directors' Report on Corporate Governance, Board Audit Committee Report, Directors' Remuneration Report and the Directors' Report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

The directors have voluntarily complied with the UK Corporate Governance Code (the Code) and prepare a Corporate Governance Statement in accordance with the Disclosure Guidance and Transparency Rules of the FCA.

The directors have requested that we review the parts of the Corporate Governance Statement relating to the Society's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) as if the Society were a premium listed company.

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- fair, balanced and understandable set out on page 79 – the statement given by the directors that they consider the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Board Audit Committee reporting set out on page 77 – the section describing the work of the Board Audit Committee does not appropriately address matters communicated by us to the Board Audit Committee; or
- directors' statement of compliance with the UK Corporate Governance Code set out on page 93 – the parts of the directors' statement required under the Listing Rules relating to the Society's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

- the Annual Business Statement and the Directors Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

- proper accounting records have not been kept by the Group and Society; or
- the Group and Society's financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

Other voluntary reporting matters

Directors' Remuneration Report

The Society voluntarily prepares a Report of the directors on remuneration in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Report of the directors on remuneration specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the Director's Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 92, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are: to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and determined that the most significant were the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures involved inquiries of legal counsel, executive management and internal audit.
- We understood how the Group is complying with those frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Board Risk Committee meetings held; and gained an understanding of the Group's approach to governance, demonstrated by the Board's review of the Group's Enterprise Risk Management Framework (ERMF) and internal control processes.
- We assessed the susceptibility of the Group and Society's financial statements to material misstatement, including how fraud might occur, by considering the entity level controls that the Group has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings.
- The Group operates in the financial services industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- The period of total uninterrupted engagement including previous renewals and reappointments of predecessor firms is 88 years, covering the years ending 31 December 1930 to 31 December 2018.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting the audit.
- The audit opinion is consistent with the additional report to the Board Audit Committee.

Use of our report

This report is made solely to the Society's members, as a body, in accordance with Section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Stephen Littler (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
Manchester

28 February 2019

Notes:
1. The maintenance and integrity of the Coventry Building Society's website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Income Statements

For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Interest receivable and similar income	3	976.3	895.1	893.1	846.1
Interest payable and similar charges	4	(550.5)	(484.1)	(557.9)	(522.2)
Net interest income		425.8	411.0	335.2	323.9
Fees and commissions receivable	5	8.1	9.1	6.3	7.3
Fees and commissions payable	6	(10.4)	(9.1)	(7.6)	(7.1)
Other operating income	7	1.1	5.1	1.1	5.1
Net (losses)/gains from derivatives and hedge accounting	8	(0.3)	(0.3)	3.1	(1.8)
Total income		424.3	415.8	338.1	327.4
Administrative expenses	9	(200.2)	(148.9)	(189.6)	(140.8)
Amortisation of intangible assets	18	(13.7)	(12.3)	(13.7)	(12.3)
Depreciation of property, plant and equipment	19	(7.8)	(6.7)	(7.8)	(6.7)
Impairment credit/(charge) on loans and advances to customers	13	0.4	(0.2)	(0.8)	0.1
Provisions for liabilities and charges	25	–	(3.5)	(0.1)	(3.5)
Charitable donation to Poppy Appeal		(1.4)	(1.5)	(1.4)	(1.5)
Profit before tax		201.6	242.7	124.7	162.7
Taxation	14	(45.5)	(57.9)	(30.9)	(43.0)
Profit for the financial year		156.1	184.8	93.8	119.7

Profit for the financial year arises from continuing operations and is attributable to the members of the Society.

Statements of Comprehensive Income

For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Profit for the financial year		156.1	184.8	93.8	119.7
Other comprehensive income					
Items that will not be transferred to the Income Statement:					
Remeasurement of defined benefit pension plan	20	2.5	14.5	2.5	14.5
Taxation	14	(0.6)	(3.9)	(0.6)	(3.9)
Effect of change in corporation tax rate	14	0.1	0.2	0.1	0.2
Items that may be transferred to the Income Statement:					
Fair value through other comprehensive income investments[1]:					
Fair value movements taken to reserves		(12.4)	(21.6)	(12.4)	(21.6)
Amount transferred to Income Statement		13.4	20.1	13.4	20.1
Taxation	14	(0.2)	0.4	(0.2)	0.4
Effect of change in corporation tax rate	14	–	0.1	–	0.1
Cash flow hedges:					
Fair value movements taken to reserves	24	24.4	(10.9)	0.9	(29.3)
Amount transferred to Income Statement	24	(18.9)	(17.9)	(8.0)	14.2
Taxation	14	(1.5)	7.9	1.8	4.2
Effect of change in corporation tax rate	14	0.1	(0.4)	–	(0.3)
Other comprehensive income for the year, net of tax		6.9	(11.5)	(2.5)	(1.4)
Total comprehensive income for the year, net of tax		163.0	173.3	91.3	118.3

1. Fair value through other comprehensive income reserve relates to assets classified as fair value through other comprehensive income under IFRS 9 from 1 January 2018, in previous reporting periods this represented the Available-for-sale reserve.

The notes on pages 106 to 150 form part of these accounts.

Balance Sheets

As at 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Assets					
Cash and balances with the Bank of England		**5,219.4**	4,995.2	**5,048.6**	4,763.1
Loans and advances to credit institutions		**231.3**	202.0	**231.3**	202.0
Debt securities	15	**951.2**	1,012.3	**951.2**	982.3
Loans and advances to customers	16	**39,264.6**	35,930.9	**24,660.2**	23,064.3
Hedge accounting adjustment		**6.5**	17.2	**6.5**	17.2
Derivative financial instruments	24	**268.9**	306.5	**186.4**	215.2
Investment in equity shares		**3.1**	2.5	**3.1**	2.5
Investment in group undertakings	17	**–**	–	**14,232.6**	12,557.5
Intangible assets	18	**37.2**	40.8	**37.2**	40.8
Property, plant and equipment	19	**48.8**	36.2	**48.8**	36.2
Pension benefit surplus	20	**22.9**	18.5	**22.9**	18.5
Prepayments and accrued income		**17.0**	10.4	**17.0**	10.3
Total assets		**46,070.9**	42,572.5	**45,445.8**	41,909.9
Liabilities					
Shares		**33,281.6**	31,035.7	**33,281.6**	31,035.7
Deposits from banks	22	**5,453.8**	3,499.0	**5,380.7**	3,440.3
Other deposits		**9.5**	4.0	**9.5**	4.0
Amounts owed to other customers		**496.5**	735.5	**588.9**	735.5
Debt securities in issue	23	**4,353.9**	4,888.8	**4,191.5**	4,695.9
Hedge accounting adjustment		**36.5**	76.5	**36.5**	71.0
Derivative financial instruments	24	**167.4**	214.0	**167.4**	214.0
Current tax liabilities		**15.4**	23.2	**8.1**	16.7
Deferred tax liabilities	21	**17.2**	10.3	**13.0**	9.4
Accruals and deferred income		**38.1**	28.0	**32.5**	23.1
Other liabilities		**10.5**	8.7	**10.5**	8.7
Provisions for liabilities and charges	25	**3.0**	5.7	**3.0**	5.5
Subordinated liabilities	26	**25.5**	25.5	**25.5**	25.5
Subscribed capital	27	**41.6**	41.6	**41.6**	41.6
Total liabilities		**43,950.5**	40,596.5	**43,790.3**	40,326.9
Members' interests and equity					
General reserve		**1,693.5**	1,553.1	**1,241.0**	1,163.1
Other equity instruments	28	**396.9**	396.9	**396.9**	396.9
Fair value through other comprehensive income reserve[1]		**5.6**	5.7	**5.6**	5.7
Cash flow hedge reserve		**24.4**	20.3	**12.0**	17.3
Total members' interests and equity		**2,120.4**	1,976.0	**1,655.5**	1,583.0
Total members' interests, liabilities and equity		**46,070.9**	42,572.5	**45,445.8**	41,909.9

1. Fair value through other comprehensive income reserve relates to assets classified as fair value through other comprehensive income under IFRS 9 from 1 January 2018, in previous reporting periods this represented the Available-for-sale reserve.

The notes on pages 106 to 150 form part of these accounts.

Approved by the Board of directors on 28 February 2019 and signed on its behalf by

Gary Hoffman
Chair of the Board

Mark Parsons
Chief Executive

Michele Faull
Chief Financial Officer

Statements of Changes in Members' Interests and Equity

For the year ended 31 December 2018

Group	General reserve £m	Other equity instruments £m	Fair value through other comprehensive income reserve[1] £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2018	1,553.1	396.9	5.7	20.3	1,976.0
Changes on initial application of IFRS 9[2]	1.0	–	(0.9)	–	0.1
Restated position at 1 January 2018	1,554.1	396.9	4.8	20.3	1,976.1
Profit for the financial year	156.1	–	–	–	156.1
Net remeasurement of defined benefit plan	2.0	–	–	–	2.0
Net movement in Fair value through other comprehensive income reserve	–	–	0.8	–	0.8
Net movement in cash flow hedge reserve	–	–	–	4.1	4.1
Total comprehensive income	158.1	–	0.8	4.1	163.0
Distribution to Additional Tier 1 capital holders[3]	(18.7)	–	–	–	(18.7)
As at 31 December 2018	1,693.5	396.9	5.6	24.4	2,120.4
As at 1 January 2017	1,376.1	396.9	6.7	41.6	1,821.3
Profit for the financial year	184.8	–	–	–	184.8
Net remeasurement of defined benefit plan	10.8	–	–	–	10.8
Net movement in Available-for-sale reserve	–	–	(1.0)	–	(1.0)
Net movement in cash flow hedge reserve	–	–	–	(21.3)	(21.3)
Total comprehensive income	195.6	–	(1.0)	(21.3)	173.3
Distribution to Additional Tier 1 capital holders[3]	(18.6)	–	–	–	(18.6)
As at 31 December 2017	1,553.1	396.9	5.7	20.3	1,976.0

1. Fair value through other comprehensive income reserve relates to assets classified as fair value through other comprehensive income under IFRS 9 from 1 January 2018, in previous reporting periods this represented the Available-for-sale reserve.
2. More information on IFRS 9 transition is provided in note 1 to the accounts.
3. The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £6.9 million (2017: £7.0 million).

Society	General reserve £m	Other equity instruments £m	Fair value through other comprehensive income reserve[1] £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2018	1,163.1	396.9	5.7	17.3	1,583.0
Changes on initial application of IFRS 9[2]	0.8	–	(0.9)	–	(0.1)
Restated balance at 1 January 2018	1,163.9	396.9	4.8	17.3	1,582.9
Profit for the financial year	93.8	–	–	–	93.8
Net remeasurement of defined benefit plan	2.0	–	–	–	2.0
Net movement in Fair value through other comprehensive income reserve	–	–	0.8	–	0.8
Net movement in cash flow hedge reserve	–	–	–	(5.3)	(5.3)
Total comprehensive income	95.8	–	0.8	(5.3)	91.3
Distribution to Additional Tier 1 capital holders[3]	(18.7)	–	–	–	(18.7)
As at 31 December 2018	1,241.0	396.9	5.6	12.0	1,655.5
As at 1 January 2017	1,051.2	396.9	6.7	28.5	1,483.3
Profit for the financial year	119.7	–	–	–	119.7
Net remeasurement of defined benefit plan	10.8	–	–	–	10.8
Net movement in Available-for-sale reserve	–	–	(1.0)	–	(1.0)
Net movement in cash flow hedge reserve	–	–	–	(11.2)	(11.2)
Total comprehensive income	130.5	–	(1.0)	(11.2)	118.3
Distribution to Additional Tier 1 capital holders[3]	(18.6)	–	–	–	(18.6)
As at 31 December 2017	1,163.1	396.9	5.7	17.3	1,583.0

1. Fair value through other comprehensive income reserve relates to assets classified as fair value through other comprehensive income under IFRS 9 from 1 January 2018, in previous reporting periods this represented the Available-for-sale reserve.
2. More information on IFRS 9 transition is provided in note 1 to the accounts.
3. The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £6.9 million (2017: £7.0 million).

Statements of Cash Flows

For the year ended 31 December 2018

	Notes	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Cash flows from operating activities					
Profit before tax		201.6	242.7	124.7	162.7
Adjustments for:					
Expected credit loss provisions and other provisions	13, 25	(0.4)	3.7	0.9	3.4
Depreciation and amortisation		21.5	19.0	21.5	19.0
Interest on subordinated liabilities and subscribed capital		6.7	6.7	6.7	6.7
Changes to fair value adjustment of hedged risk		(19.4)	(68.6)	(35.3)	(41.3)
Other non-cash movements		17.1	15.6	17.0	15.8
Non-cash items included in profit before tax		25.5	(23.6)	10.8	3.6
Loans to credit institutions		(69.8)	7.5	(69.8)	7.4
Loans and advances to customers		(3,333.2)	(3,049.1)	(1,596.7)	(1,679.0)
Prepayments, accrued income and other assets		(8.5)	11.8	(8.6)	11.9
Changes in operating assets		(3,411.5)	(3,029.8)	(1,675.1)	(1,659.7)
Shares		2,238.4	2,987.7	2,238.4	2,987.7
Deposits and other borrowings		1,713.7	474.6	1,791.7	465.7
Debt securities in issue		(229.0)	159.6	(229.2)	159.3
Accruals and deferred income and other liabilities		9.2	(8.1)	22.3	8.2
Changes in operating liabilities		3,732.3	3,613.8	3,823.2	3,620.9
Interest paid on subordinated liabilities and subscribed capital		(6.7)	(6.7)	(6.7)	(6.7)
Taxation		(41.6)	(50.0)	(41.6)	(50.2)
Net cash flows from operating activities		499.6	746.4	2,235.3	2,070.6
Cash flows from investing activities					
Purchase of investment securities		(454.2)	(65.2)	(454.2)	(35.2)
Sale and maturity of investment securities and equities		477.1	357.0	447.1	357.0
Proceeds from sale of properties		–	0.2	–	–
Purchase of property, plant and equipment and intangible assets		(31.5)	(28.7)	(31.5)	(28.7)
Net cash flows from investing activities		(8.6)	263.3	(38.6)	293.1
Cash flows from financing activities					
Loans to connected undertakings		–	–	(1,675.1)	(1,374.9)
Distribution paid to Additional Tier 1 capital holders		(25.6)	(25.6)	(25.6)	(25.6)
Repurchase and repayment of debt securities		(780.7)	(479.8)	(750.0)	(441.3)
Issue of debt securities		499.0	1,226.8	499.0	1,226.8
Net cash flows from financing activities		(307.3)	721.4	(1,951.7)	(615.0)
Net increase in cash		183.7	1,731.1	245.0	1,748.7
Cash and cash equivalents at start of year		4,938.6	3,207.5	4,706.5	2,957.8
Cash and cash equivalents at end of year		5,122.3	4,938.6	4,951.5	4,706.5
Cash and cash equivalents:					
Cash and balances with central banks[1]		5,122.3	4,938.6	4,951.5	4,706.5

1. This does not include the mandatory reserve with the Bank of England of £97.1 million (2017: £56.6 million).

The notes on pages 106 to 150 form part of these accounts.

Notes to the accounts

1. Accounting policies

Basis of preparation

These accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union; interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC); and those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to organisations reporting under IFRSs.

The accounts comprise the standalone financial statements of the Society and the consolidated financial statements of the Society, which is referred to as the Group. They have been prepared on an historical cost basis, as modified by the revaluation of fair value through other comprehensive income (FVOCI) debt securities and certain financial instruments which are measured at fair value. As stated in the Directors' Report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts. A summary of the Group's accounting policies is set out within this note.

Basis of consolidation

The assets, liabilities and results of the Society and its consolidated subsidiaries and structured entities are included in the financial statements of the Group.

The Group consolidates another entity from the date on which it: (a) has power over the entity; (b) is exposed to, or has the right to, variable returns from its involvement with the entity; and (c) has the ability to affect those returns through the exercise of its powers. Upon consolidation, intra-group transactions, balances and unrealised gains and losses are eliminated. The Group reassesses whether it controls an entity if facts and circumstances indicate that there are changes in one or more of these three elements. The Group deconsolidates entities from the date that control ceases.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control. In making this judgement, the Group considers factors such as the purpose and design of the entity, size and exposure to variability of returns. and the nature of the relationship, including power over the structured entity.

The Society's investment in its subsidiaries is recognised on the balance sheet at cost less any provision for impairment in value.

Changes in accounting standards

The Group adopted IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* from 1 January 2018. Further information, including IFRS 9 transitional disclosures, is set out below.

IFRS 9 Financial Instruments

IFRS 9 *Financial Instruments* replaces IAS 39 *Financial Instruments: Recognition and Measurement*. It has resulted in changes to accounting policies for the classification, measurement and impairment of financial assets. The revised policies for financial assets and impairment of financial assets are set out later in this note. There are no changes to the classification and measurement of financial liabilities under IFRS 9.

As permitted, the Group has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9. The International Accounting Standards Board (IASB) is currently working on a project for macro hedges, and until this project is complete the Group will continue to use IAS 39 for its entire hedge accounting requirements.

