Pillar 3 Disclosures

for the year ended 31 December 2018

COVENTRY
Building Society

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Please note the term Society is used in this Pillar 3 document to refer to the activities of the Society and its subsidiaries except where the context indicates otherwise.

1. Overview

1.1 Background

This Pillar 3 document sets out disclosure requirements under the Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRD IV).

These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

CRD IV requires a concise risk statement approved by the management body which describes the institution's overall risk profile associated with the business strategy. The Society has a risk philosophy to be a below median risk building society. This is evidenced by a prudent lending policy with a conservative balance weighted indexed loan to value of 54.6% (2017: 53.9%) and low levels of arrears. 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%[1]. As a result, the Society's Common Equity Tier 1 capital ratio was 35.5% (2017: 34.9%), the highest reported by any top 20 lender[2]. Additional information on the risks the Society is exposed to and how it manages these risks is included in this document and also within the Risk Management Report in the 2018 Annual Report & Accounts (accounts).

1.2 Policy and frequency of disclosures

The CRR requires the Society to adopt a formal policy to comply with Pillar 3 disclosure requirements and the European Banking Authority has issued guidelines on materiality, proprietary and confidential information and on disclosure frequency. The Board has put in place such a policy and confirm that no disclosures have been omitted as either being proprietary or confidential. The only omissions on materiality grounds are those required under Article 447 'Exposures in equities not included in the trading book'. The fair value of these investments is £3.1 million (less than 0.007% of the Society's total assets) and they are made up of shares in Visa Inc. and VocaLink Holdings Limited (see note 31 to the accounts). In addition, the regulatory capital ratios disclosed in this report do not include the impact of IFRS transitional relief as this relief is not material for the Society (see 1.7 below).

Pillar 3 disclosures are published on an annual basis in conjunction with the accounts in accordance with regulatory guidelines.

1.3 Verification

These disclosures have been reviewed by the Board Audit Committee on behalf of the Board. Independent external review on compliance with Part Eight of the CRR has also been obtained. These disclosures have not been, and are not required to be, subject to independent external audit, and do not constitute any part of the Society's financial statements.

1.4 Governance arrangements and remuneration

Disclosure requirements relating to governance arrangements under CRR Part Eight Article 435, and in particular the declaration approved by the Board of the adequacy of risk management arrangements, are included in the Directors' Report on Corporate Governance and Annual Business Statement within the 2018 accounts published on the Society's website (www.coventrybuildingsociety.co.uk/accounts2018).

The disclosures required under CRR Part Eight Article 450 and the Prudential Regulation Authority's (PRA) Remuneration Code are included in the Directors' Remuneration Report within the 2018 accounts.

1 Source: Prudential Regulation Authority – latest available information at 30 September 2018.
2 Source: CML Economics – 2017 top mortgage lenders (balance outstanding) – latest published CET data, as at 27 March 2019.

1.5 Scope of disclosures

The Society is a European Economic Area (EEA) parent institution that is regulated by the PRA and Financial Conduct Authority (FCA). The CRD IV framework therefore applies to the Society and its subsidiary undertakings. Information on these subsidiaries is set out in note 17 to the 2018 accounts. There are no differences between the basis of consolidation of the Group for accounting and CRD IV purposes in preparing the Pillar 3 disclosures.

Regulatory capital ratios are calculated on both a Group and an Individual Consolidated (or solo) basis. The subsidiaries included in the Individual Consolidated basis are Godiva Mortgages Limited and ITL Mortgages Limited.

The Society does not foresee any practical or legal impediments to the transfer of capital resources or the repayment of liabilities between the Society and the entities included in the Individual Consolidated basis.

The Group consolidation also includes structured entities used by the Society in its wholesale funding programmes. These entities have minimal levels of retained capital and risk weighted assets. As a result there are no significant differences between the Individual Consolidated basis and the Group. For this reason, the disclosures in this document are made on a Group basis only and the term Society is used as a reference for the Group.

1.6 European Banking Authority Guidelines on Pillar 3 disclosures

The Society is not a Globally or Other Systemically Important Institution and taking account of its simple business model and low risk profile, has chosen not to reflect the 2016 and 2017 EBA Guidelines for such institutions in its 2018 disclosures other than abbreviated disclosures of the Liquidity Coverage Ratio (LCR) in Appendix 6.

1.7 IFRS 9 – Impact on impairment and regulatory capital

The Society implemented IFRS 9 Financial Instruments on 1 January 2018 and information on the transition impact is in note 1 to the 2018 accounts.

The transition did not have a material impact on the Society's balance sheet and the impact on regulatory capital was negligible.

To coincide with IFRS 9 implementation, CRD IV introduced transitional capital arrangements which reduced the impact of IFRS 9 expected credit losses on a phased basis over 5 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.

2. Risk management policies and objectives

2.1 Overview

The Society is a mutual organisation run for the long-term benefit of its members. In keeping with this, the Board adopts a prudent approach to managing risk.

2.2 The Society's mission and objectives

The Society exists solely for the benefit of its members, meeting their needs for good value savings and mortgage products. In delivering its strategic objectives, the Society is committed to Putting Members First, which means doing the right thing for both current and future members. The Society fully embraces the mutual ethos on which it was founded and the Board believes that remaining an independent mutual building society produces the best outcomes for members and for the communities in which the Society operates.

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, business model and values are in the Strategic Report in the 2018 accounts.

Effective risk management complements this simple business model to make sure financial and operational resilience are maintained. The Society's 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.

2.3 Principal risks categories

As a UK Building Society there are a number of risks which it is inherently exposed to. These Principal risk categories are summarised below, in addition to information on how the Society mitigates and manages 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 Society 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 arising from changes to the business model or that macroeconomic, geopolitical, regulatory or other factor 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.

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 at the 2018 year end were change and execution risk in relation to the Society's major strategic investment programmes, UK political and economic uncertainty and the risk that the market environment exerts pressure on the Society's net interest margin.

The Society also has pension obligation risk in relation to the now closed defined benefit pension scheme. Pension obligation risk is not considered material for the Society.

Disclosures relating to market, liquidity and funding, conduct, operational, model and strategic risks and top and emerging risks are included in the Risk Management Report in the 2018 accounts and are not duplicated in this document. The required Pillar 3 asset encumbrance disclosures are included in Appendix 3 and Pillar 3 Liquidity Coverage Ratio (LCR) disclosures in Appendix 6. This document does, however, include additional credit risk information to that in the 2018 accounts given that credit risk is the principal driver of the Society's Pillar 1 capital requirement. In order to provide the reader with a comprehensive overview of credit risk, the 2018 accounts disclosures on credit risk are also included in this document.

2.4 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.

2.5 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 integrity, especially in the fair treatment of customers, and to act and 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.

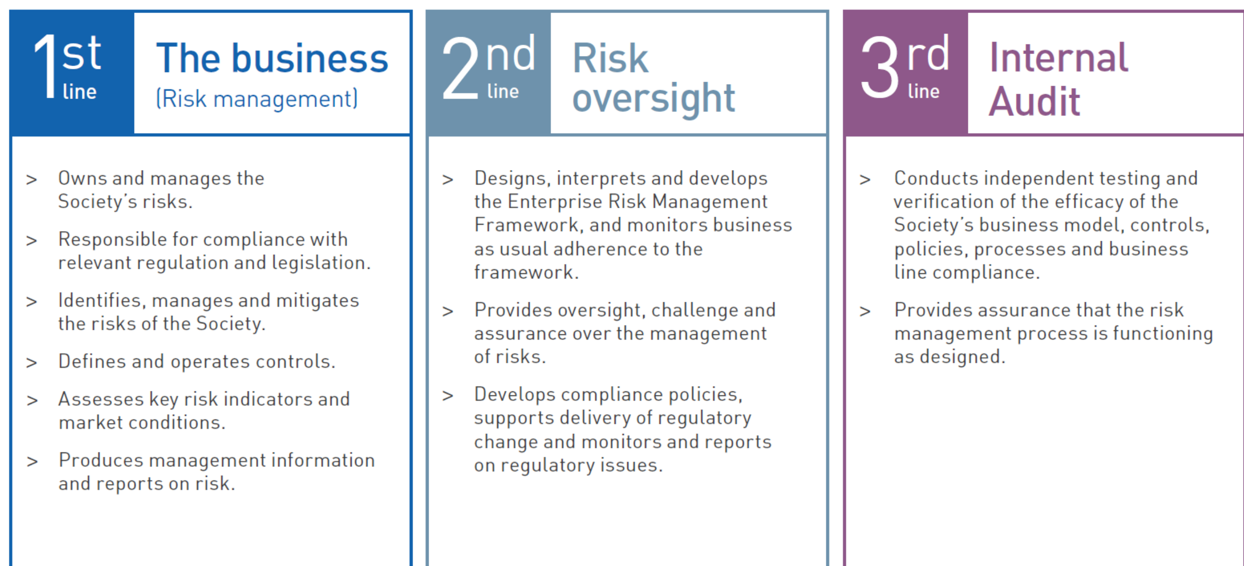
Performance and adherence to Board limits is reviewed by the Executive Risk Committee (ERC), the Board Risk Committee (BRC) and the Board.

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.