The Group has elected not to restate comparative financial information and is presented in accordance with IAS 39. In addition, any consequential amendments to IFRS 7 *Financial Instruments: Disclosures* have also been applied to the current period only.

The transition to IFRS 9 has resulted in a gain recognised in reserves on 1 January 2018 of £0.1 million. The following table sets out the classification and measurement category of financial assets under IAS 39 and IFRS 9 in addition to the adjustments made to the Group balance sheet on transition to IFRS 9.

	Notes	IAS 39 Classification	IFRS 9 Classification	As at 31 December 2017 £m	Impact of change in classification £m	Impact of change in measurement £m	As at 1 January 2018 £m
Cash and balances with the Bank of England		Loans and receivables	Amortised cost	4,995.2	–	–	4,995.2
Loans and advances to credit institutions		Loans and receivables	Amortised cost	202.0	–	–	202.0
Debt securities (Gilts)		Available-for-sale	FVOCI[1]	1,012.3	(22.0)	–	990.3
Debt securities (MBS, FRNs)	(i)	Available-for-sale	Amortised cost	–	22.0	(1.0)	21.0
Loans and advances to customers	(ii)	Loans and receivables	Amortised cost	35,930.9	–	0.1	35,931.0
Hedge accounting adjustment		Loans and receivables	Amortised cost	17.2	–	1.0[3]	18.2
Derivative financial instruments		FVTPL[2]	FVTPL[2]	306.5	–	–	306.5
Investment in equity shares	(iii)	Available-for-sale	FVTPL[2]	2.5	–	–	2.5
Assets not impacted by the transition to IFRS 9		–	–	105.9	–	–	105.9
Total assets				42,572.5	–	0.1	42,572.6
Total liabilities				40,596.5	–	–	40,596.5
Members' interests and equity							
General reserve	(i), (ii), (iii)			1,553.1	0.9	0.1	1,554.1
Fair value through other comprehensive income reserve	(i), (iii)			5.7	(0.9)	–	4.8
Capital and reserves not impacted by the transition to IFRS 9				417.2	–	–	417.2
Total members' interests and equity				1,976.0	–	0.1	1,976.1
Total members' interests, liabilities and equity				42,572.5	–	0.1	42,572.6

1. Fair value through other comprehensive income.
2. Fair value through profit and loss.
3. On transition to IFRS 9 certain debt securities have been reclassified resulting in a £1.0 million increase in hedge accounting adjustment within assets. This was disclosed in the hedge accounting adjustment within liabilities in the 2018 Interim Financial Report.

(i) Debt securities – previously classified as Available-for-sale under IAS 39

The Group has reassessed the classification and measurement of its debt securities. Certain mortgage backed securities (MBS) and floating rate notes (FRNs) meet the criteria for amortised cost classification following application of the business model tests required by IFRS 9. These assets are held for collecting contractual cash flows and are not routinely sold by the Group. They have therefore been reclassified under IFRS 9. Had these items continued to be included at fair value through other comprehensive income then a gain of £0.4 million would have been recognised in other comprehensive income during the year.

(ii) Loans and advances to customers – previously classified as loans and receivables under IAS 39

Included within loans and advances to customers are £3.5 million of loan notes which the Group had fully provided for within its IAS 39 impairment provision. On transition to IFRS 9, the notes no longer meet business model tests for amortised cost and have been reclassified as fair value through profit and loss. As the notes were already fully provided for, there is no impact on the balance sheet overall, although the impact of the reclassification reduces the Society's impairment provision by £3.5 million as detailed below.

Impairment of loans and advances to customers is £0.1 million lower under IFRS 9 than IAS 39. A fuller explanation of this movement is included in the Risk Management Report.

1. Accounting policies continued

(iii) Investment in equity shares – previously classified as Available-for-sale under IAS 39

The Group's investments in equity shares do not meet the business model test for recognition as fair value through other comprehensive income (FVOCI) under IFRS 9, and no election to treat as FVOCI has been taken. Therefore they have been reclassified as fair value through profit or loss on transition to IFRS 9.

Adjustment to the Group's impairment provision

The adjustments to the Group's impairment provision as a result of the transition from IAS 39 to IFRS 9 are set out in the table below.

Impairment provision	IAS 39 £m	Reclassification[1] £m	Remeasurement £m	IFRS 9 £m
Loans and advances to customers	(17.1)	3.5	0.1	(13.5)
Total impairment	**(17.1)**	**3.5**	**0.1**	**(13.5)**

1. Reclassification of assets which were fully provided for under IAS 39 and therefore do not have a carrying value under IAS 39 or IFRS 9. See note (ii) above for more information.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 *Revenue from Contracts with Customers* replaced IAS 18 *Revenue* on 1 January 2018. The changes in the new revenue standard applied within the year have not had a significant impact on the Group as nearly all of the Group's income is generated from financial instruments which are accounted for under IFRS 9 and therefore do not fall within the scope of IFRS 15.

Future accounting developments

The following changes in financial reporting standards will be relevant to the Group's future reporting but have not been applied in preparing these financial statements as they are not effective as at 31 December 2018:

Pronouncement	Nature of change	Periods beginning on or after
IFRS 16 *Leases*	IFRS 16 requires operating leases to be capitalised on the balance sheet as is currently the case for finance leases. The Group's operating leases relate mainly to its branch network and head office buildings. An implementation project has been established during 2018 and new models and calculations have been prepared for transition. The Society will implement IFRS 16 using a modified retrospective approach with the impact of transition being recognised in reserves on 1 January 2019. The Society has also elected to adopt a number of expedients permissible on transition where appropriate. The new standard is expected to result in the recognition of a lease asset of approximately £30 million and corresponding lease liability. The difference between the asset and the liability will be recognised in reserves and is not expected to be significant. The ongoing impact of IFRS 16 is not expected to be significant to the Society's financial statements.	1 January 2019
Amendments to IAS 12 *Income Taxes*	IAS 12 has been amended to clarify that income tax on Additional Tier 1 instruments must be recognised in the Income Statement. The Society currently recognises this tax in the Statement of Changes in Members' Interests and Equity. Distributions to Additional Tier 1 capital holders will continue to be recognised in equity. This change will not have a significant impact on the Group's financial statements.	1 January 2019

Derecognition of financial assets and liabilities

The Group derecognises financial assets where the right to receive cash flows has expired, or where the assets are transferred with substantially all the risks and rewards of ownership. Where the transfer does not result in the transfer of cash flows, but the Group assumes an obligation to pay the cash flows to the transferee, the financial assets are also derecognised.

Significant judgement – sale of buy to let portfolio

In the year there was one transaction which required significant judgement. The Group completed a whole loan sale of its beneficial interest in a buy to let loan portfolio. Further information on this is provided in note 11.

The Group derecognises financial liabilities when the obligation is discharged, cancelled or has expired.

Securitisation and covered bond transactions

The Group has securitised certain mortgage loans by transferring the loans to structured entities controlled by the Group. The securitisations enable issuance of debt to investors, who gain the security of the underlying assets as collateral. The structured entities are fully consolidated into the Group accounts.

Transfers of mortgage loans to the structured entities are not treated as sales and the loans are not derecognised but remain on the transferor's own balance sheet as it retains substantially all the risks and rewards of the mortgage loans. In the accounts of the transferor, the proceeds received from the transfer of mortgage loans to structured entities are accounted for as a deemed loan from the structured entity and are disclosed within other liabilities on the balance sheet.

For covered bonds, the Society itself and not the structured entity issues the covered bonds and then lends the proceeds to the structured entity on back to back terms. The structured entity then uses these proceeds as consideration for the loans transferred from the Society. In the accounts of the Society, neither the loan to the structured entity nor the consideration for the transfer of mortgage loans are recognised separately as an additional asset and liability. This avoids the 'grossing up' of the financial statements that would otherwise arise.

The Group has also issued debt to be used as collateral for central government schemes or for use in sale and repurchase agreements (repos) and similar transactions. Some or all of the debt issuances may be retained by the Society. Investments in such self-issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Society's financial statements. This avoids the 'grossing up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with its structured entities, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IFRS 9, these internal derivatives are treated as part of the deemed loan and not separately measured at fair value because the relevant mortgage loans are not derecognised. All other derivatives relating to securitisations and covered bonds are explained in the derivatives and hedge accounting policy below.

Sale and repurchase agreements (repos)

Securities sold subject to a commitment to repurchase them are retained on the balance sheet when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately on the balance sheet, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the Effective Interest Rate method.

1. Accounting policies continued

Interest receivable and interest payable

For instruments measured at amortised cost, the Effective Interest Rate (EIR) method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The EIR is the rate that discounts the 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. Interest income on FVOCI debt is also included on an EIR basis.

In calculating the EIR, the Group estimates cash flows considering all contractual terms of the financial instrument. For assets which are in default and assessed as stage 3 under IFRS 9, interest is calculated by applying the EIR to the expected recoverable amount. The EIR calculation includes all fees received and paid and costs borne, and all other premiums above or below market rates.

Fees and commissions

Fees and commissions receivable and payable that are not spread across expected asset lives under the EIR method are taken to income on an accruals basis as the related obligations are satisfied.

Taxation including deferred tax

Corporation tax on the profits for the year comprises current and deferred taxation.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which they can be utilised.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled. Deferred tax assets and liabilities are offset when there is both a legally enforceable right and intention to settle on a net basis.

Corporation tax is charged or credited directly to the Statement of Comprehensive Income if it relates to items that are credited or charged to the Statement of Comprehensive Income, and to the Statements of Changes in Members' Interests and Equity if it relates to other equity instruments. Otherwise corporation tax is recognised in the Income Statement.

Research and development expenditure credits

Research and development expenditure credits are recognised in the balance sheet when receipt is virtually certain. They are released in the Income Statement within administrative expenses in line with the recognition of the underlying cost to which the credit relates.

Segmental reporting

The Group operates solely within the retail financial services sector and within the United Kingdom. As such, no segmental analysis is required.

Financial assets

From 1 January 2018, the Group adopted IFRS 9 and has therefore revised its accounting policy for the classification and measurement of financial assets as set out below. Comparative information continues to be presented under IAS 39 and the relevant accounting policy is set out in the 2017 Annual Report & Accounts.

Financial assets comprise cash and balances with the Bank of England, loans and advances to credit institutions, debt securities, loans and advances to customers, derivative financial instruments and investment in equity shares.

At initial recognition, the Group measures financial assets at their fair value. Subsequently, financial assets are classified in one of the following measurement categories:

- Amortised cost.
- Fair value through other comprehensive income (FVOCI).
- Fair value through profit and loss (FVTPL).

Financial assets are classified based on an assessment of the Group's business model for managing the assets and their contractual cash flow characteristics.

Amortised cost

Financial assets held to collect contractual cash flows and where contractual terms comprise solely payment of principal and interest are classified as amortised cost. This category of financial asset includes cash and balances with the Bank of England, loans and advances to credit institutions, loans and advances to customers and a small portfolio of debt securities.

Financial assets within this category are recognised on either the receipt of cash or deposit of funds into one of the Group's bank accounts, when the funds are advanced to borrowers or, for debt securities on the trade date. After initial recognition, the assets are measured at amortised cost using the EIR method, less provision for expected credit losses.

Assets acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the opening amortised cost for acquired assets. Fair value adjustments are made to reflect both credit risk and interest yield associated with the acquired loan assets. Any discount between the amount due and the fair value is subsequently recognised in interest receivable and similar income using the EIR method.

Significant judgements – classification and measurement of equity release loans

The Group has a £248.4 million (2017: £264.5 million) portfolio of equity release mortgages where the borrower is guaranteed that the amount recoverable at the end of the mortgage will not exceed the value of the property. The Society has not offered new mortgages on this basis since September 2009. The average loan to value of the portfolio is 38% (2017: 36%). The Group has assessed the cash flow characteristics at recognition of each loan within the portfolio to confirm that the IFRS 9 criteria for amortised cost classification are met. The Group has concluded that this is the case as the low loan to value of the portfolio means that the guarantee is a de minimis feature of the product.

Fair value through other comprehensive income (FVOCI)

Financial assets held with the intent of collecting contractual cash flows and selling, where contractual terms comprise solely payment of principal and interest, are classified and measured at FVOCI. This category of financial asset includes most of the Group's debt securities which are held to manage liquidity.

Assets are measured at fair value based on quoted market prices or prices obtained from market intermediaries where available. In cases where quoted market prices are not available, discounted cash flow valuations are used.

Interest on FVOCI assets is recognised in interest receivable and similar income in the Income Statement, using the EIR interest rate method.

Unrealised gains and losses arising from changes in fair value are recognised directly in other comprehensive income, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income Statement. Gains and losses arising on the sale of FVOCI assets, including any cumulative gains or losses previously recognised in other comprehensive income, are recognised in the Income Statement.

1. Accounting policies continued

Fair value through profit and loss (FVTPL)

FVTPL is the default category for financial assets which do not meet the criteria for amortised cost or FVOCI assets. Assets which are classified as FVTPL include derivative financial instruments and investments in equity shares.

These assets are carried at fair value and are initially recognised at the trade date.

Interest income and changes in the fair value of derivatives other than the effective portion of those in cash flow hedge accounting relationships are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy.

Dividends and changes in the fair value of equity instruments are recognised in the Income Statement.

Impairment of financial assets

From 1 January 2018, the Group has adopted IFRS 9 and has revised its accounting policy for impairment of financial assets as set out below. Comparative information continues to be presented under IAS 39 and the relevant accounting policy is set out in the 2017 Annual Report & Accounts.

The Group assesses, on a forward looking basis, the expected credit loss (ECL) associated with its financial assets carried at amortised cost and FVOCI and its mortgage pipeline commitments. Financial assets held at FVTPL are not subject to impairment under IFRS 9.

IFRS 9 requires the Society to categorise its financial assets into one of three stages at the balance sheet date. Assets that are performing are shown in stage 1; assets where there has been a significant increase in credit risk since origination are in stage 2; and assets which are in default are in stage 3. The Society is required to recognise a 12 month expected credit loss allowance on all stage 1 assets and a lifetime expected credit loss allowance on all stage 2 and 3 assets. The Society does not have any purchased or originated credit-impaired financial assets.

Loans and advances to customers

Significant judgement – determining criteria for significant increase in credit risk

The Group considers a loan to have experienced a significant increase in credit risk when one or more of the following qualitative, quantitative or backstop criteria have been met.

Qualitative criteria

The qualitative measures used to allocate a loan to stage 2 are aligned to underwriting and forbearance practices. In some cases, the qualitative measures will be evident before the credit score is impacted and they are therefore lead indicators of a deteriorating credit risk. The most significant qualitative criteria include bankruptcy, cancelled direct debits or poor external credit bureau data which would exceed the Society's underwriting policy at the reporting date, even if the loan is currently performing. Qualitative criteria are monitored and reviewed periodically for appropriateness.

Quantitative criteria

The Group uses internal credit risk gradings that reflect its assessment of the probability of default (PD) of individual counterparties. Given the Society's very low risk loan book, a three grade decrease may still result in a very low PD and the application of the current decline limit ensures that loans below this threshold are regarded as still being of sufficiently high quality that they are allocated to stage 1. The loan will be assessed as stage 2 where there has been a three risk grade decrease and the remaining lifetime PD has doubled since origination, providing that the remaining lifetime PD is also above the Group's current risk appetite decline limit.

Backstop criteria

In addition, a loan is considered to have experienced a significant increase in credit risk if its total arrears are equal to one current monthly repayment amount. Loans subject to this backstop measure will continue to be classified as stage 2 for a period of 12 months (cure period) from the date that the arrears fall below one current monthly repayment. A cure period is not applied to the quantitative and qualitative criteria as the credit score will be adversely affected for some time after the trigger event and to add a further cure period beyond this would overstate the impact on the credit risk of the account.

Default

The Society considers a loan to be in default when the loan is three months or more in arrears i.e. current arrears balances are equal to three or more current monthly repayments. Alternatively, a loan is considered to be in default if the following unlikeliness to pay indicators are present:

- A payment concession has been agreed with the borrower whereby a sum less than the contractual monthly payment is made for a limited period of time.
- Litigation proceedings against the borrower have begun.
- The customer is bankrupt and the account is in arrears.
- The loan is interest only and has gone 12 months past the scheduled term date.
- The property has been taken into possession by the Group.
- A specific provision has been raised indicating a potential issue that may give rise to a loss (e.g. title or boundary issues).

A loan is considered to be no longer in default (i.e. to have been cured) when a consecutive period of 12 months has passed since it met any of the above qualitative and quantitative criteria. The 12 month period has been determined based on an analysis which considers the likelihood of a loan returning to default status after cure using different possible cure definitions.

Inputs, assumptions and estimation techniques

The measurement of expected credit loss reflects:

- An unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes.
- The time value of money.
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Expected credit losses (ECL), being forward looking, are discounted back to the reporting date and are calculated by multiplying the probability of default (PD), exposure at default (EAD) and loss given default (LGD) where:

- The PD represents the likelihood of a borrower defaulting over either the next 12 months or over the remaining lifetime of the mortgage (being the contractual lifetime).
- EAD is the amount the Society expects to be owed at the time of default. The Society does not have any significant revolving commitments where guaranteed further amounts can be drawn down by the borrower.
- LGD represents the Society's expectation of the extent of loss on a default and takes account of available collateral, likely sales cost and potential discount needed to secure a sale.