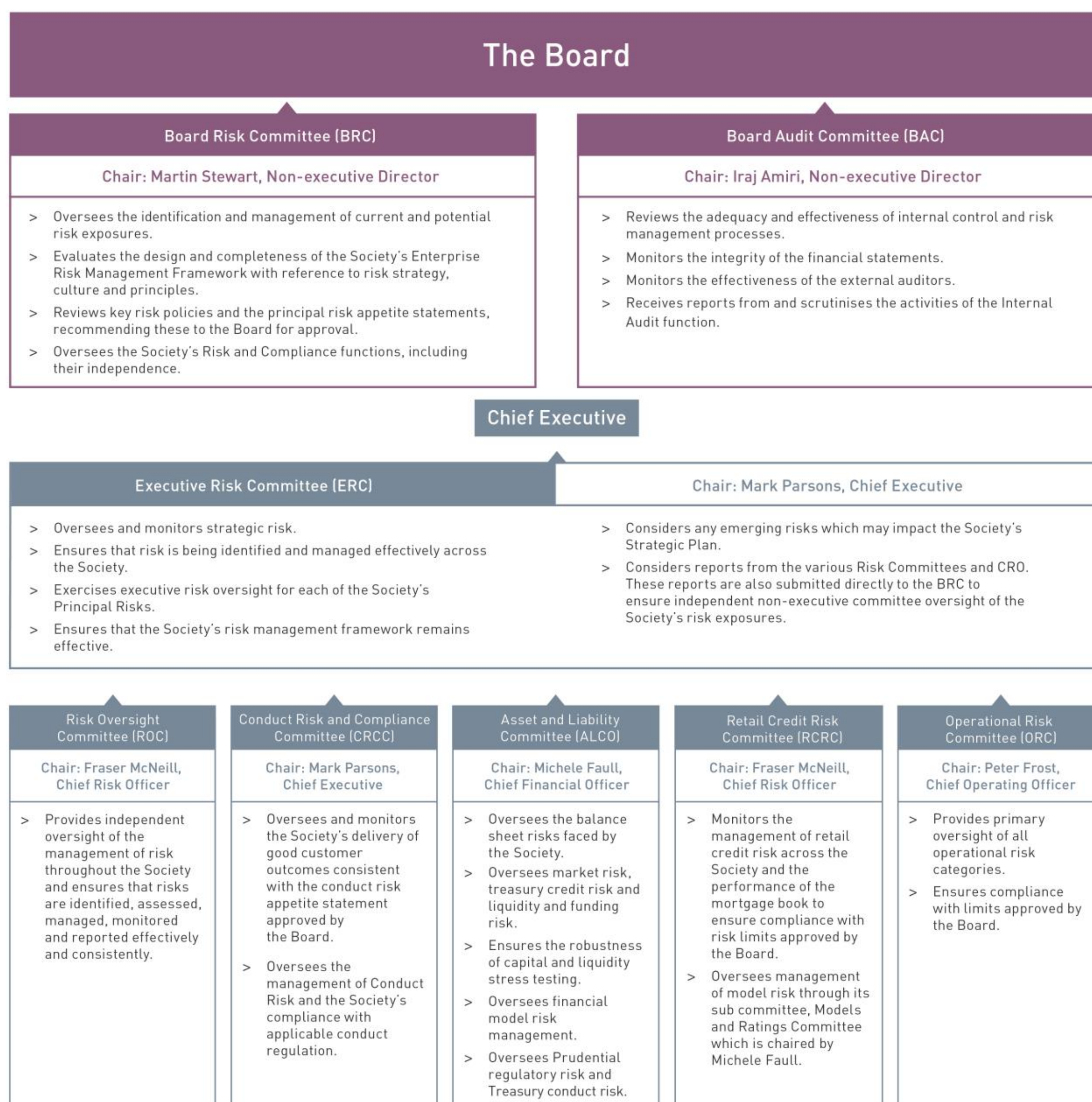


2.6 Governance and control

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 reports to the Chief Executive and has an independent reporting line directly to the Chair of 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 accounts in the Directors' Report on Corporate Governance and in the Board Audit Committee Report respectively.



2.7 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.

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.

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 Internal Capital Adequacy Assessment Process (ICAAP) is the Society's evaluation of its capital position and requirements. Additional information is available in Sections 4.1 and 4.2.

More detail on the Internal Liquidity Adequacy Assessment Process (ILAAP) together with reverse stress testing is set out in the Liquidity and Funding risk section in the Risk Management Report in the 2018 accounts.

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.

3. Capital resources

3.1 Total available capital and compliance with capital requirements

As at 31 December 2018 and throughout the financial year, the Society complied with the capital requirements in force.

As explained in Section 1, the capital information in this section is set out on a Group basis only and the term 'Society' is used as a reference for the Group and the regulatory ratios disclosed do not include IFRS 9 transitional relief as this is not material.

The Society continues to use an Internal Ratings Based (IRB) approach for over 99% of its retail credit risk exposures and a Standardised approach for other exposures and risks in order to calculate capital requirements.

From January 2008, the Financial Services Authority (a predecessor of the PRA) granted the Society permission to use the IRB approach. This was extended by the PRA in July 2013 to include the majority of mortgages transferred from the merger with the Stroud & Swindon Building Society in 2010. These permissions were updated to become a CRR IRB permission from 1 January 2014 and further extended during 2015 to include the then £0.5 billion mortgage book acquired from the Bank of Ireland in 2012.

Table 1 shows the composition of capital resources for the Society as at 31 December 2018 on a CRD IV basis on both a transitional and end-point basis (i.e. assuming all CRD IV requirements were in force with no transitional provisions permitted).

No transitional provisions apply to the Society's Common Equity Tier 1 (CET 1) capital and CET 1 ratio and there is therefore no difference between the end-point and transitional disclosures for CET 1. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital ratios) include instruments that are grandfathered and are therefore disclosed on both a transitional and end-point basis. The transition period ends on 31 December 2021.

Table 1: CRD IV – transitional and end-point analysis

	Notes	Transitional 2018 £m	Transitional 2017 £m	End-point 2018 £m	End-point 2017 £m
Common Equity Tier 1 (CET 1)					
General reserve		**1,693.5**	1,553.1	**1,693.5**	1,553.1
Fair value through other comprehensive income reserve	1	**5.6**	5.7	**5.6**	5.7
Cash flow hedge reserve		**24.4**	20.3	**24.4**	20.3
Common Equity Tier 1 prior to regulatory adjustments		**1,723.5**	1,579.1	**1,723.5**	1,579.1
Common Equity Tier 1 regulatory adjustments					
Prudent additional valuation adjustment	2	**(0.9)**	(1.0)	**(0.9)**	(1.0)
Intangible assets	3	**(33.1)**	(40.8)	**(33.1)**	(40.8)
Cash flow hedge reserve	3	**(24.4)**	(20.3)	**(24.4)**	(20.3)
Excess of expected loss over impairment	4	**(23.5)**	(21.9)	**(23.5)**	(21.9)
Pension fund surplus adjustment	3	**(17.5)**	(14.2)	**(17.5)**	(14.2)
Foreseeable distributions	5	**(9.3)**	(9.3)	**(9.3)**	(9.3)
Common Equity Tier 1 capital		**1,614.8**	1,471.6	**1,614.8**	1,471.6
Additional Tier 1 capital (AT 1)					
Permanent Interest Bearing Shares (PIBS)		**40.0**	40.0	**–**	–
Additional Tier 1 - Perpetual Capital Securities (PCS)		**396.9**	396.9	**396.9**	396.9
Total Additional Tier 1 capital		**436.9**	436.9	**396.9**	396.9
Total Tier 1 capital		**2,051.7**	1,908.5	**2,011.7**	1,868.5
Tier 2					
Collective provisions for impairment		–	1.5	**–**	1.5
Permanent Interest Bearing Shares (PIBS)	6	–	–	**–**	40.0
Subordinated debt		**22.2**	25.0	**–**	–
Total Tier 2 capital		**22.2**	26.5	**–**	41.5
Total capital		**2,073.9**	1,935.0	**2,011.7**	1,910.0
Risk weighted assets					
IRB approach					
Credit risk - retail exposures		**3,592.4**	3,270.8	**3,592.4**	3,270.8
Standardised approach					
Credit risk - retail exposures		**140.7**	159.5	**140.7**	159.5
Credit risk - liquidity book		**86.4**	99.0	**86.4**	99.0
Credit risk - other		**68.3**	50.0	**68.3**	50.0
Credit valuation adjustment risk		**48.7**	46.8	**48.7**	46.8
Operational risk		**612.0**	587.0	**612.0**	587.0
Total risk weighted assets		**4,548.5**	4,213.1	**4,548.5**	4,213.1
Capital ratios (as a percentage of risk weighted assets)	7				
Common Equity Tier 1		**35.5%**	34.9%	**35.5%**	34.9%
Total Tier 1		**45.1%**	45.3%	**44.2%**	44.3%
Total capital		**45.6%**	45.9%	**44.2%**	45.3%

Notes
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 was the Available-for-sale reserve.
2. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
3. Items do not form part of regulatory capital, net of associated deferred tax.
4. The expected loss over accounting provisions is deducted gross of tax.
5. Foreseeable distributions in respect of AT 1 securities (Perpetual Capital Securities) are deducted, net of tax.
6. 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.
7. CRD IV sets a minimum for Tier 1 capital of 6% of risk weighted assets (RWAs) of which CET 1 is required to be a minimum of 4.5% of RWAs. The total of Tier 1 and Tier 2 capital must be a minimum of 8% RWAs.

Appendix 1 sets out this information in the template format published by the EBA in 'Implementing Technical Standard (ITS) 2013/01'.

CET 1 capital, Tier 1 capital and total capital have increased primarily as a result of retained profits for the year of £156.1 million. 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. As a result, CET 1 ratio has been maintained at 35.5% (2017: 34.9%).

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.

Table 2 shows the movement in capital during 2018. CET 1 capital is the same on an end-point and transitional basis. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital) are disclosed on a transitional basis.

Table 2: Regulatory capital flow statement

	£m
Common Equity Tier 1 capital at 31 December 2017	1,471.6
Changes on initial application of IFRS 9[1]	0.1
Restated position Common Equity Tier 1 capital at 1 January 2018	**1,471.7**
Retained profit for the year	156.1
Other changes to General reserves	(16.7)
Change in prudent valuation adjustments	0.1
Change in intangible assets	7.7
Change in Fair value through other comprehensive income reserve	0.8
Change in expected loss over impairment	(1.6)
Change in pension fund surplus adjustment	(3.3)
Common Equity Tier 1 capital at 31 December 2018	**1,614.8**
Additional Tier 1 capital at 1 January 2018	436.9
Additional Tier 1 capital at 31 December 2018	**436.9**
Total Tier 1 capital at 31 December 2018	**2,051.7**
Tier 2 capital at 1 January 2018	26.5
Amortisation of subordinated debt	(2.8)
Change in eligible collective provision for impairment	(1.5)
Tier 2 capital at 31 December 2018	**22.2**
Total regulatory capital at 31 December 2018	**2,073.9**

1. A reconciliation and explanation of IFRS 9 adjustments on 1 January 2018 are in note 1 to the 2018 accounts.

3.2 Tier 1 capital

Tier 1 capital comprises:

- General reserve
- Fair value through other comprehensive income reserve (formerly Available-for-sale reserve);
- AT 1 capital – Perpetual Capital Securities (PCS);
- AT 1 capital – Permanent Interest Bearing Shares (PIBS) on a transitional basis only; and
- Adjustments as set out by the regulatory requirements governing capital resources – see Table 1.

The General reserve represents the Society's accumulated accounting profits.

The Society issued £400.0 million (£396.9 million net of issuance costs) of AT 1 capital in June 2014. The capital securities are convertible into Core Capital Deferred Shares (the equivalent of common shares for a building society, with a capped return) if the Society's CET 1 capital ratio should fall below 7%. More information on the key features of these securities is included in Appendix 2.

3.3 Tier 2 capital

Tier 2 capital comprises:

- Subordinated debt (transitional basis only); and
- For 2017 only, collective provisions for impairment for Standardised exposures calculated under IAS 39. Under IFRS 9 from 1 January 2018 the Society no longer holds collective provisions.

Subordinated debt instruments are unsecured and rank behind the claims of all depositors, creditors and shareholders in the Society other than holders of PIBS and PCS.

Appendix 2 shows the key features of the Society's Tier 1 and Tier 2 capital instruments and more information can be found in notes 26, 27 and 28 to the 2018 accounts.

3.4 Leverage ratio

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 captured by 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 more onerous and become the most binding capital requirement on the Society.

Following the launch of the Term Funding Scheme (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 Additional Tier 1 capital. Neither of these modifications exists in the CRR leverage measure.

There are two leverage 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 – see section 4.4.

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 for the Society 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.

The Society has policies and procedures in place to manage the risk of excessive leverage through maintaining a prudent balance between the pace of growth and the pace of capital accumulation. This is explicitly incorporated into the Society's strategic planning process (see section 4.2.2). ICAAP stress testing considers the impact of stress events on leverage.

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 Additional Tier 1 (AT1) 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.

Table 3: Leverage ratio

	Notes	**End-point 2018 £m**	End-point 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 exposures – 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%

Notes

1. Mortgage pipeline and other commitments are assessed at 20% (2017: 50%) following the receipt of EBA guidance in the year on 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 AT1 restriction on capital and central bank reserves in exposures.
6. In previous years the UK leverage ratio has been reported as 'Leverage ratio (modified)'.

The CRR leverage ratio disclosures using the European Banking Authority Templates are in Appendix 4.

4. Capital requirements

4.1 Pillar 1

4.1.1 Introduction

The primary purpose of capital is to absorb any losses that might arise from risks. For the Society, capital is principally held for credit losses on lending, trading losses due to pressure on net interest income or expenses and losses from other adverse events such as operational incidents.

The Society manages its capital structure to ensure it continues to exceed minimum regulatory requirements and meets the expectation of other key stakeholders.

The Society employs a number of tools to support the management of capital. The Board is responsible for setting risk appetite with respect to capital and defines minimum levels of capital (primarily by reference to capital ratios, leverage ratios and surplus over regulatory capital requirements) that it is willing to operate with. These are translated into specific risk metrics which are monitored by the Board Risk Committee, Executive Risk Committee and the Asset and Liability Committee.

The Society undertakes an annual Internal Capital Adequacy Assessment Process (ICAAP) to determine the level of capital required to support the Society's business objectives as set out in the Strategic Plan. Regular stress testing is also undertaken to enhance the understanding of any potential vulnerabilities to stressed market conditions or tail-risks and management actions that could be deployed to manage these. The ICAAP and stress testing are considered further in section 4.2 below.

4.1.2 Minimum capital requirement – Pillar 1

The Society's minimum capital requirement under Pillar 1 is the sum of the credit risk capital requirement and the operational risk capital requirement. Market risk arises from foreign exchange risk and is calculated in accordance with the Standardised Approach but is set at zero as it falls below the threshold for recognition. The Society does not have a trading book and foreign exchange risk is negligible.

The credit risk capital requirement is largely dependent upon residential mortgage capital calculated under the Internal Ratings Based (IRB) approach. The remaining credit risk capital requirement is calculated using the Standardised approach. The capital requirement under both the IRB and Standardised approach is calculated as 8% of the risk weighted exposure amounts for each credit risk exposure class.

The operational risk capital requirement is calculated using the Standardised approach based on total income averaged over three years.

The following table shows the Society's assessment of its overall minimum capital requirement.

Table 4: Minimum capital requirement – Pillar 1

	RWA		Minimum capital requirements	
	2018	2017	**2018**	2017
	£m	£m	**£m**	£m
Credit risk (excluding counterparty credit risk (CCR)	**3,838.7**	3,528.6	**307.1**	282.3
Of which standardised approach	**246.3**	257.8	**19.7**	20.6
Of which the advanced IRB approach	**3,592.4**	3,270.8	**287.4**	261.7
Counterparty credit risk (CCR)	**93.7**	92.0	**7.6**	7.3
Of which mark to market	**43.8**	45.2	**3.6**	3.6
Of which the standardised approach	**1.2**	–	**0.1**	–
Of which credit valuation adjustment	**48.7**	46.8	**3.9**	3.7
Securitisation exposures	**1.6**	2.1	**0.1**	0.2
Of which standardised approach (SA)	**1.6**	2.1	**0.1**	0.2
Operational risk	**612.0**	587.0	**49.0**	46.9
Of which standardised approach	**612.0**	587.0	**49.0**	46.9
Amounts below the threshold for deduction (subject to 250%) risk weight	**2.5**	3.4	**0.2**	0.3
Total	**4,548.5**	4,213.1	**364.0**	337.0

4.1.3 Minimum capital requirement – credit risk

The following table shows the composition of the minimum capital required for credit risk (excluding credit valuation adjustment included in counterparty credit risk in Table 4) at 31 December 2018.

Table 5: Minimum capital requirement for credit risk

	Notes	**2018 £m**	2017 £m
Internal Ratings Based (IRB)			
Retail mortgages (prime secured against residential property)		**287.4**	261.7
Standardised exposure classes			
Mortgages and loans		**11.3**	12.8
Of which:			
Retail mortgages secured against residential property		**9.3**	10.2
Corporates (commercial lending)		**0.1**	0.2
Other retail (unsecured loans)		**1.4**	1.7
Past due		**0.5**	0.7
Treasury		**6.9**	7.9
Of which:			
Institutions with short term credit assessments	1	**-**	3.7
Other Institutions	2	**6.8**	4.0
Securitisation positions		**0.1**	0.2
Other		**5.5**	4.0
Of which:			
Non-credit obligation assets (fixed assets and other)		**5.3**	3.7
Amounts below the threshold for deduction		**0.2**	0.3
Total minimum capital requirement Standardised		**23.7**	24.7
Total minimum capital requirement IRB and Standardised		**311.1**	286.4

Notes:
1. Following regulatory clarification, capital requirements formally included in Institutions with short term credit assessments are now included in other institutions. The prior year number has not been restated.
2. Other institutions includes minimum capital requirement of £0.1 million (2017: £0.1 million) for covered bonds, £0.1 million for central clearing counterparties (2017: £0.1 million) and £0.2 million (2017: £0.3 million) for equity.