The Society has based its IFRS 9 ECL calculations on the models used to calculate regulatory expected losses, with the following amendments:

- The IFRS 9 PD is based on a point in time calculation adjusted to take into account estimates of future economic conditions. The regulatory PD is long run and is averaged throughout a full economic cycle.
- The IFRS 9 EAD has been modelled based on expected payments over the term up to the point of default. The regulatory EAD cannot be lower than the current balance.
- The IFRS 9 LGD includes the impact of future economic conditions such as changes in value of collateral and does not include any floors. Only costs associated with obtaining/selling the collateral are included and the discounting of the expected cash flows is performed using the Effective Interest Rate of the loan. The regulatory LGD is based on downturn conditions and includes all collection costs, is subject to regulatory floors and is discounted using a stressed measure of the cost of capital.
- IFRS 9 also requires the use of multiple economic scenarios to calculate a probability weighted forward looking ECL. More information on the forward looking information incorporated in the ECL calculations is included in note 13.

Key assumptions and judgements within the ECL calculations, such as whether the forward looking views remain appropriate or whether staging criteria require adjustment, are monitored and reviewed on a quarterly basis. These modelled ECL provisions may be adjusted by the Society if it considers that they do not adequately reflect known credit risk. These adjustments are in respect of some small loan portfolios where there is insufficient historical data on which to develop models.

1. Accounting policies continued

Since the inception of IFRS 9 on 1 January 2018 there have been no significant changes in estimation techniques used by the Society. The significant assumptions applied as part of IFRS 9 are regularly reviewed and further information can be found in note 13.

ECLs for loans and advances to customers reduce the carrying amount of these assets in the balance sheet and are included in impairment losses in the Income Statement. For mortgage pipeline exposures and undrawn mortgage loan facilities, the provision is included in the expected credit loss provision in the balance sheet.

Calculation of expected credit loss under IFRS 9 – treasury credit risk

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Credit losses on treasury assets are rare for the Group. In accordance with IFRS 9, impairment for treasury credit exposures is calculated taking the exposure value and applying an externally published PD for the credit rating applicable to the exposure. Exposures are monitored by the Treasury Credit Committee, which reviews whether any change in the counterparty credit profile reflects a significant increase in credit risk.

ECLs for treasury assets held at amortised cost reduce the carrying amount of these assets in the balance sheet and are included in impairment losses in the Income Statement. ECLs for debt securities measured at FVOCI do not reduce the carrying amount of these assets which remain at fair value in the balance sheet. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in other comprehensive income as an accumulated impairment amount with a corresponding charge to impairment losses in the Income Statement. The accumulated loss recognised in other comprehensive income is then recycled to the Income Statement upon derecognition of the assets.

Write off policy

The Group writes off financial assets when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery.

Derivative financial instruments

There are no changes to the classification and measurement of derivative financial instruments under IFRS 9. The derivative financial instrument policy set out below is therefore applicable to both the current and comparative periods.

The Group holds derivative financial instruments only to manage the risks associated with its non-variable rate assets and liabilities and its foreign currency transactions and not for speculative or trading purposes.

All external derivative financial instruments are carried at fair value. Derivatives are principally valued by discounting cash flows using yield curves that are based on observable market data. In measuring fair value, separate adjustments are made for credit risk to the extent not already included in the valuation.

Hedge accounting

Although the Group has adopted IFRS 9 from 1 January 2018, it has elected to continue to apply the hedge accounting requirements of IAS 39 until the IASB completes its project on hedge accounting. The hedge accounting policy set out below is therefore applicable to both the current and comparative periods.

Where the documentation, eligibility and testing criteria for hedge accounting set out in IAS 39 are met, the Group uses hedge accounting and designates the hedging derivative as either hedging fair value or cash flow risks.

Fair value hedges

The Group undertakes both individual and portfolio fair value hedge accounting. Changes in the fair value of derivatives that qualify as fair value hedges are recorded in the Income Statement under net gains/losses from derivatives and hedge accounting in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that is attributable to the hedged risk (interest rate risk). This also applies if the hedged item is classified as a fair value though other comprehensive income financial asset.

Cash flow hedges
Gains and losses on derivative financial instruments hedging the variability in cash flows of a designated asset or liability are recognised directly through the Statement of Comprehensive Income in the cash flow hedge reserve. The relevant portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately to the extent that the hedge is deemed ineffective under IAS 39. Any amounts deferred to the cash flow hedge reserve are subsequently recycled to the Income Statement when the underlying asset or liability being hedged impacts the Income Statement, for example when foreign exchange movements occur.

Leases and contract purchase agreements
Where the Group enters into a lease that involves taking substantially all the risks and rewards of ownership of the asset, this is treated as a finance lease and the asset is recorded in the balance sheet and depreciated over its estimated useful life. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life. Future instalments under such leases, net of finance charges, are included within other liabilities. Lease rentals are apportioned between the finance element, which is charged to the Income Statement, and the capital element, which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and payments are charged to administrative expenses on a straight line basis over the period of the lease. Rents receivable are credited to other operating income on a straight line basis over the period of the lease.

Intangible assets
Intangible assets are stated at cost less accumulated amortisation and any impairment. Maintenance costs associated to the operation of these intangibles are charged to the Income Statement as incurred. Amortisation is charged to the Income Statement on a straight line basis over the useful life of the asset commencing from the date the asset is ready for use. The useful life of computer software is reviewed by management at each financial year end and is currently between three and eight years for assets which are currently in use.

Software development costs, both internal and external, and purchased software that is not an integral part of a related hardware purchase are recognised as an intangible asset if it is probable that the asset created will generate future economic benefits. For each significant project undertaken by the Group, an assessment of capitalisation criteria including future economic benefit is performed by the relevant business area and reviewed in accordance with agreed governance processes.

Intangible assets, including assets in the course of construction, are reviewed for impairment at each reporting date or whenever events or changes in circumstances indicate that the carrying amount may exceed the recoverable amount. Where impairment is identified the asset is written down immediately to the estimated recoverable amount and the impairment amount is charged to the Income Statement.

Significant judgements – capitalisation of intangible assets and assessment for impairment
The Group's continuing strategic investment programmes include upgrades to the Society's data infrastructure and core technology platform. Significant judgement is required when assessing whether the conditions of IAS 38 have been met in order to allow the capitalisation of project development costs as intangible assets. Judgement is also required in performing the review for impairment of these assets.

1. Accounting policies continued

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment. The carrying values of property, plant and equipment are reviewed at each reporting date for impairment or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Where this is the case the asset is written down immediately to the estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying value of the asset and are included within the Income Statement.

Depreciation is provided on a straight line basis over the anticipated useful life of the asset which is currently as follows:

Freehold buildings	Over a period of 50 years
Leasehold buildings	Shorter of remaining term of the lease and useful life
Equipment, fixtures, fittings and vehicles	Three to eight years

Employee benefits

Pensions

The Group operates a defined benefit pension scheme and a defined contribution scheme for employees.

Contributions to the defined contribution pension scheme are recognised as an expense in the Income Statement as incurred, on an accruals basis.

The Group's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds. This calculation allows the net obligation of the scheme to be expressed as either a surplus or deficit, which is recognised as either an asset or a liability respectively in the Group's accounts at the balance sheet date.

Gains or losses arising from the remeasurement of the defined benefit plan are recognised in full, in the year they occur, in the Statement of Comprehensive Income.

Other long-term employee benefits

The cost of bonuses payable 12 months or more after the end of the financial years in which they are earned is recognised in the year in which the employees render the related service.

Short-term employee benefits

The cost of short-term employee benefits, including wages and salaries, social security costs, bonuses payable within 12 months and healthcare, is recognised in the year of service.

Financial liabilities

There are no changes to the classification and measurement of financial liabilities under IFRS 9 for the Group. The financial liabilities policy set out below is therefore applicable to both the current and comparative periods.

Financial liabilities include shares, bank and other deposits, amounts owed to other customers, debt securities in issue, derivative financial liabilities, subordinated liabilities and subscribed capital. The Group classifies its financial liabilities into the following categories:

Amortised cost

Financial liabilities, other than derivatives, are measured on an amortised cost basis reflecting their face value adjusted for any unamortised premiums, discounts and transaction costs directly attributable to the acquisition or issue. Amortisation is recognised in interest payable and similar charges at the Effective Interest Rate of the liability.

Fair value through profit or loss

All derivatives are carried at fair value.

Changes in the fair value of derivatives other than those in cash flow hedge accounting relationships are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy above.

For changes in the fair value of derivatives in cash flow hedge accounting relationships, see the hedge accounting policy for cash flow hedges.

Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably. For the Financial Services Compensation Scheme (FSCS) levy, a provision is recognised when the levy is legally enforceable, in accordance with IFRIC 21 *Levies*.

Contingent liabilities are potential obligations from past events which will only be confirmed by future events. Contingent liabilities are not recognised within the balance sheet.

Equity instruments

Financial instruments are classified as equity instruments where the contractual arrangements with the holder do not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity net of the costs directly attributable to the issuance.

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, as a deduction from the general reserve.

Foreign currency translation

The consolidated financial statements are presented in pounds sterling, which is the functional currency of the Group.

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from retranslation and settlement are recognised in the Income Statement.

Cash and cash equivalents

Cash and cash equivalents in the Statement of Cash Flows comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks and loans and advances to credit institutions.

IFRS disclosure

For ease of reference, certain audited IFRS disclosures related to credit, market, and liquidity and funding risks are included within the Risk Management Report.

A maturity analysis for all assets and liabilities is presented in the Liquidity and Funding section of the Risk Management Report.

Audited information is also included within the Directors' Remuneration Report. These disclosures, where marked as 'Audited', are covered by the Independent Auditor's Report.

2. Judgement in applying accounting policies and significant accounting estimates

There are judgements relating to the application of the Group's accounting policies which have had a significant effect on the amounts recognised in the financial statements. The Group has also made significant judgements relating to assumptions and estimates that could affect the reported amount of assets and liabilities both in the accounts and in the following financial years. The most significant judgements and assumptions and estimates are disclosed in the following notes:

Significant accounting policy judgements	Notes
Sale of buy to let loan portfolios	1, 11
Classification and measurement of equity release loans	1
Determining a significant increase in credit risk under IFRS 9	1
Capitalisation of intangible assets and assessment for impairment	1

Significant assumptions and estimates	
Mortgage EIR	3
Expected credit loss provision on loans and advances to customers	13

From 1 January 2018 the assumptions and estimates applied in the application of impairment provisions on loans and advances to customers have changed following the adoption of IFRS 9 to expected credit loss provision.

3. Interest receivable and similar income

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
On loans fully secured on residential property	965.5	958.4	560.1	563.9
On other loans				
Connected undertakings	–	–	323.2	320.5
Foreign currency gain	–	–	10.9	27.0
Other	1.7	1.9	1.2	1.3
	967.2	960.3	895.4	912.7
Interest and other income on debt securities	23.4	30.3	23.4	30.3
Interest and other income on other liquid assets	30.6	9.9	29.8	9.6
Net expense on financial instruments hedging assets	(60.0)	(106.7)	(60.0)	(106.7)
Gain on derecognition of financial assets	14.9	–	4.4	–
Foreign currency gains	0.2	1.3	0.1	0.2
Total	976.3	895.1	893.1	846.1

The £14.9 million gain on derecognition of financial assets relates to the derecognition of a £350.9 million mortgage portfolio and associated derivative financial instruments. For more information see note 11.

In the year ended 31 December 2017, interest receivable on loans fully secured on residential property included £12.6 million from the release of fair value adjustments for credit risk initially made on the merger with Stroud & Swindon Building Society.

Significant assumptions and estimates – Effective Interest Rate (EIR)

The Group recognises interest on loans and advances to customers on the basis of their Effective Interest Rate (EIR). This is a single constant rate that averages out the effect of fixed and variable rates of interest and fees across the expected life of the loan account. Critical assumptions in the EIR calculation are the expected life and the assumed reversion rate at the end of the fixed rate period, as these determine the assumed period over which customers may be paying differentiated interest rates and the amount of those rates. The calculation of the EIR uses assumptions on expected life that are based on the experience of similar products.

These assumptions are monitored to ensure their ongoing appropriateness. Changes in the amortised cost arising from actual product experience, differing from the assumptions, are periodically calculated and an adjustment made to loans and advances to customers, with a corresponding adjustment to the Income Statement. This adjustment reflects changes to income which has been previously been recognised, in addition to changes in expectations of future interest and therefore can introduce significant volatility.

As at 31 December 2018, the EIR method resulted in an asset of £84.2 million (2017: £89.1 million), gross of fees, within loans and advances to customers. This adjustment represented 0.2% (2017: 0.2%) of the balance sheet carrying value of mortgages. The movement in the year of £4.9 million was recognised in the Income Statement.

A significant proportion of the Society's mortgage portfolio includes balances on fixed rate deals. The level of repayment immediately post-maturity of the fixed rate deal is a key sensitivity within the EIR assumptions. Modelling is undertaken to analyse customer behaviour at the end of their fixed rate period and support the assumptions used. If the proportion of customers who redeem their mortgage at the end of their fixed rate deal differs to the estimate, it can have a material impact on the revised future cash flows. To illustrate this, the Society has undertaken sensitivity analysis on post-maturity behaviour. An increase in the redemption rates of loans after the initial fixed rate incentive period of 5% for 12 months would result in a decrease in the balance sheet value of mortgages of £12.7 million, with a corresponding reduction in the Income Statement.

The other key sensitivity within the EIR assumptions is the rate to which the mortgage will revert following the initial fixed rate period, usually the Standard Variable Rate (SVR). The EIR calculation assumes an average SVR rate based on the spread of current SVR to Bank of England Base Rate adjusted for an expected change in base rate over the next five year period. At 31 December, the adjustment for future rates resulted in an assumed SVR 13 basis points higher than the current SVR (2017: 43 basis points). If the actual future base rate, and therefore SVR, differs to the estimate it can also have a material impact on the revised future cash flows. The Society has undertaken sensitivity analysis on the SVR. A decrease of 25 basis points would result in a decrease in the balance sheet value of mortgages of £18.7 million, with a corresponding reduction in the Income Statement.

4. Interest payable and similar charges

	Group 2018 £m	Group 2017 £m	**Society 2018 £m**	Society 2017 £m
Bank and customer				
Subordinated liabilities	**1.8**	1.8	**1.8**	1.8
Other	**33.0**	14.1	**33.2**	14.1
Debt securities in issue	**102.1**	125.4	**98.5**	121.8
Other borrowed funds				
On shares held by individuals	**444.2**	410.4	**444.1**	410.4
On subscribed capital	**4.9**	4.9	**4.9**	4.9
Net income on financial instruments hedging liabilities	**(35.5)**	(73.7)	**(35.5)**	(57.8)
Foreign currency losses	**–**	1.2	**10.9**	27.0
Total	**550.5**	484.1	**557.9**	522.2

5. Fees and commissions receivable

	Group 2018 £m	Group 2017 £m	**Society 2018 £m**	Society 2017 £m
Mortgage related fees	**4.9**	5.2	**3.1**	3.4
General insurance commissions	**1.1**	1.7	**1.1**	1.7
Other fees and commissions	**2.1**	2.2	**2.1**	2.2
Total	**8.1**	9.1	**6.3**	7.3

6. Fees and commissions payable

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Banking fees	**2.8**	2.6	**2.8**	2.6
Other fees and commissions	**7.6**	6.5	**4.8**	4.5
Total	**10.4**	9.1	**7.6**	7.1

7. Other operating income

Operating income of £1.1 million includes the gain on investments in equity shares measured at fair value through profit and loss. The Society holds investments in Visa Inc. and VocaLink Holdings Limited (VocaLink).

In 2017, other operating income of £5.1 million included £5.0 million relating to the gain on completion of the sale of 90% of the Society's equity investment in VocaLink to MasterCard.

8. Net losses/gains from derivatives and hedge accounting

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Derivatives designated as fair value hedges				
Gains on derivatives designated as fair value hedges	**10.6**	100.5	**16.2**	120.9
Movement in fair value of hedged items attributable to hedged risk	**(10.8)**	(103.0)	**(16.3)**	(123.3)
Ineffectiveness on fair value hedges	**(0.2)**	(2.5)	**(0.1)**	(2.4)
Derivatives designated as cash flow hedges[1]				
Foreign exchange	**–**	–	**–**	–
Foreign exchange and interest rate	**(1.0)**	2.1	**–**	1.1
Interest rate	**0.9**	0.1	**0.9**	0.1
Ineffectiveness on cash flow hedges	**(0.1)**	2.2	**0.9**	1.2
Gains/(losses) on other derivatives	**–**	–	**2.3**	(0.6)
Total	**(0.3)**	(0.3)	**3.1**	(1.8)

1. Represents ineffectiveness on cash flow hedge relationships which will mature over a period of six years (2017: seven).