4.1.4 Movement in credit risk – Risk Weighted Assets (RWAs)

The following table shows the movement in credit risk RWAs (excluding credit valuation adjustment) over 2018.

Table 6: Risk Weighted Assets (RWA) flow statement

	IRB mortgages		Standardised mortgages and loans		Treasury		Other		Total	
	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m
RWAs at 1 January 2018	3,270.8	261.7	159.5	12.8	99.0	7.9	50.0	4.0	3,579.3	286.4
Book size increase/(decrease)	492.3	39.3	(16.8)	(1.3)	(0.2)	-	18.3	1.5	493.6	39.5
Book quality (improvement)/ deterioration	(170.7)	(13.6)	(2.0)	(0.2)	(12.4)	(1.0)	-	-	(185.1)	(14.8)
RWAs at 31 December 2018	**3,592.4**	**287.4**	**140.7**	**11.3**	**86.4**	**6.9**	**68.3**	**5.5**	**3,887.8**	**311.1**

The increase in IRB RWAs attributable to book size is driven by growth of the Society's mortgage book. All new lending is on an IRB basis. Book quality improvements reflect an increase in house prices and lower arrears.

The majority of the treasury book is made up of exposures to central banks and sovereigns, which are zero risk weighted. The book quality improvement relates to a reduction in exposures to financial institutions subject to a higher risk weighting.

4.2 Pillar 2

4.2.1 Introduction

The Pillar 2 capital requirement reflects the Society's ICAAP assessment and any capital add-ons 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 – see section 4.3) and risks to which a firm may become exposed under a severe but plausible stress Pillar 2B).

4.2.2 Internal Capital Adequacy Assessment Process (ICAAP) and stress testing

The Board determines the level of capital required to support the Society's business objectives by undertaking an annual ICAAP. In the ICAAP, the Society reviews its risk management framework together with the financial projections developed for the Strategic Plan in order to assess the significant risks to which it is exposed, the adequacy of risk arrangements and the capital resources it needs to support the risk exposures over the planning horizon. The ICAAP includes consideration of Pillar 1 and Pillar 2 requirements.

The calculation of the Pillar 2 requirement examines the Society's business plans in detail, subjecting them to economic and operational stresses over a five year planning horizon. The Society bases its capital stress tests on severe but plausible stressed 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 conducted 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.

This stress testing enables the Society to estimate the magnitude of losses that may be incurred, determine the impact of these losses on the stock of capital available to the Society, and compare this with the additional capital requirements that may be needed in a stressed environment.

Although the stress tests indicate that the Society remains above regulatory minima, potential management actions that could be deployed in a capital stress are considered including the ability to control the rate of asset growth.

The Recovery Plan, see section 2.7, contains a menu of options that may be used to address any shortage of capital resulting from an extreme stress.

The output from the capital planning model, including stress results, is reviewed in detail by ALCO and by BRC before submission to the Board for formal approval.

Capital levels for the Society are reported to, and monitored by the Board regularly. The Society continues to be strongly capitalised and maintains capital substantially above current regulatory requirements. The Society's Common Equity Tier 1 ratio is the highest reported by any top 20 lender[1]. The Society's level of regulatory capital surplus will tend to be driven by non-risk based measures such as the leverage ratio and potentially in the future the minimum requirement for own funds and eligible liabilities (MREL) - see section 4.5. The impact of other potential regulatory reforms including the Basel Committee on Banking Supervision review of the Standardised approach for calculating credit risk capital requirements and the replacement of the Basel 1 floor is covered in section 4.6 Future regulatory developments.

4.3 Pillar 2A

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.

The PRA Pillar 2A risk factors include those not fully covered by Pillar 1 such as credit concentration and operational risks and those risks outside the scope of Pillar 1 such as pension and interest rate risk.

1 Source: 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.

4.4 Regulatory capital buffers

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.

Appendix 5 discloses information relevant for the calculation of the CCyB as at 31 December 2018 in accordance with Regulation (EU) 2015/1555.

4.5 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[2]. The new Basel IV rules on risk weighted asset output floors – see 4.6 – 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.

4.6 Future regulatory developments

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

The Basel Committee published their final reforms to the Basel III framework in December 2017. The amendments include changes to the standardised approaches for credit and operational risks and the introduction of a new RWA output floor. The rules are subject to a transitional period from 2022 to 2027. In addition, in June 2017, the PRA published a policy statement relating to residential mortgage risk-weights, including proposals to align firms' IRB modelling approaches for residential mortgage risk-weighted assets. This sets out a number of modifications to the IRB modelling methodologies for residential mortgages, and sets the expectation for firms to update IRB models by the end of December 2020.

These reforms represent a re-calibration of regulatory requirements with no underlying change in the capital resources the Society holds or the risk profile of its assets. The final impacts are subject to uncertainty for future balance sheet size and mix, and because the final detail of some elements of the regulatory changes remain at the PRA's discretion. The Society currently expects that introduction of these RWA floors and IRB calibration changes will result in a significant reduction of its capital ratios as compared to its reported ratios as at 31 December 2018. On an indicative basis and for illustrative purposes only, the Society anticipates that if these amendments (as the Society understands them) had been applied as at 31 December 2018 (i) with the initial transitional 50 per cent. floor, its reported CET1 ratio as at that date would have reduced to approximately 26 per cent; or (ii) on an end-point basis (i.e. ignoring the transitional provisions through to 2027), its reported CET1 ratio as at that date would have reduced to approximately 17.9 per cent. On such end-state basis, the Society's surplus over the revised CET1 ratio would have remained over 13 times the aggregate credit losses incurred in the last ten years (or, if applying the initial transitional floor of 50 per cent., would have remained over 16 times the aggregate credit losses incurred in the last ten years).

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2 Two times Pillar 1 and Pillar 2a.

5. Credit risk

5.1 Overview

5.1.1 Credit risk overview and exposures

Credit risk is the risk that customers or counterparties will not be able to meet their financial obligations to the Society as they fall due. Credit risk is sub-divided into:

- Credit risk for retail exposures (covered in section 5.2)
- Credit risk for the treasury liquidity book and derivatives (covered in section 5.3)

5.1.2 Credit risk exposures

The exposures presented below relate to on balance sheet exposures only. Exposures are presented net of impairment provisions. The limited number of classes disclosed illustrates the Society's very simple business model. All retail credit risk exposures are in the United Kingdom. A distribution of this lending by region is provided in Table 13.

Table 7: Credit risk exposure

	Notes	**Average during 2018 £m**	**As at 31 December 2018 £m**	Average during 2017 £m	As at 31 December 2017 £m
Residential mortgages	1	**37,570.3**	**39,239.7**	34,373.3	35,900.9
Unsecured and other lending	1	**27.4**	**24.9**	33.0	30.0
Total retail credit risk exposures		**37,597.7**	**39,264.6**	34,406.3	35,930.9
Treasury:					
Central banks and sovereigns	1,2	**5,809.5**	**5,886.0**	5,024.2	5,733.0
Multilateral development banks (supranational bonds)	2	**37.5**	**75.1**	–	–
Financial institutions	1,2	**449.2**	**432.6**	482.2	465.8
Residential Mortgage Backed Securities (RMBS)	1,2	**9.5**	**8.2**	12.2	10.7
Total treasury credit risk exposures		**6,305.7**	**6,401.9**	5,518.6	6,209.5
Total credit risk exposures		**43,903.4**	**45,666.5**	39,924.9	42,140.4

Table 8a: Geographical distribution of credit risk 2018

As at 31 December 2018	Notes	**United Kingdom £m**	**Rest of Europe £m**	**Rest of the World £m**	**Total £m**
Residential mortgages	1	**39,239.7**	–	–	**39,239.7**
Unsecured and other lending	1	**24.9**	–	–	**24.9**
Total retail credit risk exposures		**39,264.6**	–	–	**39,264.6**
Treasury:					
Central banks and sovereigns	1,2	**5,886.0**	–	–	**5,886.0**
Multilateral development banks (supranational bonds)	2	–	**50.1**	**25.0**	**75.1**
Financial institutions	1,2	**372.6**	**60.0**	–	**432.6**
Residential Mortgage Backed Securities (RMBS)	1	**8.2**	–	–	**8.2**
Total treasury credit risk exposures		**6,266.8**	**110.1**	**25.0**	**6,401.9**
Total credit risk exposures		**45,531.4**	**110.1**	**25.0**	**45,666.5**

Notes
1. Held at amortised cost using the effective interest method and after deduction of impairment provisions where appropriate.
2. Held at fair value.

Table 8b: Geographical distribution of credit risk 2017

As at 31 December 2017	Notes	United Kingdom £m	Rest of Europe £m	Rest of the World £m	Total £m
Residential mortgages	1	35,900.9	–	–	35,900.9
Unsecured and other lending	1	30.0	–	–	30.0
Total retail credit risk exposures		35,930.9	–	–	35,930.9
Treasury:					
Central banks and sovereigns	1,2	5,733.0	–	–	5,733.0
Financial institutions	1,2	432.0	33.8	–	465.8
Residential Mortgage Backed Securities (RMBS)	2	10.7	–	–	10.7
Total treasury credit risk exposures		6,175,7	33.8	–	6,209.5
Total credit risk exposures		42,106.6	33.8	–	42,140.4

The maturity of exposures is shown on a contractual basis:

Table 9a: Residual maturity of credit risk 2018

As at 31 December 2018	**Notes**	**Up to 12 months £m**	**1-5 years £m**	**5-10 years £m**	**More than 10 years £m**	**Total £m**
Residential mortgages	1	**2,850.8**	**10,035.3**	**10,361.6**	**15,992.0**	**39,239.7**
Unsecured and other lending	1	**2.1**	**6.9**	**7.4**	**8.5**	**24.9**
Total retail credit risk exposures		**2,852.9**	**10,042.2**	**10,369.0**	**16,000.5**	**39,264.6**
Treasury:						
Central banks and sovereigns	1,2	**5,134.7**	**309.1**	**442.2**	–	**5,886.0**
Multilateral development banks (supranational bonds)	2	**0.2**	**74.9**	–	–	**75.1**
Financial institutions	1,2	**424.6**	**5.0**	**3.0**	–	**432.6**
Residential Mortgage Backed Securities (RMBS)	1	–	–	–	**8.2**	**8.2**
Total treasury risk credit exposures		**5,559.5**	**389.0**	**445.2**	**8.2**	**6.401.9**
Total credit risk exposures		**8,412.4**	**10,431.2**	**10,814.2**	**16,008.7**	**45,666.5**

Table 9b: Residual maturity of credit risk 2017

As at 31 December 2017	Notes	Up to 12 months £m	1-5 years £m	5-10 years £m	More than 10 years £m	Total £m
Residential mortgages	1	2,667.0	9,267.0	9,518.3	14,448.6	35,900.9
Unsecured and other lending	1	2.2	6.6	7.5	13.7	30.0
Total retail credit risk exposures		2,669.2	9,273.6	9,525.8	14,462.3	35,930.9
Treasury:						
Central banks and sovereigns	1,2	4,883.8	657.0	192.2	–	5,733.0
Financial institutions	1,2	456.3	5.6	3.9	–	465.8
Residential Mortgage Backed Securities (RMBS)	2	–	–	–	10.7	10.7
Total treasury risk credit exposures		5,340.1	662.6	196.1	10.7	6,209.5
Total credit risk exposures		8,009.3	9,936.2	9,721.9	14,473.0	42,140.4

Notes
1. Held at amortised cost using the effective interest method and after deduction of impairment provisions where appropriate.
2. Held at fair value.

5.2 Retail credit risk

5.2.1 Management of retail credit risk

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 geographic region or counterparty.
- That 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 good 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:

Table 10: Analysis of Society arrears compared with UK Finance

	2018		2017	
	Society %	**UK Finance %**	Society %	UK Finance %
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

Extent and use of forbearance

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:

Table 11: Forbearance

	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

Note:
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.

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 now 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

Table 12: Credit risk profile

Loans and advances to customers	**2018 £m**	**2018 %**	2017 £m	2017 %
Residential mortgages:				
Owner-occupier	**23,261.5**	**59.2**	21,714.4	60.4
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
Non-traditional mortgages:				
Residential near-prime	**66.3**	**0.2**	77.2	0.2
Residential self-certification	**184.2**	**0.5**	215.9	0.6
Commercial[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

Note:
1. Legacy books of unsecured personal loans and commercial mortgages.

Residential mortgages: owner-occupier includes £248.4 million (2017: £264.5 million), less than 1% of the total gross balances, of ‘equity-release mortgages’, where the borrower is guaranteed that the amount recoverable by the Society at the end of the mortgage will not exceed the value of the property. The Society is therefore exposed to the risk that the value of the property at the time of redemption is lower than the loan including accumulated interest. The Society mitigated this risk by granting loans at a relatively low loan to value and has not offered new mortgages on this basis since 2009. The weighted average loan to value of the equity release book is 38.1% (2017: 36.4%).

Geographical concentration

The mortgage portfolio is well diversified and reflects the national coverage of the Society's distribution channels. The geographical split of mortgages by balance, gross of impairment provisions is shown below:

Table 13: Geographical distribution of residential mortgages

Region	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

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:

Table 14: Total mortgage book loan to value (number of accounts)

Total mortgage book profile	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 (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.

Table 15: Gross lending new business profile

Gross lending	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 (balance weighted)	**62.6**	59.8

5.2.2 IRB rating system

The Society has used the retail IRB approach since January 2008 to determine the required level of capital for the vast majority of its retail credit exposures. Across the Society, 99% of on balance sheet exposures as at December 2018 (2017: nearly 99%) were assessed on the IRB approach.

Capital is calculated using the Standardised approach on certain small legacy portfolios. No new lending has been originated on these products for a number of years (a drawdown facility is available for a small element of existing equity release customers).

The internal rating model and process

Three models provide the rating of credit risk:

- The Probability of Default model;
- The Loss Given Default model; and
- The Exposure at Default model.

Probability of default model

Credit scores are used to allocate exposures to risk grades. There are separate scorecards for the buy-to-let and owner-occupier portfolios. Once allocated to a risk grade, the probability of default (PD) model provides a “long run” estimate of the PD for the grade i.e. the average PD across an economic cycle. It is this PD that is used in the capital calculation.

The credit scores of new applications generated by the application scorecards are determined using a combination of loan data, borrower credit details, and in the case of the buy to let model, information about the rental property.

Behavioural scores are calculated using a combination of internal mortgage performance data together with regular updates of the borrower's credit behaviour with other lenders.

Depending on the length of time the account has been on the books, the application credit score, behavioural credit score, or a blend of the two is used to determine the risk grade for the account and therefore the long run PD to be used in the capital calculation.

In addition, the application and behavioural scores also produce a point-in-time estimate of the probability of an account defaulting. The point-in-time estimates are compared with actual default rates to test the performance of the scorecards.

Loss given default model

The loss given default (LGD) model uses internal data and is calibrated to downturn economic conditions for use in the regulatory capital calculations.

The model assesses the likelihood of repossession once an account defaults, the forced sale discount that is likely to be experienced in selling a property from possession (the 'haircut') and, if repossessed, the likelihood and amount of loss.

Exposure at default (EAD) model

The exposure at default (EAD) model calculates the balance of accounts at the point of default using a combination of estimated time to default and the interest payments that will be missed.

The combination of PD, LGD and EAD models is used to determine the expected loss and capital requirement for all mortgages within the retail IRB exposure class.

Comparison of impairment provisions with regulatory expected losses

From 1 January 2018, the Society has adopted IFRS 9 in the preparation of its financial statements. More information on the transition from IAS 39 to IFRS 9 is in note 1 to the accounts and in 5.2.6 below.

The £8.4 million IFRS 9 impairment provision on IRB loans recognised in the financial statements at 31 December 2018 differs from the £31.9 million determined from the IRB regulatory expected loss models due to the methodology differences set out below. The Society envisages that IRB expected losses will continue to exceed IFRS 9 expected losses.

The IFRS 9 / IRB methodology differences are as follows:

- The IFRS 9 PD is an estimate of the residual lifetime probability of default based on expectations for future economic conditions at the balance sheet date. The first 12 months of the residual lifetime PD estimate is utilised for accounts in Stage 1 whilst the full residual lifetime PD is used for accounts in Stages 2 and 3. The regulatory PD is a long run average 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; and

- IFRS 9 also requires the use of multiple economic scenarios to calculate a probability weighted forward looking ECL.

Allocation of exposures to risk grades by the IRB rating system

The following table shows the Society's retail exposures under IRB.

Table 16: Allocation of exposures (including undrawn) to IRB risk band

PD bands up to and including:	**Exposure at default estimate 2018 £m**	**Average loss given default 2018 %**	**Average risk weight 2018 %**	**RWAs 2018 £m**	Exposure at default estimate 2017 £m	Average loss given default 2017 %	Average risk weight 2017 %	RWAs 2017 £m
0.10	**30.148.9**	**14.6**	**5.0**	**1,516.2**	27,724.6	14.5	5.0	1,375.5
0.20	**7,628.1**	**19.5**	**11.1**	**850.0**	6,707.1	19.0	10.9	729.9
0.30	**2,082.8**	**21.1**	**17.0**	**354.6**	1,809.9	20.2	16.5	299.7
0.50	**1,345.3**	**21.7**	**22.9**	**308.3**	1,193.8	21.0	22.2	265.2
1.00	**616.2**	**22.7**	**37.2**	**229.5**	606.1	22.1	37.2	225.6
3.00	**195.9**	**24.0**	**56.4**	**110.4**	208.8	25.0	59.3	123.8
9.99	**84.8**	**16.2**	**61.2**	**51.9**	100.8	15.6	59.1	59.6
99.99	**136.5**	**16.9**	**84.2**	**114.9**	142.2	18.3	90.5	128.6
In Default	**35.9**	**18.0**	**157.5**	**56.6**	43.2	16.9	145.6	62.9
Total	**42,274.4**			**3,592.4**	38,536.5			3,270.8

The PDs disclosed in the table above are on a point in time basis.