Further information on the Society's risk management strategy and how it hedge accounts interest and foreign exchange risk is in note 24.

Foreign exchange losses of £18.0 million (2017: £61.8 million) have been recognised in the Income Statement relating to the principal amount of financial instruments held at amortised cost. This is offset by £18.0 million (2017: £61.8 million) of foreign exchange gains on derivative financial instruments held at fair value.

9. Administrative expenses

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Employee costs				
Wages and salaries	82.0	73.7	82.0	73.7
Social security costs	8.7	7.7	8.7	7.7
Pension costs				
Defined benefit plan (note 20)	(0.5)	(0.1)	(0.5)	(0.1)
Defined contribution plan	5.4	4.9	5.4	4.9
	95.6	86.2	95.6	86.2
Other expenses				
Loss on disposal of property, plant and equipment and intangibles	0.9	0.7	0.9	0.7
Premises and facilities	13.4	12.6	13.4	12.6
Project costs	49.2	12.6	49.2	12.6
Information systems	12.2	9.6	12.2	9.6
Other	28.9	27.2	18.3	19.1
Total	200.2	148.9	189.6	140.8

Included within employee costs is £5.2 million relating to employee time spent on the Society's strategic investment programmes (2017: £2.8 million).

Included within project costs are the costs of major strategic programmes not capitalised. This includes elements of branch redesign, enhanced data centre capability and the core technology platform upgrade.

The remuneration of the auditor, Ernst & Young LLP, is set out below:

Group and Society	2018 £m	2017 £m
Audit of the annual accounts	0.3	0.2
Audit related assurance services – subsidiary audits	0.1	0.1
Other non-audit services	0.1	0.1
Total	0.5	0.4

The Group's policy in relation to its auditors providing non-audit engagements sets out the services they are generally precluded from performing. Further details are included in the Board Audit Committee Report in the Governance section. All non-audit engagements provided by the Group's auditor are subject to pre-approval by either the Board Audit Committee or the Chief Financial Officer (under delegation from the Board Audit Committee), depending upon the nature of the non-audit engagement.

10. Employee numbers

Group and Society	2018 Full time	2018 Part time	2017 Full time	2017 Part time
The average number of persons employed during the year (including executive directors) was:				
Head office and administrative centres	1,482	435	1,354	405
Branches	311	304	315	301
Total	1,793	739	1,669	706

The average number of employees on a full time equivalent basis was 2,240 (2017: 2,088) and all of these are employed within the United Kingdom.

11. Interest in unconsolidated structured entity

The Group completed a whole loan sale of its beneficial interests in £350.9 million of buy to let mortgages originated by its subsidiary Godiva Mortgages Limited (Godiva) to a third party in June 2018. The Society continues to service this book. The gain on derecognition of the mortgages and associated derivative financial instruments is included in interest receivable and similar income in the Income Statement.

Significant judgement – sale of buy to let loan portfolio

An initial assessment was made to confirm that it was appropriate to derecognise the buy to let mortgages under IFRS 9. Having confirmed this, a further assessment was made to confirm that there was no requirement to consolidate the results of the third party who purchased the loan book under IFRS 10 *Consolidated Financial Statements*.

Derecognition

In order for derecognition of the loan book to occur, the Group has to transfer its rights to receive the cash flows and transfer substantially all risks and rewards associated with them. Although Godiva continues to receive the contractual cash flows it has an obligation to pay these cash flows to the third party.

With regard to risks and rewards, the beneficial interests in the mortgages were sold for cash and neither Godiva nor the Society has any interest in the third party. Godiva will retain any fees relating to further advances and product switches on the mortgages; this income is expected to cover processing costs and procurement fees paid by the Society to brokers. Any loan repurchase commitments are expected to be de minimis and relate to all loans, and would only arise as a result of a breach of representations and warranties which are limited to 12 months from the point of sale.

Taking all of the facts and circumstances into account, the Group has transferred substantially all the risk and rewards of ownership and it is therefore appropriate to derecognise the assets.

Consolidation of the results of the structured entity

The Group is required to consolidate another entity from the date on which the Group: has power over the entity; is exposed to, or has rights to, variable returns from its involvement with the entity; and has the ability to affect those returns through the exercise of its power.

Under the Mortgage Sale Agreement and the Service Agreement, Godiva retains the right to set lending criteria in relation to further advances on the transferred mortgages; to set policies and subsequently amend mortgages in line with these policies; and to set the Standard Variable Rate (SVR). However, in exercising these powers the Group is not exposed to any variable return and therefore does not benefit from the exercise of its discretionary powers. The Society is in receipt of a service provider fee which is set on an arms-length basis and on market standard terms. The Group has therefore concluded that it is acting as agent for the beneficial holders of the loan book and not as a principal acting in its own interests. The purchasing entity is therefore not consolidated in the Group results.

12. Classification and measurement of financial instruments

The following table summarises the classification of carrying amounts of the Group's financial assets and liabilities at the reporting date. A separate Society table is not presented as there are no differences in classification to that of the Group. The Group reassessed the classification of its financial assets and liabilities on 1 January 2018 on transition to IFRS 9. More information relating to this, including classification as at 31 December 2017, is included in note 1.

	31 December 2018			
Group	Amortised cost £m	Fair value through other comprehensive income £m	Fair value through profit or loss £m	Total £m
Financial assets				
Cash and balances with the Bank of England	5,219.4	–	–	5,219.4
Loans and advances to credit institutions	231.3	–	–	231.3
Debt securities	16.3	934.9	–	951.2
Loans and advances to customers	39,264.6	–	–	39,264.6
Hedge accounting adjustment	6.5	–	–	6.5
Derivative financial instruments	–	–	268.9	268.9
Investment in equity shares	–	–	3.1	3.1
Total financial assets	44,738.1	934.9	272.0	45,945.0
Other non-financial assets	125.9	–	–	125.9
Total assets	44,864.0	934.9	272.0	46,070.9
Financial liabilities				
Shares	33,281.6	–	–	33,281.6
Deposits from banks	5,453.8	–	–	5,453.8
Other deposits	9.5	–	–	9.5
Amounts owed to other customers	496.5	–	–	496.5
Debt securities in issue	4,353.9	–	–	4,353.9
Hedge accounting adjustment	36.5	–	–	36.5
Derivative financial instruments	–	–	167.4	167.4
Subordinated liabilities	25.5	–	–	25.5
Subscribed capital	41.6	–	–	41.6
Total financial liabilities	43,698.9	–	167.4	43,866.3
Other non-financial liabilities	84.2	–	–	84.2
Total liabilities	43,783.1	–	167.4	43,950.5

13. Impairment on loans and advances to customers

Under IFRS 9, impairment provisions are required to be calculated on amortised cost, fair value through other comprehensive income assets and on mortgage pipeline commitments.

For the Group substantially all impairment relates to loans and advances to customers and the tables below provide additional information. Further information on the credit quality of these loans, including by IFRS 9 stage, is included in the Risk Management Report.

Given the low risk nature of the Society's treasury assets all were assessed as performing on transition to IFRS 9 and throughout the period and therefore the resulting ECL is immaterial.

A reconciliation of the impairment provision split by IFRS 9 stage from 1 January 2018 to 31 December 2018 is set out below:

Group Loans and advances to customers	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Total £m
Loss allowance at 1 January 2018	1.3	3.9	8.3	13.5
Movements with Income Statement impact				
Transfers:				
Transfers from stage 1 to stage 2	(0.1)	1.1	–	1.0
Transfers from stage 1 to stage 3	–	–	0.8	0.8
Transfers from stage 2 to stage 1	0.1	(0.5)	–	(0.4)
Transfers from stage 3 to stage 1	–	–	(0.1)	(0.1)
New mortgages originated	0.6	–	–	0.6
Remeasurement of ECL	(0.1)	(0.7)	0.4	(0.4)
Financial assets derecognised during the period	(0.4)	(0.2)	(1.0)	(1.6)
Net write off to Income Statement	0.1	–	(0.4)	(0.3)
Total net Income Statement charge in the period	0.2	(0.3)	(0.3)	(0.4)
Other movements with no Income Statement impact				
Transfers:				
Transfers from stage 2 to stage 3	–	(0.2)	0.2	–
Transfers from stage 3 to stage 2	–	0.5	(0.5)	–
Net write off	(0.1)	–	(1.4)	(1.5)
Loss allowance at 31 December 2018	1.4	3.9	6.3	11.6

Society Loans and advances to customers	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Total £m
Loss allowance at 1 January 2018	0.8	1.3	3.1	5.2
Movements with Income Statement impact				
Transfers:				
Transfers from stage 1 to stage 2	–	0.5	–	0.5
Transfers from stage 1 to stage 3	–	–	0.2	0.2
Transfers from stage 2 to stage 1	0.1	(0.3)	–	(0.2)
Transfers from stage 3 to stage 1	–	–	(0.1)	(0.1)
New mortgages originated	0.5	–	–	0.5
Remeasurement of ECL	(0.1)	(0.4)	1.3	0.8
Financial assets derecognised during the period	(0.3)	–	(0.3)	(0.6)
Net write off to Income Statement	–	–	(0.3)	(0.3)
Total net Income Statement charge in the period	0.2	(0.2)	0.8	0.8
Other movements with no Income Statement impact				
Transfers:				
Transfers from stage 2 to stage 3	–	(0.1)	0.1	–
Transfers from stage 3 to stage 2	–	0.4	(0.4)	–
Net write off	(0.1)	–	(0.6)	(0.7)
Loss allowance at 31 December 2018	0.9	1.4	3.0	5.3

Significant assumptions and estimates – forward looking information incorporated in the ECL models

The assessment of a significant increase in credit risk and the calculation of ECL both incorporate forward looking information and therefore require significant management judgement. The Group has used four economic scenarios to assess expected credit losses for its core owner-occupier and buy to let portfolios which represent over 99% of total loans and advances to customers. An explanation of each scenario and its relative weighting in calculating ECL is as follows:

Scenario	Weighting
Base – a central scenario based on the Group's Strategic Plan	60%
Downside – based on the Internal Capital Adequacy Assessment Process (ICAAP) high rate stress (being the worst case scenario from a credit loss perspective used in capital stress testing)	10%
Upside – based on an improved credit environment (best case), given the current benign conditions the improvement on base case is minor	1%
Midpoint – a scenario between the downside and upside cases which reflects a more moderate downturn than the downside scenario	29%

The weighting applied to the Downside scenario was increased from 2% to 10% during 2018. There has been a corresponding reduction in the Upside scenario (1% decrease) and Base scenario (7% decrease). The changes in weightings reflect a more uncertain economic outlook. The most significant assumptions used in these scenarios are:

Scenario		Base %	Downside %	Upside %	Midpoint %
Bank of England Base Rate	Five year average	1.1	3.3	0.5	1.9
Unemployment	Five year average	4.5	8.1	4.1	6.1
House Price Index	Peak to trough	9.8	(37.8)	20.3	(13.0)
	Range	0.1 to 9.9	(37.8) to 0.0	0.2 to 20.5	(12.6) to 0.4
UK GDP	Peak to trough	7.5	(4.7)	15.5	8.0
	Range	0.1 to 7.6	(4.5) to 0.2	0.2 to 15.7	(0.6) to 7.4

13. Impairment on loans and advances to customers continued

The ECL calculation is particularly sensitive to changes in:

- House Price Index, given the significant impact it has on mortgage collateral valuations.
- Unemployment rate, given its impact on borrowers' ability to meet their loan repayments.

The most significant degree of judgement relates to the relative weightings of the scenarios themselves, incorporating different views of the House Price Index and unemployment rate as indicated above. In order to demonstrate this sensitivity, the impact of applying 100% of a particular scenario on the reported IFRS 9 impairment provision is shown below; for example, if the provision was wholly calculated on the base case scenario it would be a decrease of £2.0 million, 17.2% less than the reported provision.

Scenario	IFRS 9 provision £m	Increase/ (decrease) %
IFRS 9 weighted average	11.6	–
Base	9.6	(17.2)
Downside	25.6	120.7
Upside	8.7	(25.0)
Midpoint	11.9	2.6

If average regional house prices were to fall by 10% alongside a 10% increase in the unemployment rate, the estimated impact on the impairment provision to the Base scenario would be an increase of £3.3 million, with a corresponding charge in the Income Statement.

14. Taxation

	Group 2018 £m	Group 2017 £m	**Society 2018 £m**	Society 2017 £m
Current tax				
UK corporation tax	**46.7**	55.4	**32.1**	42.4
UK corporation tax – adjustment in respect of prior years	**(5.6)**	0.1	**(5.6)**	0.1
Total current tax	**41.1**	55.5	**26.5**	42.5
Deferred tax				
Current year	**(0.8)**	2.8	**(0.8)**	0.9
Adjustment in respect of prior years	**5.2**	(0.4)	**5.2**	(0.4)
Total deferred tax	**4.4**	2.4	**4.4**	0.5
Total	**45.5**	57.9	**30.9**	43.0

A reconciliation between the actual tax expense and tax that would be due if the UK standard corporation tax rate of 19.0% (2017: 19.25%) was applied to the profit before tax without adjustment is as follows:

	Group 2018 £m	Group 2017 £m	**Society 2018 £m**	Society 2017 £m
Profit before tax (PBT)	**201.6**	242.7	**124.7**	162.7
Tax at UK standard rate of corporation tax on PBT of 19.0% (2017: 19.25%)	**38.3**	46.7	**23.7**	31.3
Recurring items				
Surcharge on banking profits	**8.1**	11.1	**8.1**	11.1
Expenses not deductible for tax purposes – compensation payments	**0.2**	0.2	**0.2**	0.2
Effect of tax rate change	**(0.5)**	(0.3)	**(0.5)**	(0.3)
Non-recurring items				
Adjustments in respect of prior years	**(0.4)**	(0.3)	**(0.4)**	(0.3)
Other	**(0.2)**	0.5	**(0.2)**	1.0
Total	**45.5**	57.9	**30.9**	43.0

Since 1 January 2016 the Society, but not other Group companies, has been subject to a surcharge of 8% on taxable profits in excess of £25 million in line with other banking companies, including building societies.

The effective tax rate for the year is 22.6% (2017: 23.9%) for the Group and 24.8% (2017: 26.4%) for the Society. Effective tax rates are significantly above the UK standard corporation tax rate, because of the £8.1 million (2017: £11.1 million) surcharge.

The Finance Act 2016 introduced legislation requiring the Society to publish its tax strategy which is published on the Society's website.

Tax on items reported through the Statements of Comprehensive Income is as follows:

Statements of Comprehensive Income	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Tax charge on remeasurement of defined benefit pension plan	0.6	3.9	0.6	3.9
Tax charge/(credit) on fair value through other comprehensive income movements	0.2	(0.4)	0.2	(0.4)
Tax charge/(credit) on cash flow hedges	1.5	(7.9)	(1.8)	(4.2)
Effect of change in corporation tax rate	(0.2)	0.1	(0.1)	–
Total	2.1	(4.3)	(1.1)	(0.7)

Tax on other items reported through the Statements of Changes in Members' Interests and Equity is as follows:

Statements of Changes in Members' Interests and Equity	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Tax credit on Additional Tier 1 capital distribution	(6.9)	(7.0)	(6.9)	(7.0)
Total	(6.9)	(7.0)	(6.9)	(7.0)

Further information relating to deferred tax is presented in note 21.

15. Debt securities

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Fair value through other comprehensive income[1]:				
UK Government investment securities	859.8	990.3	859.8	960.3
Other listed transferable debt securities	75.1	22.0	75.1	22.0
Amortised cost				
Other listed transferable debt securities	16.3	–	16.3	–
Total	951.2	1,012.3	951.2	982.3
Movements during the year are analysed below:				
At 31 December 2017	1,012.3	–	982.3	–
IFRS 9 adjustment[2]	(1.0)	–	(1.0)	–
At 1 January	1,011.3	1,354.3	981.3	1,354.3
Additions	454.2	65.2	454.2	35.2
Maturities and disposals	(477.1)	(351.9)	(447.1)	(351.9)
Changes in fair value	(37.2)	(55.3)	(37.2)	(55.3)
At 31 December	951.2	1,012.3	951.2	982.3

1. Fair value through other comprehensive income relates to assets classified as FVOCI under IFRS 9 from 1 January 2018. In previous periods this was represented by the Available-for-sale classification.
2. More information on IFRS 9 transition is provided in note 1 to the accounts.

A maturity analysis of the Group debt securities is included in the Liquidity and Funding section of the Risk Management Report.

15. Debt securities continued

At the year end £629.4 million (2017: £300.4 million) of debt securities had been sold under sale and repurchase agreements. The cash received and accrued interest in relation to these agreements of £623.8 million (2017: £300.1 million) was included within deposits from banks (see note 22). The Group was unable to use, sell or pledge the transferred assets for the duration of the transactions and remained exposed to any associated interest rate and credit risk of the assets.

16. Loans and advances to customers

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Residential				
Owner-occupier mortgages	23,255.4	21,710.6	22,809.3	21,195.4
Buy to let mortgages	15,734.2	13,899.0	1,736.6	1,735.7
Near-prime mortgages	66.1	76.8	4.1	4.3
Self-certification mortgages	184.0	214.5	94.1	109.7
Other				
Commercial mortgages	1.5	2.0	0.5	0.5
Unsecured personal loans	23.4	28.0	15.6	18.7
Total	39,264.6	35,930.9	24,660.2	23,064.3

More detailed analysis at the balance sheet date together with a reconciliation of opening and closing balances by IFRS 9 stage is included in the Risk Management Report.

Maturity analysis

The remaining contractual maturity of loans and advances to customers at the balance sheet date is as follows:

	Note	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Repayable in less than one year		2,853.7	2,670.4	1,715.0	1,636.1
Repayable in more than one year		36,422.5	33,277.6	22,950.5	21,436.9
		39,276.2	35,948.0	24,665.5	23,073.0
Impairment provision	13	(11.6)	(17.1)	(5.3)	(8.7)
Total		39,264.6	35,930.9	24,660.2	23,064.3

Actual redemption levels experienced by the Group or Society may differ from the contractual analysis.

Pledged assets – loans and advances to customers

Certain loans and advances to customers have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools with the Bank of England to enable the Group to obtain secured funding.

Loans and advances to customers pledged to support secured funding and the notes in issue are as follows:

		Notes in issue[1]			
2018	Mortgages pledged £m	Held by third parties £m	Held by the Group drawn £m	Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bond programme	4,960.3	2,047.3	927.4	472.6	3,447.3
Securitisation programme – Mercia No.1 plc	1,094.7	–	–	973.6	973.6
Securitisation programme – Offa No.1 plc	285.0	162.4	–	90.3	252.7
Whole mortgage loan pools[2]	7,235.0	–	5,470.1	1,764.9	7,235.0
Total	13,575.0	2,209.7	6,397.5	3,301.4	11,908.6

1. Notes in issue exclude Class Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.
2. The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under TFS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

2017	Mortgages pledged £m	Notes in issue[1] Held by third parties £m	Held by the Group drawn £m	Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bond programme	4,887.3	2,311.2	1,400.0	–	3,711.2
Securitisation programme – Mercia No.1 plc	1,089.4	–	973.6	–	973.6
Securitisation programme – Offa No.1 plc	331.6	192.9	–	107.3	300.2
Whole mortgage loan pools[2]	3,573.9	–	1,498.0	2,075.9	3,573.9
Total	9,882.2	2,504.1	3,871.6	2,183.2	8,558.9

1. Notes in issue exclude Class Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.
2. The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under TFS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

Mortgages pledged are not derecognised from the Group or Society balance sheets as the Group has retained substantially all the risks and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue and held by third parties are included within debt securities in issue (note 23).

Notes in issue, held by the Group and drawn, include debt securities issued by the covered bond programme to the Society, notes issued by the Mercia securitisation programme and whole mortgage loan pools all pledged as collateral.

Notes in issue, held by the Group and undrawn, are other debt securities issued by the programmes to the Society, and mortgage loan pools that have been pre-positioned at the Bank of England but not utilised. These are held to provide collateral for potential future use in sale and repurchase agreements or central bank operations.

Notes in issue, and held by the Group, are not recognised on the Group or Society balance sheets, thus preventing inappropriate grossing up of the Group and Society balance sheets.

During the year, the Group increased the amount of whole mortgage loan pools pre-positioned at the Bank of England and used this as part of its liquidity risk management strategy.

Covered bonds

Coventry Building Society Covered Bonds LLP (the LLP) provides security for issues of self-issued covered bonds and for external issuances. As at 31 December 2018, the Society had £2,550.0 million (2017: £2,800.0 million) and €1,000.0 million (2017: €1,000.0 million) of covered bonds in issue, of which £1,400.0 million (2017: £1,400.0 million) was retained by the Group. At the reporting date, the Society has overcollateralised the LLP as set out in the table above to secure the ratings of the covered bonds and to provide operational flexibility. From time to time, the obligation of the Society to provide collateral may increase due to the formal requirements of the covered bonds programme and the value of the collateral would depend upon conditions at that time. The Society may also voluntarily contribute collateral to support the covered bond ratings; no such contributions were made during 2018 or 2017.

During the period, the Society voluntarily repurchased £80.5 million (2017: £115.2 million) of mortgages from the LLP to maintain the quality of the pool and minimise the overcollateralisation requirement.

Securitisation – Mercia No.1 plc

Mercia No.1 plc (Mercia) was incorporated in October 2012 and in December 2012 Mercia issued £1,436.4 million of listed debt securities, all of which were retained by the Group. The Society's obligations in respect of the Mercia securitisation vehicle are limited to transferring cash flows from the underlying assets.

In March 2016, Godiva Mortgages Limited repurchased £462.8 million of the mortgages from Mercia and Mercia used the proceeds to reduce notes in issue by this same amount.

16. Loans and advances to customers continued

Securitisation – Offa No.1 plc

Offa No.1 plc (Offa) was incorporated in February 2016 and in March 2016 Offa issued £427.5 million of listed debt securities secured against certain loans of Godiva Mortgages Limited, of which £152.5 million was held by the Group. The Society's obligations in respect of the Offa securitisation vehicle are limited to transferring cash flows from the underlying assets.

Under the terms of the securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme.

The fair value of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset are presented in the table below:

	Fair value assets pledged 2018 £m	Fair value liabilities 2018 £m	Fair value net position 2018 £m	Fair value assets pledged 2017 £m	Fair value liabilities 2017 £m	Fair value net position 2017 £m
Securitisation programme – Offa No.1 plc	285.0	164.2	120.8	331.6	195.2	136.4

The above table excludes the Mercia securitisation programme as all the notes issued were retained by the Society.

17. Investments in Group undertakings

Society	Shares £m	Loans £m	Total £m
At 1 January 2018	8.0	12,549.5	12,557.5
Additions	–	1,675.1	1,675.1
At 31 December 2018	8.0	14,224.6	14,232.6

The Society has the following consolidated subsidiary undertakings, all of which operate in the United Kingdom and are wholly owned by Coventry Building Society:

Subsidiary undertakings	Principal activity
Godiva Mortgages Limited	Mortgage lending
ITL Mortgages Limited	Mortgage lending and mortgage acquisition vehicle
Coventry Financial Services Limited	Non-trading
Coventry Property Services Limited	Non-trading
Godiva Financial Services Limited	Non-trading
Godiva Housing Developments Limited	Non-trading
Godiva Savings Limited	Non-trading
Godiva Securities and Investments Limited	Non-trading

During 2018 Five Valleys Property Company Limited, which was a former investment properties holding company and a subsidiary of the Society, entered winding up proceedings which are expected to be completed during 2019.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control in accordance with the accounting policy set out in note 1. The following structured entities are consolidated:

Consolidated structured entities	Principal activity
Coventry Building Society Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds
Mercia No.1 plc	Funding vehicle
Offa No.1 plc	Funding vehicle

The nature and risks associated with the Society's investments in these entities (including obligations of financial support) are disclosed in note 16.

The registered office for Mercia No.1 plc and Offa No.1 plc is 35 Great St. Helens, London EC3A 6AP, for Godiva Mortgages Limited is Oakfield House, Binley Business Park, Binley, Coventry CV3 2TQ and for all of the others is Oakfield House, PO Box 600, Binley Business Park, Coventry CV3 9YR.

18. Intangible assets

Group and Society	Externally acquired 2018 £m	Internally developed 2018 £m	Total 2018 £m	Externally acquired 2017 £m	Internally developed 2017 £m	Total 2017 £m
Cost						
At 1 January	15.0	59.0	74.0	12.1	42.5	54.6
Additions	2.1	8.0	10.1	3.1	17.6	20.7
Retirements	–	(0.8)	(0.8)	(0.2)	(1.1)	(1.3)
At 31 December	17.1	66.2	83.3	15.0	59.0	74.0
Amortisation						
At 1 January	9.0	24.2	33.2	6.5	15.6	22.1
Charge for the year	3.0	10.7	13.7	2.6	9.7	12.3
Retirements	–	(0.8)	(0.8)	(0.1)	(1.1)	(1.2)
At 31 December	12.0	34.1	46.1	9.0	24.2	33.2
Net book value at 31 December	5.1	32.1	37.2	6.0	34.8	40.8

Intangible assets primarily consist of externally acquired and internally developed software that is not an integral part of a related hardware purchase.

Internally developed assets at 31 December 2018 include £5.3 million (2017: £9.8 million) of assets in course of construction. These assets relate mainly to the Society's investment in new systems platforms to meet the future needs of the business. To the extent that these new system platforms are not yet ready for use by the business, no amortisation has been charged against these assets.

In the 2018 Interim Financial Report, intangible assets included £9.6 million relating to the core technology platform upgrade. During the second half of 2018, in light of the findings from the detailed design work, the Society has reassessed this and recognised the costs within administrative expenses in the Income Statement. See note 9 for further information.

19. Property, plant and equipment

Group and Society	Land and buildings			Equipment, fixtures, fittings and vehicles £m	Total £m
	Freehold £m	Long leasehold £m	Short leasehold £m		
Cost					
At 1 January 2018	9.3	6.1	3.2	49.0	67.6
Additions	–	–	–	21.4	21.4
Disposals	–	(0.1)	–	(4.9)	(5.0)
At 31 December 2018	9.3	6.0	3.2	65.5	84.0
Depreciation					
At 1 January 2018	2.0	1.4	2.1	25.9	31.4
Charge for the year	0.1	0.3	–	7.4	7.8
Depreciation on disposals	–	–	–	(4.0)	(4.0)
At 31 December 2018	2.1	1.7	2.1	29.3	35.2
Net book value at 31 December 2018	7.2	4.3	1.1	36.2	48.8

Group and Society	Land and buildings			Equipment, fixtures, fittings and vehicles £m	Total £m
	Freehold £m	Long leasehold £m	Short leasehold £m		
Cost					
At 1 January 2017	9.3	6.1	3.2	44.9	63.5
Additions	–	–	–	8.0	8.0
Disposals	–	–	–	(3.9)	(3.9)
At 31 December 2017	9.3	6.1	3.2	49.0	67.6
Depreciation					
At 1 January 2017	1.9	1.1	2.1	22.7	27.8
Charge for the year	0.1	0.3	–	6.3	6.7
Depreciation on disposals	–	–	–	(3.1)	(3.1)
At 31 December 2017	2.0	1.4	2.1	25.9	31.4
Net book value at 31 December 2017	7.3	4.7	1.1	23.1	36.2

Disposals relate to assets that were retired during the year.

Equipment, fixtures, fittings and vehicles includes assets held under finance leases as follows:

Group and Society	2018 £m	2017 £m
Net book value	2.1	2.2
Accumulated depreciation	1.5	1.3

The net book value of land and buildings occupied by the Group for its own activities is as follows:

Group and Society	2018 £m	2017 £m
At 31 December	12.6	13.1

20. Pension scheme

The Society operates both a funded defined benefit and a defined contribution pension scheme.

The Coventry Building Society defined benefit pension scheme (the Fund) is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are required to act in the best interest of the Fund members. The appointment of the trustees is determined by the Fund's trust documentation and one third of trustees are nominated by the members of the pension fund. A full actuarial valuation carried out by a qualified independent actuary as at 31 December 2017 is in progress and at that date there were 1,758 members comprising current employees, former employees and former executive directors. The date of the last completed full actuarial valuation was 31 December 2014.

The Fund is subject to the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, set out the framework for funding defined benefit occupational pension plans in the UK.

The Fund typically exposes the Society to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the balance sheet and may give rise to increased charges in future periods. This effect would be partially offset by an increase in the value of the plan's bond and liability matching holdings. Caps on inflationary increases are in place to protect the plan against extreme inflation.

The pension scheme assets are predominantly invested in Liability Matching Funds (LMFs) being leveraged pooled funds used to help manage interest rate and inflation risk. The investment policy of the LMFs is summarised as follows:

- Each LMF relates to a single named benchmark gilt – the Fund holds units in the 2027, 2032, 2040, 2050, 2062 and 2068 index-linked gilt LMFs, the 2040, 2052 , 2060 and 2068 fixed interest gilt LMFs and the LMF real 2020–2024 swap.
- The LMFs holds a combination of gilt sale and repurchase agreements (repos), gilt total return swaps and physical gilts.
- The fund manager manages the amount of underlying cash and gilt collateral held to support the derivative exposure within the funds (known as leverage) to keep the leverage of each individual fund within a particular range. If leverage increases too much then the manager will ask the Fund to pay in additional capital, and if leverage falls too low the manager will return capital to the Fund in order to increase the leverage.
- The fund manager aims to limit the exposure to each counterparty to 30% of each LMF's overall exposure.

For the purposes of IAS 19 *Employee Benefits (Revised)* the preliminary results of the full actuarial valuation in progress as at 31 December 2017, which was carried out by a qualified independent actuary, have been updated on an approximate basis to 31 December 2018. There have been no changes in the valuation methodology adopted for this period's disclosures compared to the previous period's disclosures.

The cost of the Fund was assessed in accordance with the advice of a qualified actuary on the basis of valuations using the projected unit method. The main assumptions used in the valuations were:

i. An investment return pre-retirement of 0.8% (2017: 0.5%) per annum in excess of projected pre-retirement benefit increase.
ii. An investment return post-retirement of -0.1% (2017: -0.4%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 0.85% (2017: 0.5%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

The 31 December 2014 actuarial valuation showed a deficit of £11.5 million. The Society agreed with the trustees that it would aim to eliminate the deficit by 30 September 2019 by the payment of annual contributions of £1.4 million in respect of the deficit.

20. Pension scheme continued

Since the Fund is closed to future service accrual no contributions were made in respect of members' pensionable salaries during 2018 (2017: £nil); however, the Society contributed £1.4 million in line with the deficit recovery plan. The Group expects to pay £1.05 million to the plan in 2019 in respect of the deficit recovery plan agreed following the 2014 actuarial valuation. Any additional contributions following the 2017 actuarial valuation will be agreed in 2019. The Society met and continues to meet the Fund's expenses including levies to the Pension Protection Fund.

The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is then deducted from the fair value of plan assets and the net surplus is presented on the balance sheet as shown below:

Group and Society	2018 £m	2017 £m
Present value of funded obligation	(196.0)	(203.2)
Fair value of plan assets	218.9	221.7
Funded status/pension benefit surplus	22.9	18.5

	2018			2017		
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Present value of obligation £m	Fair value of plan assets £m	Total £m
As at 1 January	(203.2)	221.7	18.5	(211.9)	214.4	2.5
Included within administrative expenses:						
Interest (expense)/income	(5.2)	5.7	0.5	(5.6)	5.7	0.1
Included within other comprehensive income:						
Remeasurements:						
Return on plan assets (excluding amounts in the Income Statement)	–	(3.7)	(3.7)	–	7.0	7.0
Gains from changes in financial assumptions	6.2	–	6.2	7.5	–	7.5
	6.2	(3.7)	2.5	7.5	7.0	14.5
Other contributions and payments:						
Employer contributions	–	1.4	1.4	–	1.4	1.4
Benefit payments	6.2	(6.2)	–	6.8	(6.8)	–
	6.2	(4.8)	1.4	6.8	(5.4)	1.4
As at 31 December	(196.0)	218.9	22.9	(203.2)	221.7	18.5

In October 2018 the High Court ruled that Guaranteed Minimum Pensions (GMPs) must be equalised for male and female pensioners and any arrears following this calculation paid. The estimated cost of this for the Fund was £0.4 million and this is included in changes in financial assumptions.

The surplus reflects the Society's ability to recover a surplus either through reduced contributions in the future or through refunds from the Fund after the last benefit has been paid in line with IAS 19.

The major categories of plan assets are:

	Plan assets at 31.12.2018 £m	Plan assets at 31.12.2017 £m
Quoted		
Corporate bonds and liability matching	111.8	113.2
Diversified growth funds	14.3	18.7
Direct lending	15.8	12.9
Cash	2.6	0.9
Unquoted		
Corporate bonds and liability matching	48.4	56.8
Property	26.0	19.2
Total	218.9	221.7

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligation at	31.12.2018 %	31.12.2017 %
Discount rate	2.95	2.60
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	3.15	3.10
Rates of inflation (Consumer Prices Index)	2.15	2.10

Weighted average assumptions used to determine net pension cost for the year ended	31.12.2018 %	31.12.2017 %
Discount rate	2.60	2.70
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	3.10	3.25
Rates of inflation (Consumer Prices Index)	2.10	2.25

Weighted average life expectancy for mortality tables used to determine benefit obligation at	31.12.2018		31.12.2017	
	Male	Female	Male	Female
Member age 60 (current life expectancy)	26.3	28.3	26.5	28.4
Member age 45 (life expectancy at age 60)	26.7	28.9	26.9	28.9

The Group has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension fund surplus and changes in these assumptions could affect the reported surplus. The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is indicated below for isolated changes in assumptions; in reality it is likely that assumptions will be related to each other and impact simultaneously.

Impact on present value of obligation:	Change in assumption	Increase in assumption %	Decrease in assumption %
Discount rate	0.25%	(4.2)	4.5
Rates of inflation (Retail Prices Index and Consumer Prices Index)	0.25%	2.1	(2.5)
Life expectancy	1 year	3.1	(3.1)

The average duration of the defined benefit obligation at the period ended 31 December 2018 is 19 years.