Treatment of undrawn exposures

At any point the Society has a number of undrawn exposures that it assigns ratings to using the IRB rating system. These undrawn exposures relate to mortgage applications that have reached the 'offer' stage, where the Society has agreed to advance the funds, but completion of the mortgage has not yet taken place. An offer will generally only be cancelled if adverse information is received after the offer has been made or if it has not been taken up by the customer and hence expires. To assess credit risk it is assumed that all offers will complete, and therefore a conversion factor of 100% is assigned to these undrawn exposures.

At 31 December 2018, the value of undrawn exposures being rated under the IRB approach was £1,729.2 million (2017: £1,465.5 million).

5.2.3 Controls and governance

The Society has a comprehensive retail credit model governance framework which sets out policies and statements that govern IRB models throughout their life cycle.

The Retail Credit Risk Committee oversees management of model risk through its sub-committee, Models and Ratings Committee (MRC). MRC is chaired by the Chief Financial Officer and includes in its membership the Chief Risk Officer and senior managers from the Prudential & Enterprise Risk and Retail Credit Risk functions. Internal Audit also attends the MRC. MRC is responsible for ensuring that the retail credit risk model governance framework is operating effectively.

Model developments and ongoing performance monitoring are undertaken in the first line by the Retail Credit Risk function. Additionally, throughout the year the various elements of the retail credit model governance framework are reviewed by Retail Credit Risk function and on an annual basis are assessed and presented to MRC for approval.

The second line risk function also undertakes an annual review of the IRB models independently and presents its findings to MRC.

MRC's review of IRB models includes:

- The scope and design of the models, including key assumptions and judgements;
- Progress updates during the model development;
- The results of independent second line model validation and confirmation that the models are fit for purpose. The validation assesses the quality of data used in the model development and model documentation;
- Ongoing model performance monitoring reports, to ensure that the models are operating as designed. If model performance deteriorates beyond expectation, a review of the model may be triggered which could result in a recalibration or redevelopment; and
- Submission of any new IRB models and material changes to existing models to the regulator.

As part of its third line responsibilities, Internal Audit undertakes an annual review of the effectiveness of the controls governing the use of IRB models.

Annually, a detailed self-assessment is undertaken of the regulatory requirements over IRB models, which includes assessment against the EU Capital Requirements Regulations and the PRA's supervisory statements and guidance. This self-assessment is undertaken by the first line Retail Credit Risk function and overseen by the second line Prudential & Enterprise Risk function. Following this self-assessment, the Chief Risk Officer attests compliance with IRB regulatory requirements.

Credit models are used for more than regulatory capital purposes. An annual assessment of the use of models is undertaken by the Retail Credit Risk function and reviewed by MRC. Examples of use include credit scores which are used to assist the New Lending function in its underwriting of mortgage applications, and behavioural information which is used to identify customers who are potentially vulnerable to financial stresses. Various components of the LGD model are also used in the impairment model.

Governance over the IFRS 9 ECL calculation is the responsibility of the Expected Credit Loss Group (ECLG). This group is chaired by the Chief Financial Officer and attendees include the Chief Risk Officer, Chief Internal Auditor and other senior managers from the Finance, Credit Risk and Risk functions. ECLG is tasked with overseeing the choice of economic scenarios and weightings used to determine the forward looking views that are required in the IFRS 9 standard as well as the key judgments and assumptions supporting the calculation. ECLG also monitor IFRS model performance. Oversight and approval of the IFRS 9 models is the responsibility of the Models & Ratings Committee.

5.2.4 IRB model performance over time

Back testing methodologies are applied to assess model performance. Results from these exercises continue to show that models are conservative against actual outcomes.

For capital calculations, the PD and LGD models are calibrated to long run or downturn conditions respectively. This means that in current economic conditions the outputs of both models are significantly higher than actual outcomes.

In order to provide an assessment of the accuracy of the PD and LGD models, point-in-time calibrations are used. For the PD model, the predicted default rate for accounts not in default at the start of the year is compared against the actual rate of default that emerged over the following twelve months. With respect to the LGD model, the actual losses incurred during 2018 are compared against the predicted loss on these accounts at the start of the year without the additional downturn parameters required in the regulatory capital calculation. The accuracy of the EAD estimate is calculated by comparing the balance of accounts that went into default during the year with the predicted balance 12 months prior to the account defaulting.

Point in time PD and LGD predictions against actual results are shown below. The ratio of estimated to actual EAD is also shown (a ratio of greater than 1 indicates that estimated EAD was greater than actual EAD).

Table 17: Actual Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD) against predicted

IRB retail mortgages	**Actual 2018 %**	**Predicted 2018 %**	Actual 2017 %	Predicted 2017 %
PD	**0.09**	**0.16**	0.10	0.19
LGD	**3.94**	**3.95**	4.14	4.14
EAD (Estimated to actual)	**1.04**	**N/a**	1.03	N/a

Note: The PD model predicts defaults from performing (up-to-date) accounts, with a separate roll-rate model used to predict default from accounts already in arrears. The PD predictions shown above relate to performing accounts. Including non-performing accounts the actual PD was 0.15% (2017: 0.17%). As at 31 December 2018 the projected portfolio average long run PD was 0.40% (2017: 0.48%).

Predicted and actual PD and LGD rates have fallen, reflecting the continuing benign economic environment and the improved credit risk profile of the book. The point in time PD is conservatively above actual PD in both years.

5.2.5 Credit risk mitigation

The Society does not employ credit risk mitigation techniques in relation to retail credit risk apart from taking a first legal charge on each property being offered as security for a mortgage.

All properties taken as security are valued at the outset of the loan and when any further advance is made during the lifetime of the loan.

The initial value of the security is established by way of an internal physical inspection of the property and written report by a qualified Royal Institution of Chartered Surveyors (RICS) surveyor. An Automated Valuation Model (AVM) or drive-by valuation may be used for low loan to value owner-occupier re-mortgages and low loan to value further advances.

All buy to let properties are valued at origination by a qualified RICS surveyor who makes a physical internal inspection of the property.

Regular reviews of the appropriateness and accuracy of the various valuation methods used by the Society are undertaken, to ensure these remain appropriate and accurate.

Assumptions regarding realisation (or work-out) costs, the time it takes to effect repossession and sale, and the effect of forced sale on estimated property values are updated regularly and are used in the impairment model to determine the realistic value that could be achieved upon repossession and sale of the property. Conservative, stressed values for these assumptions are used in calculating the regulatory capital requirement.

5.2.6 Identifying impaired loans

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 months or more in arrears, have been three months or more in arrears in the last twelve months or have other 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. Note 13 to the accounts provides further information on the forward looking information used in the ECL calculations and sensitivities.

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

Table 18: Movement in impairment on loans and advances to customers from IAS 39 to IFRS 9

	£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 scenario[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 macro-economic scenarios are incorporated into the ECL calculation. Details of these are 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 historic 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.

Table 19: Gross loans and advances to customers split by IFRS 9 stage

			Of which			Of which		
2018	**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 represent 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.

Table 20: Impairment on loans and advances to customers split by IFRS 9 stage

			Of which			Of which		
Impairment provision as at 31 December 2018	**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:

Table 21: Reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage

	Stage 1		Stage 2		Stage 3		Total	
	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 9.3% 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.

Table 22: Loan to value distribution by IFRS 9 stage

As at 31 December 2018 Indexed loan to value	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 months or more in arrears, have been three months or more in arrears at some point in the last twelve 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.

Table 23: Lifetime probability of default by IFRS 9 stage

As at 31 December 2018 Probability of default (%)	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.

Table 24: Not impaired and impaired loans by segment 2017

As at 31 December 2017	Not impaired		Impaired				
	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
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
Unsecured	28.9	2.5	0.3	0.1	–	(3.8)	28.0
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**

Table 25: Past due and impaired loans by loan to value 2017

As at 31 December 2017	Not impaired		Impaired				
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
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**

5.3 Treasury credit risk

5.3.1 Management of 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.

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 and the Risk function.

Exposures are reviewed continuously to ensure that they remain within the approved limits and ongoing 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 assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities. Over 99% of the Society's treasury assets have an investment grade as set out below:

Table 26a: Treasury assets exposure value by rating 2018

As at 31 December 2018	**Aaa–Aa3 £m**	**A1–A3 £m**	**Baa1–Baa3 £m**	**Unrated[1] £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**
Residential mortgage-backed securities	**8.2**	**-**	**-**	**-**	**8.2**
Total	**6,077.7**	**276.0**	**48.2**	**-**	**6,401.9**

Table 26b: Treasury assets exposure value by rating 2017

As at 31 December 2017	Aaa–Aa3 £m	A1–A3 £m	Baa1–Baa3 £m	Unrated[1] £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
Residential 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 disposed of in 2018.

Capital for credit risk within the liquidity book is calculated using the Standardised approach. For central banks, sovereigns, and UK Financial Institutions with a residual maturity of less than three months, risk weights prescribed in CRD IV are used. At 31 December 2018, the exposure for UK Financial Institutions with a residual maturity of less than three months was £179.1 million (2017: £232.6 million) with a capital requirement of £2.9 million (2017: £3.7 million).

For covered bonds, RMBS and other Financial Institutions the Society uses credit ratings published by Moody's. Moody's is recognised as an eligible External Credit Assessment Institution (ECAI) for this purpose. The following table shows the exposure values and rating associated with each credit quality step. There is no credit risk mitigation applicable to these exposure values.

Table 27: ECAI exposure values and ratings

	Moody's rating	Risk weight %	Exposure value 2018 £m	Minimum capital requirement 2018 £m	Exposure value 2017 £m	Minimum capital requirement 2017 £m
Retail Mortgage Backed Securities (RMBS)						
Credit quality step 1	Aaa-Aa3	20	**8.2**	**0.1**	10.7	0.2
Total RMBS			**8.2**	**0.1**	10.7	0.2
Covered bonds						
Credit quality step 1	Aaa-Aa3	10	**8.2**	**0.1**	9.7	0.1
Total covered bonds			**8.2**	**0.1**	9.7	0.1
Financial institutions						
Credit quality step 1	Aaa-Aa3	20	**46.0**	**0.7**	80.9	1.3
Credit quality step 2	A1-A3	50	**63.4**	**2.6**	52.5	2.1
Credit quality step 3	Baa1	50	**5.1**	**0.2**	3.4	0.1
Total financial institutions			**114.5**	**3.5**	136.8	3.5
Total			**130.9**	**3.7**	157.2	3.8

5.3.2 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 does not enter into a master netting agreement due to the structure of the covered bonds programme. However, it has entered into separate ISDA agreements 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 a specified credit rating.

5.3.3 Counterparty credit risk - derivatives

The balance sheet exposure values of derivative instruments are as follows. The net derivative credit exposure has reduced following the maturity of a covered bond where collateralisation of the hedging derivative was subject to an exposure threshold.

Table 28: Derivative counterparty credit exposure

	Exposure value As at 31 December 2018 £m	Exposure value As at 31 December 2017 £m
Gross positive fair value of contracts	**268.9**	306.5
Netting benefits	**(85.5)**	(95.1)
Net credit exposure	**183.4**	211.4
Collateral held	**(166.0)**	(166.2)
Net derivative credit exposure	**17.4**	45.2

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.

The derivative exposure can only be settled net following a default or other predetermined event and therefore there is no right of set-off in the balance sheet.

For regulatory capital purposes, the Society measures derivative counterparty credit exposure values using the counterparty credit risk mark to market method. The net exposure value of derivatives at 31 December 2018, which includes uplifts for Potential Future Credit Exposure (PFCE) under this method, totalled £150.6 million (2017: £163.7 million).

Wrong way risk occurs when exposure to counterparty is adversely correlated with the credit quality of that counterparty. Hence, there is a tendency for the exposure to increase as the creditworthiness decreases. Wrong way credit risk can occur where transactions are collateralised by related party securities and the Society mitigates this by only accepting cash or UK government securities as collateral.

5.3.4 Analysis of treasury assets by IFRS 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.

5.3.5 Securitisation

Purchased securitisation positions

The exposure values relating to the Society's ownership of Residential Mortgage Backed Securities (RMBS) and their associated risk weightings for capital purposes are included in Table 27 in section 5.3.1. All exposures comprise senior tranche RMBS.

Purchases and retention of RMBS are undertaken within a clearly defined credit risk policy and no purchases were made in 2018. RMBS are held at amortised cost on the Society's balance sheet. If the assets are sold before maturity, a gain or loss would be recognised in the Income Statement. RMBS are regularly reviewed in line with article 406 of the Capital Requirements Regulations. Pricing and credit conditions are reviewed weekly and positions are stress tested quarterly against a 30% fall in house prices using Moody's published default frequencies for UK mortgages.

As at 31 December 2018, no purchased securitisation positions were past due or impaired (2017: none). The Society uses the Standardised approach for its purchased securitised positions.

Originated securitisations

The Society has securitised certain mortgage loans by transferring the loans to structured entities under the Mercia and Offa securitisation programmes. The programmes enable the Society to obtain secured funding or to create additional collateral which can be used to source additional funding.

The transferred mortgages remain on balance sheet as the Society has retained substantially all the risks and rewards of ownership. These assets are held at amortised cost. The structured entities are fully consolidated into the Group accounts. The transfers of the mortgage loans to the structured entities are not treated as sales and therefore no gains or losses are recognised.

As there is not considered to be a transfer of significant credit risk, the Society does not calculate risk weighted exposure amounts for any positions it holds in the securitisation and these continue to be calculated in line with CRD IV requirements consistent with other mortgage assets. The risk relating to the underlying mortgage pool therefore remains with the Society and is included in 'Residential mortgages' detailed throughout this document.

The Society's obligations in respect of the Mercia and Offa securitisation vehicles are limited to transferring cash flows from the underlying assets and the Society and its subsidiaries are under no obligation to support any losses that may be incurred by the securitisation programmes or holders of the issued notes. The parties holding the notes in issue are therefore only entitled to obtain payment to the extent of the resources in the Mercia and Offa securitisation vehicles respectively.

As at 31 December 2018, Mercia and Offa create a potential liquidity requirement for the Society due to legal covenants within the swap documentation which need to be fulfilled in the event of a downgrade of the Society. The cash flows from these legal covenants are in respect of amounts required to collateralise swaps and these are considered in the Society's internal assessment of its liquidity requirements. At 31 December 2018, the impact of a one notch downgrade would be to require collateral to be posted of £89.1 million (2017: £53.3 million) and for a two notch downgrade a further £23.7 million (2017: £24.5 million) would be required to be posted. The Society's covered bond programme gives rise to a similar liquidity risk and for a one notch downgrade the additional collateral required would be £151.4 million (£129.4 million) and for a two notch downgrade a further £10.4 million (2017: £nil) would be required. The Society also acts as bank account provider to the covered bond programme, and if the Society were to be downgraded by one or more notches, the vehicle would be obliged to move these deposits to the stand-by bank account provider. The covered bond vehicle bank account balance with the Society at 31 December 2018 was £92.4m (2017: nil).

Additional information on the Mercia and Offa programmes is contained in note 16 to the accounts. This note also includes information on the Society's covered bonds.

Appendix 1: EBA Own Funds Disclosure Template

Any blank lines in the template have been removed.

		Transitional CRD IV		End-point CRD IV	
		2018 £m	2017 £m	**2018 £m**	2017 £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves					
2	Retained earnings	**1,693.5**	1,553.1	**1,693.5**	1,553.1
3	Accumulated other comprehensive income (and other reserves)	**30.0**	26.0	**30.0**	26.0
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(9.3)**	(9.3)	**(9.3)**	(9.3)
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	**1,714.2**	1,569.8	**1,714.2**	1,569.8
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	**(0.9)**	(1.0)	**(0.9)**	(1.0)
8	Intangible assets (net of related deferred tax liability (negative amount)	**(33.1)**	(40.8)	**(33.1)**	(40.8)
11	Fair value reserves related to gains or losses on cash flow hedges	**(24.4)**	(20.3)	**(24.4)**	(20.3)
12	Negative amounts resulting from the calculation of expected loss amounts	**(23.5)**	(21.9)	**(23.5)**	(21.9)
15	Defined-benefit pension fund assets (negative amount)	**(17.5)**	(14.2)	**(17.5)**	(14.2)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(99.4)**	(98.2)	**(99.4)**	(98.2)
29	Common Equity Tier 1 (CET1) capital	**1,614.8**	1,471.6	**1,614.8**	1,471.6
Additional Tier 1 (AT1) capital: instruments					
30	Capital instruments and the related share premium accounts	**396.9**	396.9	**396.9**	396.9
31	of which: classified as equity under applicable accounting standards	**396.9**	396.9	**396.9**	396.9
32	of which: classified as liabilities under applicable accounting standards				
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	**40.0**	40.0	–	–
36	Additional Tier 1 (AT1) capital before regulatory adjustments	**436.9**	436.9	**396.9**	396.9
44	Additional Tier 1 (AT1) capital	**436.9**	436.9	**396.9**	396.9
45	Tier 1 capital (T1 = CET1 + AT1)	**2,051.7**	1,908.5	**2,011.7**	1,868.5
Tier 2 (T2) capital: instruments and provisions					
46	Capital instruments and the related share premium accounts	–	–	–	40.0[1]
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	**22.2**	25.0		–
50	Credit risk adjustments	–	1.5	–	1.5
51	Tier 2 (T2) capital before regulatory adjustments	**22.2**	26.5	–	41.5
58	Tier 2 (T2) capital	**22.2**	26.5	–	41.5
59	Total capital (TC = T1 + T2)	**2,073.9**	1,935.0	**2,011.7**	1,910.0
60	Total risk weighted assets	**4,548.5**	4,213.1	**4,548.5**	4,213.1

1. 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.