21. Deferred tax

Deferred tax assets and liabilities are attributable to the following items:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Deferred tax liabilities/(assets)				
Cash flow hedges	8.7	7.3	4.5	6.4
Defined benefit pension plan surplus	5.4	4.4	5.4	4.4
Transfer of engagements – fair value adjustments	0.1	0.1	0.1	0.1
Investment in equity shares	0.8	0.2	0.8	0.2
Fair value through other comprehensive income	1.8	1.9	1.8	1.9
Excess of capital allowances over depreciation	0.9	(3.0)	0.9	(3.0)
Provisions	(0.5)	(0.5)	(0.5)	(0.5)
Deferred consideration on the sale of equity shares	–	(0.1)	–	(0.1)
Total	17.2	10.3	13.0	9.4

Deferred tax assets are recognised where they have arisen on the basis that sufficient future taxable trading profits will be available to utilise the deferred tax assets. The deferred tax on the IFRS 9 opening adjustment disclosed in note 1 is negligible and so is not disclosed separately above.

The deferred tax balances at 31 December 2018 reflect future reductions in the standard rate of corporation tax, as introduced by the Finance (No. 2) Act 2015 and the Finance Act 2016, to 17% from 1 April 2020.

22. Deposits from banks

A maturity analysis for the Group's deposits from banks is included in the Risk Management Report Liquidity and Funding section.

For the Group and Society, deposits from banks include £4,250.0 million (2017: £3,000.0 million) drawn down against the Bank of England Term Funding Scheme (TFS).

Deposits from banks also includes £623.8 million (2017: £300.1 million) in respect of sale and repurchase agreements (repos) of on-balance sheet debt securities (see note 15).

23. Debt securities in issue

The change in debt securities issued by the Group from financing activities arises as follows:

2018 Group	2017 £m	Cash flows £m	Non-cash flows: Foreign exchange movements £m	Non-cash flows: Change in accrued interest £m	Amortisation £m	2018 £m
Certificates of deposit	251.3	(250.5)[1]	–	(0.8)	–	–
Medium-term notes	2,135.2	–	7.2	–	1.8	2,144.2
Covered bonds	2,309.4	(251.0)	11.0	(23.5)	1.4	2,047.3
Residential Mortgage Backed Securities	192.9	(30.6)	–	–	0.1	162.4
Total	4,888.8	(532.1)	18.2	(24.3)	3.3	4,353.9

1. Cash flows relating to certificates of deposits are included within changes in operating liabilities in the Statements of Cash Flows.

2017 Group	2016 £m	Cash flows £m	Non-cash flows: Foreign exchange movements £m	Non-cash flows: Change in accrued interest £m	Amortisation £m	2017 £m
Certificates of deposit	156.5	94.3[1]	–	0.5	–	251.3
Medium-term notes	1,742.6	354.7	35.3	1.2	1.4	2,135.2
Covered bonds	1,847.8	430.8	27.1	2.1	1.6	2,309.4
Residential Mortgage Backed Securities	231.2	(38.5)	–	–	0.2	192.9
Total	3,978.1	841.3	62.4	3.8	3.2	4,888.8

1. Cash flows relating to certificates of deposits are included within changes in operating liabilities in the Statements of Cash Flows.

The position for the Society is the same as that for the Group other than the Society had no Residential Mortgage Backed Securities at the reporting date for the current and prior year.

In April 2018 a £750.0 million covered bond was repaid and in November 2018, a £500.0 million covered bond was issued. The Society change in liabilities from financing activities is the same as the Group, other than they exclude Residential Mortgage Backed Securities (issued by Offa No.1 plc, a consolidated structured entity).

Debt securities in issue are repayable in the ordinary course of business as follows:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Accrued interest	18.4	42.6	18.3	42.5
Other debt securities in issue with residual maturity repayable:				
In not more than one year	349.7	1,000.3	349.7	1,000.3
In more than one year	3,985.8	3,845.9	3,823.5	3,653.1
Total	4,353.9	4,888.8	4,191.5	4,695.9

24. Derivative financial instruments

The Group has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9. However, as a result of IFRS 9 amendments, IFRS 7 includes a number of new disclosure requirements and these are included below for the current period only.

Risk management strategy

Derivative financial instruments, predominantly interest rate and cross currency swaps, are held solely for purposes of mitigating interest rate, foreign exchange risk or interest rate and foreign exchange risk together, as explained in the Risk Management Report. Where appropriate, they are designated as hedging instruments within either fair value or cash flow hedge relationships under the terms of IAS 39. Derivatives can hedge specific assets or liabilities such as liquidity or wholesale instruments (sometimes referred to as 'micro' hedges) or portions of a portfolio of fixed rate mortgages or savings products (sometimes referred to as 'macro' hedges).

For micro hedges, the Group establishes the hedging ratio by matching the notional of the derivatives with the principal of the instruments being hedged. For macro hedges, the Group establishes the hedging ratio by matching the notional of the derivatives with the principal of that portion of the portfolio being hedged and manages this on a monthly basis by entering into interest rate swaps.

Where interest rate risk is hedged, only the interest rate risk element of the underlying position is designated as the hedged item and therefore other risks, such as credit risk, which are managed but not hedged by the Group, are excluded. The interest rate risk element is determined with regard to the fixed rate that represents the benchmark rate of interest being hedged. Where foreign exchange risk is hedged, the foreign currency risk component is determined as the change in cash flows of the foreign currency debt arising solely from changes in the relevant forward exchange rates.

For fair value hedges, the effectiveness of the hedge relationship is assessed by comparing changes in the fair value of the hedged item attributable to changes in the benchmark rate of interest with changes in the fair value of the derivative. For cash flow hedges, effectiveness is assessed by comparing the changes in the fair value of the derivative with changes in the fair value of the hedged item attributable to the hedged risk, using the hypothetical derivative method. Possible sources of ineffectiveness are as follows:

- Differences in the benchmark rates of interest used to value the hedged item and the hedging instrument, such as when cash collateralised interest rate swaps are discounted using SONIA but this is not the benchmark rate of interest for the hedged item.
- Differences in timing of cash flows between the derivative and the hedged item.
- Differences between the expected and actual volume of prepayments where a portfolio is being hedged, as the hedging ratio is calculated with regard to expected repayment dates, taking account of expected prepayments based on past experience.
- Hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument.
- Counterparty credit risk which impacts the fair value of uncollateralised swaps but not the hedged item.

Hedging instruments

The following tables contain details of the hedging instruments used in the Group's hedging strategies. The notional amount indicates the amount on which payment flows are derived at the balance sheet date and do not represent risk. Derivatives assets and liabilities are included in the balance sheet at fair value.

Group	2018 Notional amount £m	2018 Fair value assets £m	2018 Fair value liabilities £m	2017 Notional amount £m	2017 Fair value assets £m	2017 Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate risk	30,676.0	121.5	166.3	24,890.7	185.0	212.8
Derivatives designated as cash flow hedges:						
Interest rate risk	369.0	0.4	1.1	445.0	–	1.2
Foreign exchange risk[1]	428.0	20.0	–	428.0	3.9	–
Foreign exchange and interest rate risk[1]	935.4	127.0	–	935.4	117.6	–
Total derivatives	32,408.4	268.9	167.4	26,699.1	306.5	214.0

1. Cash flows are expected to occur over a six year period (2017: seven).

Society	2018 Notional amount £m	2018 Fair value assets £m	2018 Fair value liabilities £m	2017 Notional amount £m	2017 Fair value assets £m	2017 Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate risk	30,676.0	121.5	166.3	24,140.7	154.3	212.8
Derivatives designated as cash flow hedges:						
Interest rate risk	369.0	0.4	1.1	445.0	–	1.2
Foreign exchange risk[1]	–	–	–	–	–	–
Foreign exchange and interest rate risk[1]	541.1	61.8	–	541.1	59.6	–
Other derivatives:						
Interest rate basis swaps	1,150.0	2.7	–	650.0	1.3	–
Total derivatives	32,736.1	186.4	167.4	25,776.8	215.2	214.0

1. Cash flows are expected to occur over a two year period (2017: three).

The Society also has intra-group interest rate swaps with the subsidiaries that operate the Group's covered bond programme. Under these agreements, the Society receives the interest income of the subsidiaries' mortgage books and pays LIBOR on the same basis as the subsidiaries' interest expense. These swaps have a nominal principal amount of £5,067.8 million (2017: £4,951.7 million) and are treated as part of the deemed loan and not separately measured at fair value because the relevant mortgage loans are not derecognised.

The following tables set out the maturity profile and average interest and foreign exchange rates of the hedging instruments used in the Group's hedging strategy at 31 December 2018. Derivative contractual maturities are included in the Risk Management Report.

	Maturity				
2018 Group	Up to one month £m	One to three months £m	Three months to one year £m	One year to five years £m	More than five years £m
Interest rate risk					
Contract/notional amount	55.0	1,485.5	7,735.8	18,729.4	3,039.3
Average fixed interest rate	1.5%	0.9%	0.9%	1.0%	1.5%
Foreign exchange risk					
Contract/notional amount	–	–	–	–	428.0
Average fixed interest rate	–	–	–	–	0.5%
Average £/€ exchange rate	–	–	–	–	0.86
Foreign exchange and interest rate risk					
Contract/notional amount	–	–	–	935.4	–
Average fixed interest rate	–	–	–	1.7%	–
Average £/€ exchange rate	–	–	–	0.81	–

24. Derivative financial instruments continued

2018 Society	Maturity Up to one month £m	One to three months £m	Three months to one year £m	One year to five years £m	More than five years £m
Interest rate risk					
Contract/notional amount	55.0	1,485.5	7,735.8	18,729.4	3,039.3
Average fixed interest rate	1.5%	0.9%	0.9%	1.0%	1.5%
Foreign exchange risk					
Contract/notional amount	–	–	–	–	–
Average fixed interest rate	–	–	–	–	–
Average £/€ exchange rate	–	–	–	–	–
Foreign exchange and interest rate risk					
Contract/notional amount	–	–	–	541.1	–
Average fixed interest rate	–	–	–	2.5%	–
Average £/€ exchange rate	–	–	–	0.83	–

Hedged items

The following table contains details of fair value hedged exposures at 31 December 2018.

	Carrying amount of hedged item		Accumulated amount of fair value adjustments on the hedged item	
2018 Group and Society	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges:				
Interest rate[1,2]	28,756.1	(13,267.1)	30.2	(36.5)

1. Assets presented in Loans and advances to customers and Debt securities in the balance sheet.
2. Liabilities presented in Shares and Debt securities in issue in the balance sheet.

The accumulated amount of fair value hedge adjustments remaining in the balance sheet for hedged items that have ceased to be adjusted for hedging losses at 31 December 2018 is £1.2 million.

The following tables provide additional information on cash flow hedges for 2018.

	Changes in fair value			Amounts reclassified from reserves to Income Statement		
2018 Group	Hedging derivative £m	Hedged item for ineffectiveness assessment £m	Gains/(losses) recognised in Other Comprehensive Income £m	Hedged cash flows will no longer occur £m	Hedged item affected Income Statement £m	Recognised in Income Statement[1] £m
Derivatives designated as cash flow hedges:						
Foreign exchange	15.9	15.9	15.9	–	5.4	–
Foreign exchange and interest rate	9.0	10.0	10.0	–	12.6	(1.0)
Interest rate	(1.5)	(1.5)	(1.5)	0.9	–	0.9

1. Ineffectiveness is shown in note 8 Net losses from derivatives and hedge accounting.

As at 31 December 2018 balances remaining in the cash flow hedge reserve, gross of tax, are £33.9 million credit for continuing hedges offset by £1.1 million for discontinued hedges.

2018 Society	Changes in fair value Hedging derivative £m	 Hedged item for ineffectiveness assessment £m	Gains/(losses) recognised in Other Comprehensive Income £m	Amounts reclassified from reserves to Income Statement Hedged cash flows will no longer occur £m	 Hedged item affected Income Statement £m	Recognised in Income Statement[1] £m
Derivatives designated as cash flow hedges:						
Foreign exchange	–	–	–	–	–	–
Foreign exchange and interest rate	2.4	2.4	2.4	–	7.1	–
Interest rate	(1.5)	(1.5)	(1.5)	0.9	–	0.9

1. Ineffectiveness is shown in note 8 Net losses from derivatives and hedge accounting.

As at 31 December 2018 balances remaining in the cash flow hedge reserve, gross of tax, are £17.3 million credit for continuing hedges offset by £1.1 million for discontinued hedges.

25. Provisions for liabilities and charges

Group and Society	2018 £m	2017 £m
At 1 January	5.7	7.5
Charge for the year	–	3.5
Provisions utilised	(2.7)	(5.3)
At 31 December	3.0	5.7

The Group's provisions relate to Payment Protection Insurance (PPI), the Financial Services Compensation Scheme (FSCS) levy and other regulatory provisions.

PPI provisions

The Group held a provision at 31 December 2018 of £2.5 million (2017: £2.6 million). There has been a charge in the year of £1.5 million which reflects an increase in the number of claims received in the period and the estimated impact of the finalised rules from the Financial Conduct Authority and the deadline for PPI claims.

FSCS levy provision

The Group has a provision of £0.4 million (2017: £2.5 million) relating to FSCS. There has been a release during the year of £1.0 million which reflects the repayment of the loans relating to the Bradford & Bingley failure. The remaining provision was raised in November 2018, as a result of the failure of a number of credit unions and notification from the FSCS of an expected charge.

Other regulatory provisions

Other regulatory provisions are £0.1 million following the release of £0.5 million relating to capitalised arrears.

The Group has no contingent liabilities.

26. Subordinated liabilities

Group and Society	2018 £m	2017 £m
Subordinated liabilities owed to note holders are as follows:		
Fixed rate subordinated notes 2026 – 6.327%	10.2	10.2
Fixed rate subordinated notes 2032 – 7.54%	15.3	15.3
Total	25.5	25.5

All the subordinated liabilities are denominated in sterling and are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, subject to prior consent of the Prudential Regulation Authority (PRA).

The subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members, other than holders of Permanent Interest Bearing Shares and Perpetual Capital Securities (PCS), for both principal and interest.

27. Subscribed capital

Group and Society	Call date	2018 £m	2017 £m
Subscribed capital owed to permanent interest holding members is as follows:			
Permanent Interest Bearing Shares 1992 – 12 1/8%	n/a	41.6	41.6
Total		41.6	41.6

Subscribed capital comprises the Permanent Interest Bearing Shares (PIBS) issued in 1992 that are only repayable in the event of the winding up of the Society. Interest is paid in arrears in half yearly instalments at 12 1/8% per annum.

PIBS rank equally with each other and PCS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than holders of PCS) for both principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

28. Other equity instruments

In June 2014, the Society issued £400.0 million of new PCS capital raising £396.9 million (net of issuance costs and associated tax). These instruments rank equally with each other and PIBS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS), for both principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.375% per annum. The rate will reset on 1 November 2019 and every five years thereafter to the five year mid swap rate plus 4.113%. Coupons are paid semi-annually in May and November.

The returns paid to holders of PCS are treated as an appropriation of profit after tax, reflecting their categorisation as equity instruments, distributed directly from the general reserve. During 2018, coupon payments of £25.6 million (2017: £25.6 million) were approved and have been recognised (net of tax) in the Statement of Change in Members' Interests and Equity.

The instruments have no maturity date. They are repayable at the option of the Society in 2019 and on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an individual consolidated or a consolidated basis, falls below 7% they convert to Core Capital Deferred Shares (CCDS) at the rate of one CCDS for every £67 PCS held.

29. Financial commitments

The Group and Society are committed to the following undrawn mortgage loan facilities relating to equity release and flexible mortgage products, which are subject to the satisfaction of previously agreed loan to value ratios:

	Group 2018 £m	Group 2017 £m	Society 2018 £m	Society 2017 £m
Undrawn mortgage loan facilities	43.3	55.4	39.5	45.4

In addition, the Group has also committed to advance £1,694.2 million (2017: £1,425.3 million) in respect of loans and advances to customers.

30. Capital and leasing commitments

Capital commitments

Group and Society	2018 £m	2017 £m
Capital expenditure contracted for but not provided for in the accounts	43.8	2.6

Capital commitments include £43.0 million relating to the Society's strategic investment programmes. These commitments include cancellation clauses which mean that less than the full amount may become due.

Leasing commitments

Future minimum lease payments under non-cancellable operating leases relating to land and buildings were as follows:

Group and Society	2018 £m	2017 £m
Amounts falling due:		
Within one year	3.5	3.3
Between one and five years	12.1	10.5
After five years	4.4	5.2
Total	20.0	19.0
Lease payments recognised as an expense in the period	4.7	4.5

31. Financial instruments – fair value of financial assets and liabilities

For the purpose of calculating fair values, fair value is assessed as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: unadjusted quoted prices in active markets for identical instruments.
- Level 2: valuation techniques for which all significant inputs are based on observable market data.
- Level 3: valuation techniques for which significant inputs are not based on observable market data.

Where applicable, the Group measures fair value using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Where this is not applicable, the Group determines fair values using other valuation techniques.

The following table summarises the fair value of the Group's financial assets and liabilities measured at amortised cost in the Group's balance sheet by the fair value hierarchy.

The Society position is not materially different to that of the Group except that it excludes £14,604.4 million (2017: £12,866.6 million) of loans and advances to customers with a fair value of £14,614.2 million (2017: £12,863.1 million) and £73.2 million (2017: £58.7 million) of deposits from banks with a fair value of £73.2 million (2017: £58.7 million) which are held in subsidiaries of the Society. The Society includes a deposit within amounts owed to customers of £92.4 million which is a cash deposit from a subsidiary but is eliminated at Group level.

2018 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	231.3	–	231.3	–	231.3
Loans and advances to customers	39,264.6	–	–	39,175.5	39,175.5
Debt securities[1]	16.3	9.1	0.3	7.1	16.5
Financial liabilities					
Shares	33,281.6	–	–	33,369.4	33,369.4
Deposits from banks	5,453.8	–	5,453.8	–	5,453.8
Other deposits	9.5	–	9.5	–	9.5
Amounts owed to other customers	496.5	–	496.5	–	496.5
Debt securities in issue	4,353.9	4,419.1	–	–	4,419.1
Subordinated liabilities	25.5	–	27.6	–	27.6
Subscribed capital	41.6	77.0	–	–	77.0

1. Debt securities measured at amortised cost have been reclassified on transition to IFRS 9 and were previously Available-for-sale. More information is included in note 1 to the accounts.

2017 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	202.0	–	202.0	–	202.0
Loans and advances to customers	35,930.9	–	–	35,824.6	35,824.6
Financial liabilities					
Shares	31,035.7	–	–	31,158.8	31,158.8
Deposits from banks	3,499.0	–	3,499.0	–	3,499.0
Other deposits	4.0	–	4.0	–	4.0
Amounts owed to other customers	735.5	–	735.8	–	735.8
Debt securities in issue	4,888.8	4,991.0	39.2	–	5,030.2
Subordinated liabilities	25.5	–	28.6	–	28.6
Subscribed capital	41.6	90.1	–	–	90.1

Loans and advances to credit institutions

The fair value of loans and advances to credit institutions over the longer term is estimated by discounting expected cash flows at a market discount rate. Amounts maturing in the short term are valued at carrying amount.

Loans and advances to customers

The fair value of loans and advances to customers is assessed as the value of the expected future cash flows, projected using contractual interest payments and repayments and the expected prepayment behaviour of borrowers. Conservative assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The estimated future cash flows are discounted at current market rates for the loan types and adjusted where necessary to reflect any observable market conditions.

Debt securities

Debt securities for which no market price or executable bid is available at the year end date are valued by one of two methods. Where there are recent market prices or executable bids for the security, these are used as the basis for establishing a year end valuation. Otherwise, a security is valued based on its relative value to comparable bonds.

Shares and deposits

The fair value of shares available on demand approximates to the carrying value. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows discounted at the current market rates for those types of deposit.

Deposits from banks, other deposits and amounts owed to other customers

The fair value of deposits taken from wholesale counterparties over the longer term is estimated by discounting expected cash flows at a market discount rate. Amounts maturing in the short term are valued at carrying amount.

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer-dated liabilities is calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those liabilities where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate to the remaining term to maturity.

The following table summarises the fair value of the Group's financial assets and liabilities measured at fair value on the face of the Group's balance sheet by fair value hierarchy and product type.

The Society position is not materially different to that of the Group except that it excludes £85.2 million (2017: £61.9 million) of Level 2 cross currency swap liabilities, which are held in subsidiaries of the Society, and includes a fair value asset of £2.7 million (2017: £1.3 million fair value asset) relating to Level 2 intercompany interest rate basis swaps. In 2017 there was £30.7 million of Level 2 interest rate swap asset but this was £nil for 2018.

31. Financial instruments – fair value of financial assets and liabilities continued

2018 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	121.9	–	121.9
Cross currency swaps	–	147.0	–	147.0
Total	–	268.9	–	268.9
Debt securities				
UK Government investment securities	859.8	–	–	859.8
Other listed transferable debt securities	75.1	–	–	75.1
Total	934.9	–	–	934.9
Investment in equity shares				
Investment in equity shares	0.4	–	2.7	3.1
Total	0.4	–	2.7	3.1
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	110.3	57.1	167.4
Total	–	110.3	57.1	167.4

2017 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	185.0	–	185.0
Cross currency swaps	–	121.5	–	121.5
Total	–	306.5	–	306.5
Debt securities				
UK Government investment securities	990.3	–	–	990.3
Other listed transferable debt securities	14.2	0.3	7.5	22.0
Total	1,004.5	0.3	7.5	1,012.3
Investment in equity shares				
Investment in equity shares	–	–	2.5	2.5
Total	–	–	2.5	2.5
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	150.5	63.5	214.0
Total	–	150.5	63.5	214.0

Financial instruments recorded at fair value

The determination of fair value for financial instruments which are recorded at fair value using valuation techniques is described below, including the assumptions that a market participant would be expected to make when valuing the instruments:

Level 1: Debt securities and Investment in equity shares – fair value through other comprehensive income – Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2: Derivatives

Derivative products utilise observable market inputs for interest rate swaps and cross currency swaps. Valuations are generated by swap models which use present value calculations and incorporate assumptions for interest rate curves, and foreign exchange spot and forward rates.

Level 3: Investment in equity shares – fair value through profit and loss – Unlisted

Investment in equity shares represent the Group's holding in Visa Inc. and VocaLink Holdings Limited shares. These shares are valued based on future cash consideration which the Group expects to receive on sale of these instruments, or the underlying market value.

Level 3: Derivatives

The items included within Level 3 are balance tracking swaps, which have remained in place during the year. These are valued using present value calculations based on market interest rate curves. The unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. Projected mortgage prepayment amounts are used in the modelling of the mortgage portfolio profile. A change of 10% in the prepayment rates used results in a £0.4 million change in the value of the swaps. However, changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact the swap and hedged item equally so that the net Income Statement and balance sheet impact would be negligible.

The following table analyses fair value movements in the Level 3 portfolio for both the Group and the Society.

Group and Society	Investment in equity shares 2018 £m	Debt securities 2018 £m	Derivative financial instruments 2018 £m	Investment in equity shares 2017 £m	Debt securities 2017 £m	Derivative financial instruments 2017 £m
As at 1 January	2.5	7.5	(63.5)	5.9	6.0	(68.6)
Reclassification under IFRS 9[1]		(7.5)				
(Losses)/gains recognised in the Income Statement						
Interest receivable and similar income	–	–	–	–	–	–
Interest payable and similar expense	–	–	(5.6)	–	–	(6.4)
Net unrealised gains/(losses)	0.2	–	6.2	(0.1)	–	5.0
Gains recognised in the Statement of Comprehensive Income[2]						
Available-for-sale reserve fair value movement[2]	–	–	–	1.8	1.5	–
Settlements	–	–	5.8	(5.1)	–	6.5
As at 31 December	2.7	–	(57.1)	2.5	7.5	(63.5)

1. All of the Level 3 debt securities at 31 December 2017 were reclassified as amortised cost on 1 January 2018 under IFRS 9. Further information can be found in note 1.
2. On transition to IFRS 9 investment in equity shares has been reclassified to FVTPL. Further information can be found in note 1.

Transfers between fair value levels

Transfers between fair value levels occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. Transfers are considered to occur at the end of the reporting period for the purposes of this disclosure.

32. Offsetting financial assets and liabilities

The Group and Society do not have any financial assets or financial liabilities that are offset with the net amount presented in the balance sheets. IAS 32 *Financial Instruments: Presentation* states that there should be both an enforceable right to set-off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously to apply this treatment and neither of these conditions is met.

The Group has entered into master netting arrangements such as International Swaps and Derivatives Association (ISDA) master agreements for its derivatives, other than derivatives held by Coventry Building Society Covered Bonds LLP. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements, which typically provide for the exchange of collateral to mitigate net mark to market credit exposure.

The Group has also entered into Global Master Repurchase Agreements, including margin collateralisation arrangements, whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event.

Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the covered bonds programme. However, it has entered into a separate ISDA agreement in respect of each of the derivatives it has transacted with external counterparties. Each agreement includes a CSA which provides for full collateralisation of the swap exposure with exposure thresholds in place for a single agreement before collateral is exchanged. The £17.4 million net derivative credit exposure in the table below includes £12.9 million in respect of this arrangement which will only be fully collateralised if the counterparty is downgraded to below specified credit rating.

The table below shows the net exposure for sale and repurchase agreements or derivative contracts after any netting benefits and collateral. The Group did not enter into securities lending or reverse sale and repurchase agreements during 2018 (2017: nil).

2018 Group	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	**268.9**	**(85.5)**	**(166.0)**	**17.4**
Total financial assets	**268.9**	**(85.5)**	**(166.0)**	**17.4**
Financial liabilities				
Derivative financial instruments	**167.4**	**(85.5)**	**(78.1)**	**3.8**
Sale and repurchase agreements	**623.8**	**–**	**(623.8)**	**–**
Total financial liabilities	**791.2**	**(85.5)**	**(701.9)**	**3.8**

2017 Group	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	306.5	(95.1)	(166.2)	45.2
Total financial assets	306.5	(95.1)	(166.2)	45.2
Financial liabilities				
Derivative financial instruments	214.0	(95.1)	(115.4)	3.5
Sale and repurchase agreements	300.1	–	(300.1)	–
Total financial liabilities	514.1	(95.1)	(415.5)	3.5

1. As reported on the balance sheet.
2. The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

As at 31 December 2018, £12.9 million of the £17.4 million exposure is to A1 rated institutions with a further £3.1 million to above A1 rated financial institutions.

2018 Society	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	**186.4**	**(85.5)**	**(93.6)**	**7.3**
Total financial assets	**186.4**	**(85.5)**	**(93.6)**	**7.3**
Financial liabilities				
Derivative financial instruments	**167.4**	**(85.5)**	**(78.1)**	**3.8**
Sale and repurchase agreements	**623.8**	**–**	**(623.8)**	**–**
Total financial liabilities	**791.2**	**(85.5)**	**(701.9)**	**3.8**

2017 Society	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	215.2	(95.1)	(108.2)	11.9
Total financial assets	215.2	(95.1)	(108.2)	11.9
Financial liabilities				
Derivative financial instruments	214.0	(95.1)	(115.4)	3.5
Sale and repurchase agreements	300.1	–	(300.1)	–
Total financial liabilities	514.1	(95.1)	(415.5)	3.5

1. As reported on the balance sheet.
2. The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

For derivative financial assets, collateral received can be in the form of cash and UK Government investment securities. Where cash is received it is included as a liability within deposits from banks (see note 22). Where UK Government investment securities are received, these are not recognised on the balance sheet, as the Group does not obtain the risks and rewards of ownership.

For derivative financial liabilities, collateral paid is in the form of cash and is included as an asset in loans and advances to credit institutions.

For sale and repurchase agreements (repos), collateral provided is predominantly in UK Government investment securities with the remainder in cash. Again, cash paid is included as an asset in loans and advances to credit institutions. UK Government investment securities are not derecognised as the Group retains substantially all the risks and rewards of ownership.

Cash collateral held and cash collateral pledged are not restricted and are returned at the end of the contract.

33. Capital management

As at 31 December 2018, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on the Group's capital resources and capital management can be found in the Capital section of the Risk Management Report.

34. Related party transactions

The Group is controlled by Coventry Building Society registered in England and Wales, which is also considered to be the ultimate parent.

	Group undertakings		Key management	
	2018 £m	2017 £m	2018 £m	2017 £m
Loans payable to the Society				
Loans outstanding as at 1 January	12,549.5	11,174.6	0.8	–
Loans issued during the year	1,675.1	1,374.9	0.7	1.1
Impairment credit	–	–	–	–
Repayments during the year[1]		–	(0.5)	(0.3)
Loans outstanding as at 31 December	14,224.6	12,549.5	1.0	0.8
Deposits payable by the Society				
Deposits outstanding at 1 January	–	–	2.5	2.6
Deposits received during the year[2]	–	–	0.7	1.3
Repayments during the year[1]	–	–	(0.4)	(1.4)
Deposits outstanding at 31 December	–	–	2.8	2.5
Net interest income				
Interest receivable	323.2	320.5	–	–
Interest payable	–	–	–	–
Foreign currency gains	10.9	27.0	–	–
Total	334.1	347.5	–	–
Other income and expenses				
Fees and expenses paid to the Society	10.3	7.7	–	–

1. Includes loans and deposits for key management on retirement.
2. Includes existing deposits for key management on appointment.

Interest on outstanding loans and deposits accrues at a rate agreed between the Society and its subsidiaries.

Deposits payable by the Society to Group undertakings relate to amounts owing to the Society's structured entities, in accordance with the accounting policy set out in note 1. These intercompany balances have been presented within other liabilities on the Society balance sheet.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The Board of directors are considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24 *Related Party Disclosures*. No director has any interest in the shares or debentures of any connected undertaking of the Society. See the Directors' Remuneration Report in the Governance section for information on Directors' remuneration for 2018.

In accordance with Section 68 of the Building Societies Act 1986, the Society maintains a register of loans falling within Section 65 made to directors and connected persons. A statement containing requisite particulars of such transactions may be inspected by members at the Society's Annual General Meeting (AGM) or at the Principal Office of the Society during the period 15 days prior to the AGM.

Transactions with related undertakings

Transactions are entered into with related parties in the normal course of business. These include loans, deposits, and the payment and recharge of interest and administrative expenses.

Annual Business Statement

For the year ended 31 December 2018

1. Statutory percentages

	2018 %	Statutory limits %
Lending limit	1.1	25.0
Funding limit	23.7	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of the business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus loan impairment less liquid assets, intangible assets and property, plant and equipment. The value of X used is the value at 31 December 2018.

Y = the principal value of, and interest accrued on, loans owed to the Group which are fully secured on residential property. The value of Y used is the value at 31 December 2018.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = shares and borrowings, being the aggregate of:

I. The principal value of, and interest accrued on, shares in the Society.
II. The principal value of, and interest accrued on, the amounts deposited with the Society or any subsidiary undertaking, by banks, credit institutions and other customers.
III. The principal value of, and interest accrued on, the amounts of debt securities of the Society or any subsidiary undertaking.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals other than bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons that include bodies corporate.

2. Other percentages

	2018 %	2017 %
As a percentage of shares and borrowings:		
Gross capital	5.02	5.09
Free capital	4.82	4.91
Liquid assets	14.7	15.5
As a percentage of mean total assets:		
Profit for the financial year	0.35	0.46
Management expenses	0.50	0.42
Net profit as a percentage of total balance sheet	0.34	0.43

Shares and borrowings represents the total of shares, deposits from banks, other deposits, amounts owed to other customers and debt securities in issue.

Gross capital represents the aggregate of reserves, other equity instruments, subordinated liabilities and subscribed capital.

Free capital represents the aggregate of gross capital and collective impairment less intangible assets and property, plant and equipment.

3. Principal Office

Coventry Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of the principal office is: Economic House, PO Box 9, High Street, Coventry CV1 5QN.

4. Information relating to directors

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Iraj Amiri, BSc, MSc, ACA (20.02.1954)	Company Director	Development Bank of Wales National Employment Savings Trust Woodford Lake Limited	28.06.2018
Peter Ayliffe, BA (Hons), FCIBS, CMgr (05.03.1953)	Company Director	TruRating Limited The Pennies Foundation	01.05.2013
Roger Burnell, BSc, FCA (08.04.1950)	Company Director	Clarence Mansions Management Company Limited	01.09.2008
Catherine Doran, BA (11.09.1956)	Company Director	None	01.08.2016
Andy Deeks, BA (Hons), MBA (18.03.1981)	Building Society Product, Marketing and Strategy Director	None	27.04.2017
Michele Faull, FCCA (24.11.1960)	Building Society Chief Financial Officer	Arkose Funding Limited Bow Arts Trust Coventry Cathedral Finance Committee Coventry Financial Services Limited Coventry Property Services Limited Five Valleys Property Company Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Mortgages Limited Godiva Savings Limited Godiva Securities and Investments Limited ITL Mortgages Limited	27.04.2017
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer	Five Valleys Property Company Limited	01.11.2012
Gary Hoffman, MEcon, MBA (21.10.1960)	Company Director	Choice Matters Limited Hastings Group Holdings plc Monzo Bank Limited The Football Foundation	26.01.2018
Joanne Kenrick, LLB (21.09.1966)	Company Director	Current Account Switch Service for Pay.uk Dŵr Cymru Cyfyngedig Glas Cymru Holdings Cyfyngedig Global Charities Global Charities (Trading) Limited Lynmouth Colossus Way Management Limited Rhapsody Court Freehold Limited Safestore Holdings plc	06.11.2017
Mark Parsons, BA (Hons), FCMA (24.10.1961)	Building Society Chief Executive	Godiva Mortgages Limited ITL Mortgages Limited UK Finance Limited	01.07.2014
Martin Stewart, MEng (08.09.1966)	Company Director	Clayton Stewart	01.09.2018

Documents may be served on the above named directors at: Coventry Building Society, c/o Ernst & Young LLP, 2 St. Peter's Square, Manchester M2 3EY.

The Society has entered into service contracts with the following directors: Peter Frost (Chief Operating Officer); Mark Parsons (Chief Executive); Andrew Deeks (Product, Marketing and Strategy Director); and Michele Faull (Chief Financial Officer). These are terminable by the individual on six months' notice and by the Society on one year's notice.

Other Information

Glossary

The following glossary defines terminology within the Annual Report & Accounts to assist the reader and to facilitate comparison with publications by other institutions:

Additional Tier 1 (AT 1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to a form of Common Equity Tier 1 capital; or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Available-for-sale reserve (AFS)	The Available-for-sale reserve was used under IAS 39 and contained unrealised gains and losses arising from changes in the fair value of non-derivative financial assets that are categorised as Available-for-sale. This has been replaced by fair value through other comprehensive income (FVOCI) reserve.
Average loan to value	The average of individual loan to values (simple average). The average loan to value of the residential mortgage book, weighted by balance (balance weighted). For indexed loan to value – see 'Indexed loan to value'.
Basel IV	The alternative industry name given to the Basel Committee's final implementation of its Basel III Banking Supervision reforms published in December 2017 addressing credit risk (standardised approach with floors, and IRB), operational risk and the leverage ratio. They are applicable from January 2022 and are phased in over five years.
Basis point	One hundredth of a percent (0.01 percent). Used when quoting movements in interest rates and yields on securities.
Brexit	The process of the UK leaving the European Union decided by the UK referendum on 23 June 2016.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital Conservation Buffer (CCoB)	A CRD IV risk adjusted capital requirement for all banks that can be used to absorb losses whilst avoiding breaching minimum capital requirements.
Capital requirements	Amount of capital required to be held by the Group to cover the risk of losses and to protect against excessive leverage. The level is set by regulators and the firm's own assessment of its risk profile.
Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)	CRD IV is the European Union legislation (part regulation and part directive) which came into force from 1 January 2014 to implement Basel III, revising the capital requirements framework and introducing liquidity requirements, which regulators use when supervising firms.
Capital Requirements Regulation (CRR) leverage ratio	A ratio defined by the Capital Requirements Regulation (CRR) which measures Tier 1 capital as a proportion of total CRR leverage ratio exposures. These exposures are the sum of the on-balance sheet exposures, adjusted for derivatives and securities financing transaction exposures, and off-balance sheet items.
Capital resources	Capital comprising the general reserve, fair value through other comprehensive income reserve, eligible Additional Tier 1 capital less all required regulatory adjustments.
Central clearing	The process by which parties to an over-the-counter derivative contract replace this with a separate contract with a central counterparty, which takes over each party's positions under the original contract.
Certificates of deposit	Bearer-negotiable instruments issued on the receipt of a fixed term deposit at a specified interest rate.
Collateral	Security pledged by the borrower to the lender in case of default.
Common Equity Tier 1 (CET 1) capital	Common Equity Tier 1 capital comprises general reserves and the fair value through other comprehensive income reserve, less regulatory deductions. Common Equity Tier 1 must absorb losses on a going concern basis.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Conduct risk	The risk that the Society's behaviour and decision making fail to deliver good customer outcomes.
Contractual maturity	The date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.
Core Capital Deferred Shares (CCDS)	A form of Common Equity Tier 1 (CET 1) capital. The Society's Perpetual Capital Securities (PCS) convert into CCDS at the rate of one CCDS for every £67 PCS held if the end-point CET 1 ratio, calculated on either an individual or consolidated basis, falls below 7%.
Countercyclical Buffer (CCyB)	A CRD IV risk adjusted capital requirement for all banks that is varied over the financial cycle to match the resilience of the banking system to the scale of risks faced.
Countercyclical Leverage Buffer (CCLB)	A leverage capital requirement under the UK leverage regime that is set at 35% of the corresponding risk adjusted Countercyclical Buffer (CCyB).
Covered bonds	Debt securities that are backed by both the resources of the issuer and a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.

Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual principal risk categories.
Currency swap	An arrangement in which two parties exchange equivalent principal amounts of different currencies at inception and subsequently exchange interest payments on the principal amounts. At the maturity of the swap, the principal amounts are re-exchanged at the original rates, protecting the participants from changes in exchange rates.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	Liabilities of the Group that are transferable by external investors that operate within the global financial markets.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods as a result of the carry-forward of tax losses or unused tax credits, or from deductible (or taxable) temporary differences between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit pension plan resulting from past employee service.
Defined benefit pension scheme	A pension or other post-retirement benefit plan offering guaranteed benefits, usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
Effective Interest Rate (EIR)	The rate of interest earned over the life of an instrument that is equivalent to the discounted rate of projected cash flows of the instrument, adjusted for compounding.
Effective tax rate	The tax charge in the Income Statement as a percentage of profit before tax.
Encumbered assets	Assets used to secure liabilities or otherwise pledged. This excludes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes.
End-point	Full implementation of regulation (for example, CRD IV) with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A Board approved framework which provides the context, guidance and principles needed for cohesive risk management activity across the Society and its subsidiaries.
European Banking Authority	An independent European Union authority which works to ensure effective and consistent financial regulation and supervision across the European banking sector.
Eurozone	An economic and monetary union (EMU) of European Union member states that have adopted the euro (€) as their common currency and sole legal tender.
Expected credit loss (ECL)	The present value of all cash shortfalls over the expected life of a financial instrument. The term is used for the accounting for impairment provisions under the new IFRS 9 standard.
ECL – 12 month	Cash shortfalls resulting from default events that are possible in the next 12 months weighted by the probability of that default occurring.
ECL – lifetime	Cash shortfalls resulting from default events that are possible over the remaining expected life of the loan, weighted by the probability of that default occurring.
Expected loss	A calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a 12 month time period.
Exposure	The quantified potential for loss that might occur as a result of a risk occurring.
Exposure at default (EAD)	A parameter to estimate the amount outstanding at the time of default.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.
Fair value through other comprehensive income (FVOCI)	Financial assets held at fair value on the balance sheet with changes on the fair value recognised through other comprehensive income.
Fair value through profit and loss (FVTPL)	Financial assets held at fair value on the balance sheet with changes in fair value being recognised through the Income Statement.
FCA Remuneration Code	The aim of the Financial Conduct Authority's (FCA) Remuneration Codes is to: ensure greater alignment between risk and individual reward; discourage excessive risk taking and short-termism; encourage more effective risk management; and support positive behaviours and a strong and appropriate conduct culture within firms.

Term	Definition
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
Financial Ombudsman Service (FOS)	The Financial Ombudsman Service provides an independent and impartial service to resolve individual complaints that consumers and financial institutions have been unable to settle themselves.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every deposit taking firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Fitch	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
Foreign currency risk	The risk of loss arising as a result of movements in exchange rates on investments, obligations or derivatives in foreign currencies.
Free capital	From 1 January 2018 the aggregate of gross capital less: property, plant and equipment; non-current assets held for sale; and intangible assets. In 2017, free capital was adjusted for provisions for collective impairment losses on loans and advances to customers, which is no longer applicable following transition to IFRS 9.
General reserve	The general reserve is the accumulation of historical and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Government investment securities (gilts)	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
Gross capital	The aggregate of reserves, other equity instruments, subscribed capital and subordinated liabilities.
IFRIC	The International Financial Reporting Interpretations Committee. IFRIC interprets the application of IAS and IFRS and provides timely guidance on financial reporting issues not specifically addressed in IAS and IFRS, in the context of the International Accounting Standards Board framework.
IFRS/IAS	International Financial Reporting Standards/International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are defaulted loans in IFRS 9 stage 3.
Impairment provision	Expected credit losses (ECL) held under IFRS 9 – see expected credit loss glossary definition.
Indexed loan to value	Loan to value calculated on the basis of the latest property valuation being adjusted by the relevant House Price Index movement since that date.
Individual Liquidity Guidance	Guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.
Interest rate risk	Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of differences between interest rates received and paid on mortgages, deposits and financial instruments.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment of the liquidity resources that are required to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on regulatory benchmarks and Society-specific tests.
Internal Ratings Based (IRB) approach	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1. The IRB approach may only be used with permission from the PRA.
ISDA	The International Swaps and Derivatives Association (ISDA) is the global trade association for over-the-counter (OTC) derivatives and providers of the industry-standard documentation for derivative transactions.
Leverage ratio	A calculation brought in as part of CRD IV which measures the relationship between eligible Tier 1 capital and exposures to on and off-balance sheet items. There are two bases of calculation – see Capital Requirements Regulation (CRR) leverage ratio and UK leverage ratio.

LIBOR	London Inter-Bank Offer Rate. A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquid assets	An amount as defined by the Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including Government investment securities (gilts)), loans to credit institutions and other liquid assets.
Liquidity and Funding risk	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Liquidity and Funding risks are principal risks of the Society.
Liquidity Coverage Ratio (LCR)	A measure brought in as part of CRD IV which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprise cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and self-issued covered bonds, RMBS and Bank of England approved mortgage portfolios.
Loan to value	The amount of mortgage loan as a percentage of the value of the property.
Loss given default (LGD)	A parameter used to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	Market risk is defined as the risk of a reduction in Society earnings and/or value resulting from adverse movements in financial markets.
Medium-term notes	Securities offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.
Minimum Requirement for own funds and Eligible Liabilities (MREL)	A requirement under the Bank Recovery and Resolution Directive (BRRD) which requires deposit takers to hold minimum levels of capital plus debt eligible for bail-in.
Model risk	The risk that an ineffective model or incorrectly interpreted model output leads to a loss, reputational damage or regulatory censure.
Moody's	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of average total assets.
Net Promoter Score® (NPS)	A measure of customer advocacy that ranges between -100 and +100 and represents how likely a customer is to recommend a brand, product or service to a friend or colleague. Net Promoter®, Net Promoter Score® and NPS® are trademarks of Satmetrix Systems , Inc., Bain & Company, Inc., and Fred Reichheld.
Net Stable Funding Ratio (NSFR)	A ratio which assesses the amount of stable funding in place as a proportion of the on and off-balance sheet funding requirements of an institution. The requirement is still to be formally implemented.
Non-linearity	Non-linearity in the relationship between ECLs and economic conditions occurs when a change to an economic assumption or scenario has a greater effect on the level of credit losses, when compared to an equivalent change in the assumption or scenario in the opposite direction.
Open Banking	The term used to describe activity mandated by the Competition and Markets Authority through the Retail Banking Market Investigation Order 2015. This requires the nine largest UK banks and building societies to develop and use open standards to enable the sharing of customer payment account data. The term 'open banking' is also used to refer to the elements of Payment Services Directive II (PSD2) that oblige financial institutions such as the Society to provide authorised third party organisations with payment account transactional data, or the ability for them to initiate a payment, where the member has requested this and provided consent.
Operational risk	The risk of loss arising from inadequate internal processes, systems or people, or from external events.
Output floor	A future requirement of Basel IV that sets a floor on the determination of risk weights. The floor will be a proportion of the standardised approach and will be phased in for firms using IRB models.
Overnight indexed swap (OIS) rate	A rate reflecting the overnight interest earned or paid in respect of overnight interbank loans, being typically SONIA for sterling loans. OIS is used to value collateralised interest rate derivatives.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Pension fund surplus	The assets in a pension fund that are in excess of its liabilities.

Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. Under Basel III, PIBS are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society and qualify as Additional Tier 1 capital.
Pillar 1/2/2A/3	Components of the Basel capital framework. Pillar 1 covers the minimum requirement, Pillar 2 covers capital requirement of risks not covered in Pillar 1 and Pillar 3 covers disclosures.
PRA buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
Probability of default (PD)	An estimate of the probability that a borrower will default on their credit obligations over a fixed time period. With respect to impairment provisions under IFRS 9, 12 month ECLs use 12 month PDs, whilst a lifetime ECL uses the estimated PD over the remaining contractual life of the loan. With respect to IRB, PD is the probability of a loan defaulting in the next 12 months calculated as an average over an economic cycle.
Principal risk	Principal risk is a class of significant inherent risk which could materially compromise the Society's ability to grow and provide attractive products to savings and borrowing members.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
PV100	Present Value 100. A calculation of the theoretical change in the net present value of financial instruments for a 100 basis point (1%) parallel shift in yield curves.
PV200	Present Value 200. A calculation of the theoretical change in the net present value of financial instruments for a 200 basis point (2%) parallel shift in yield curves.
Research and Development Expenditure Credit	A UK Government tax incentive that rewards companies for investing in research and development.
Residential Mortgage Backed Securities (RMBS)	Securities issued with interest and principal backed by interests in a group of residential mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Residual maturity	The remaining period to the contractual maturity date of a financial asset or financial liability.
Resolution Authority	In the UK, the Resolution Authority is the Bank of England which is responsible for taking charge, recapitalising and restructuring a firm, on account of the firm realised or expected failure.
Retail deposits	See Shares.
Reverse stress test	Regulatory stress test that requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.
Risk appetite	An articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving its business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.
Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a structured entity which then issues securities (RMBS) backed by the assets. The Group has used residential mortgages as the loan pool for securitisation purposes.
Self-certified mortgage	An owner-occupier mortgage where the lending decision with respect to affordability has been based solely on the borrower's declaration of their income.
Senior unsecured debt funding	Bonds issued by corporate bodies and financial institutions, which are not secured by any collateral and are not subordinated to any other wholesale liabilities of the issuer.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities of the Society.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
Significant increase in credit risk	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment, using quantitative and qualitative factors, identifies at a reporting date that the credit risk has increased significantly since the asset was originally recognised.
SONIA	A rate reflecting the interest earned or paid in respect of sterling overnight interbank loans.
Solely payments of principal and interest test	An assessment of whether the contractual terms of the financial asset give rise to cash flows that are in substance solely payment of principal and interest.
Sovereign exposure	Exposures to governments and on account of cash balances and deposits with central banks.

Stage 1	Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the balance sheet. 12 month ECLs are recognised as the impairment provision for all financial assets on initial recognition. Interest revenue is the EIR on the gross carrying amount.
Stage 2	Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision. Interest revenue is EIR on the gross carrying amount.
Stage 3	Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECL is also recognised as an impairment provision. Interest revenue is the EIR on the net carrying amount.
Standardised approach	The basic method used to calculate capital requirements for credit and operational risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
Strategic investment	Significant one off change programmes arising from strategic choice rather than business as usual or regulatory change activity.
Strategic risk	The risk that arises from a failure to adopt an appropriate business model, set appropriate goals and targets or a failure to adapt to external developments. This includes the risk of an overly ambitious Strategic Plan as well as unforeseen market, consumer, competitor or regulatory changes.
Stress testing	Testing undertaken to provide an understanding of the Society's resilience to internal and external shocks.
Structured entity	An entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.
Subordinated liabilities	A form of Tier 2 capital that is unsecured. Subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members (other than holders of Permanent Interest Bearing Shares and Perpetual Capital Securities) as to principal and interest. Under Basel III are included as Tier 2 under transitional rules only.
Subscribed capital	See Permanent Interest Bearing Shares.
Supplementary Leverage Ratio Buffer (SLRB)	Applied to systemically important banks and building societies. As a guiding principle, the FPC sets the buffer at 35% of the risk weighted Systemic Risk Buffers.
Surcharge	An 8% surcharge on the profits of banking companies which was introduced from 1 January 2016 by the Finance (No. 2) Act 2015.
Systemic Risk Buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.
Term Funding Scheme (TFS)	The Term Funding Scheme (TFS) is a tool of the Monetary Policy Committee designed to reinforce the transmission of Bank of England Base Rate cuts to those interest rates actually faced by households and businesses by providing term funding to banks and building societies at rates close to Bank of England Base Rate.
Tier 1 capital	A component of regulatory capital comprising Common Equity Tier 1 and Additional Tier 1 capital.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances.
Total Capital Requirement (TCR)	The minimum amount of capital the Society should hold as set by the PRA under Pillar 1 and Pillar 2A and informed by the Internal Capital Adequacy Assessment Process (ICAAP).
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with an intention to trade. The Society does not have a trading book.
UK Corporate Governance Code (the Code)	The code (formerly known as the Combined Code), issued by the Financial Reporting Council, that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.
UK Finance	A trade association that incorporates residential mortgage lending.
UK leverage ratio	A ratio prescribed by the PRA based on the CRR leverage ratio but modified to restrict the amount of AT 1 capital that can be included in Tier 1 capital and to exclude eligible central bank holdings from leverage ratio exposures.
Underlying profit	A measure previously used to reflect management's view of the Group's underlying performance with like for like comparisons of performance across years without distortion of one off volatility and items that were not reflective of the Group's ongoing business activities.
Unencumbered assets	Assets readily available as collateral to secure funding. This includes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes and are therefore readily available as collateral to secure funding or to pledge as collateral against margin calls.
Wholesale funding	Funding received from external counterparties that operate within the global financial markets (for example, insurance companies, pension funds, large businesses, financial institutions and sovereign entities).
Write off	To write off a financial asset when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery.

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