		Transitional CRD IV		End-point CRD IV	
		2018 **£m**	2017 £m	**2018** **£m**	2017 £m
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	**35.5%**	34.9%	**35.5%**	34.9%
62	Tier 1 (as a percentage of total risk exposure amount)	**45.1%**	45.3%	**44.2%**	44.3%
63	Total capital (as a percentage of total risk exposure amount)	**45.6%**	45.9%	**44.2%**	45.3%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	**7.375%**	5.75%	**7.375%**	5.75%
65	of which: capital conservation buffer requirement	**1.875%**	1.25%	**1.875%**	1.25%
66	of which: countercyclical buffer requirement	**1.0%**		**1.0%**	
67	of which: systemic risk buffer requirement				
67a	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer				
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**31.0%**	30.4%	**31.0%**	30.4%
Amounts below the thresholds for deduction (before risk weighting)					
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**–**	1.7	**–**	1.7
Applicable caps on the inclusion of provisions in Tier 2					
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**–**	1.5	**–**	1.5
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	**–**	1.5	**–**	1.5
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)					
82	Current cap on AT1 instruments subject to phase out arrangements	**40.0**	40.0	**–**	–
84	Current cap on T2 instruments subject to phase out arrangements	**22.2**	25.0	**–**	–
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities	**2.8**	–	**–**	–

Appendix 2: Capital Instruments Key Features

1	Issuer	Coventry	Coventry	Coventry (Stroud & Swindon)	Coventry (Stroud & Swindon)
2	ISIN	XS1079786239	GB0002290764	N/a	N/a
3	Gov. law (sub)	English	English	English	English
	Regulatory treatment				
4	Trans. CRR rules	AT1	AT1	T2	T2
5	Post-transitional CRR rules	AT1	Ineligible	Ineligible	Ineligible
6	Eligible at Group (G), Individual Consolidated (IC) or Society (S)	G; IC; S	G; IC; S	G; IC; S	G; IC; S
7	Instrument type (types to be specified by each jurisdiction)	Perpetual Capital Security	PIBS	Sub Debt	Sub Debt
8	Regulatory capital value (£m)	396,920,211	40,000,000	13,315,920	8,877,280
9	Nominal amount of instrument	400,000,000	40,000,000	15,000,000	10,000,000
9a	Issue price	100	100.749	100	100
9b	Redemption price	100	100	100	100
10	Accounting classification	Shareholders' equity	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost
11	Date of issue	19-Jun-14	28-May-92	23-Aug-01	29-Aug-03
12	Perpetual or dated	Perpetual	Perpetual	Dated	Dated
13	Original maturity	No maturity	No maturity	23-Aug-32	29-Aug-26
14	Issuer call	Yes	No	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	01/11/2019; par regulatory/tax call	N/a	23-Aug-27	29-Aug-21
16	Subsequent call dates, if applicable	5 yearly	N/a	N/a	N/a
	Coupons / dividends				
17	Fixed or floating dividend/coupon	Fixed to fixed	Fixed	Fixed to fixed	Fixed to fixed
18	Coupon rate and any related index	6.375%	12.125%	7.540%	6.327%
19	Existence of a dividend stopper	No	No	No	No
20a/b	Fully discretionary, partially or mandatory (in terms of timing)	Fully discretionary	Partially discretionary	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	No	No	Yes	Yes
22	Non-cumulative or cumulative	Non-cumulative	Non-cumulative	N/a	N/a
23	Convertible or non-convertible	Convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	Contractual - CET1 <7%	N/a	N/a	N/a

25	If convertible, fully or partially	Fully	N/a	N/a	N/a
26	If convertible, conversion rate	One for every £67 held	N/a	N/a	N/a
27	If convertible, mandatory or optional conversion	Mandatory	N/a	N/a	N/a
28	Specify output instrument	CCDS	N/a	N/a	N/a
29	Specify issuer of output instrument	Coventry	N/a	N/a	N/a
30	Write-down features	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in
31-34	If w/d, trigger(s), full/partial, PWD/TWD	N/a	N/a	N/a	N/a
35	Instrument type immediately senior	Sub Debt	Sub Debt	Senior Unsecured	Senior Unsecured
36	Non-compliant transitioned features	No	Yes	Yes	Yes
37	If yes, specify non-compliant features	N/a	No contractual write-down or conversion	Step-up reset rate	Step-up reset rate

Further information on Perpetual Capital Securities and PIBS is available on the Society's website (www.coventrybuildingsociety.co.uk/consumer/our-performance/treasury-services). Further information on the immaterial Tier 2 subordinated debt is available on request.

Appendix 3: Asset Encumbrance Disclosure Template

The templates below are as prescribed in updated EBA Guideline EBA/RTS/2017/03 on disclosure of encumbered and unencumbered assets. Prior year disclosures have been restated to reflect the updated Guidelines.

In all tables, the values reflect the median of the sums of the of the four quarter end-of-period values over the previous 12 months as prescribed by the EBA and therefore differ from encumbrance disclosures in the accounts that are based on year end balances.

Template A – Encumbered and unencumbered assets

2018		Carrying amount of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Carrying amount of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	10,278.0	9,808.4			34,351.9	4,921.2		
030	Equity instruments					2.9			
040	Debt securities	545.8	545.8	545.8	545.8	388.6	379.6	388.6	379.6
050	of which: covered bonds	8.2	8.2	8.2	8.2	8.2	8.2	8.2	8.2
060	of which: asset backed securities					8.3		8.3	
070	of which: issued by general government	541.6	541.6	541.6	541.6	312.9	312.9	312.9	312.9
080	of which: issued by financial corporations	8.2	8.2	8.2	8.2	47.5	37.6	47.5	37.6
120	Other assets [1]	9,946.9	9,477.4			34,054.0	4,636.1		

2017		Carrying amount of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Carrying amount of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	7,994.2	7,523.5			32,593.9	3,216.9		
030	Equity instruments					2.4			
040	Debt securities	402.6	402.6	402.6	402.6	604.3	590.1	604.3	590.1
050	of which: covered bonds					9.8	9.8	9.8	9.8
060	of which: asset backed securities					14.0		14.0	
070	of which: issued by general government	402.6	402.6	402.6	402.6	580.3	580.3	580.3	580.3
080	of which: issued by financial corporations					25.5	9.9	25.5	9.9
120	Other assets[1]	7,667.4	7,215.0			31,837.5	2,574.4		

1. All remaining balance sheet assets, predominantly loans and advances to customers.

Template B - Collateral received

The EBA Guidelines allow competent authorities to waive the requirement to disclose Template B – Collateral received and in Supervisory Statement SS 6/17 the PRA waived the Template B requirement subject to a firm meeting certain criteria. The Society meets the criteria and therefore Template B is not disclosed.

Template C – Encumbered assets/collateral received and associated liabilities

2018		**Matching liabilities, contingent liabilities or securities lent £m**	**Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m**
		010	030
010	Carrying amount of selected financial liabilities	**6,948.2**	**10,006.5**
2017			
010	Carrying amount of selected financial liabilities	4,741.2	6,001.8

Template D – Information on importance of encumbrance

The most material sources of encumbrance for the Society are secured funding via the Society's covered bond and securitisation programmes which are supported by pledging mortgage assets. The Society has also utilised whole mortgage pools with the Bank of England to secure amounts drawn down under the Term Funding Scheme (TFS). Further detail on these activities is set out in note 16 to the 2018 accounts. Assets are encumbered in accordance with the contractual requirements of these programmes. Furthermore, these programmes are continually assessed and a prudent buffer of over-collateralisation is voluntarily maintained for operational efficiency. The underlying assets and cover pool assets related to any securities retained by the Society are treated as unencumbered in both this disclosure and in the accounts.

The Society also pledges debt securities as collateral in sale and repurchase transactions – see note 15 to the 2018 accounts.

An additional source of encumbrance is the collateralisation of derivatives liabilities. The Society also treats some cash and balances with the Bank of England, some loans and advances to credit institutions and some debt securities as encumbered even though there are no associated liabilities. An example of this would be liquid assets held within the Society's covered bond and securitisation programmes as these are not available for use in the Society's day-to-day operations.

Encumbrance is not undertaken in any other currency other than sterling.

At the year end encumbered assets are predominantly all on the Society's own balance sheet other than around £0.2 billion of mortgage assets (2017: £1.2 billion) from its subsidiary Godiva Mortgages Limited and the liquid assets held within the Society's covered bond and securitisation programmes referenced above.

The over collateralisation of £3.1 billion in Template C (2017: £1.2 billion) predominantly represents over-collateralisation in respect of covered bonds, securitisations and whole mortgage pool operations.

The Society manages its levels of encumbrance in accordance with Board approved limits.

A general description of the terms and conditions of the collateralisation agreements entered into for securing liabilities are available in the 2018 accounts as follows; for sale and repurchase transactions of debt securities in note 15; for covered bonds, securitisation and whole mortgage pools in note 16; and for derivatives in note 24.

Appendix 4: Leverage Ratio – Disclosure Templates

Reference date	31 December 2018 (31 December 2017 for comparatives)
Entity name	Coventry Building Society
Level of application	Consolidated

Template A: Table LRSum - Summary reconciliation of accounting assets and leverage ratio exposure

		Applicable Amount	
		2018 £m	2017 £m
1	Total assets as per published financial statements	**46,070.9**	**42,572.5**
4	Adjustments for derivative financial instruments	**(39.8)**	**(94.4)**
5	Adjustments for securities financing transactions "SFTs"	**1,711.1**	**869.3**
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**358.9**	**736.8**
7	Other adjustments	**(155.1)**	**(192.6)**
8	**Total leverage exposure**	**47,946.0**	**43,891.6**

Template B - Table LRCom: Leverage ratio common disclosures

		CRR leverage ratio exposures 2018 £m	2017 £m
	On balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**45,802.0**	42,267.5
2	(Asset amounts deducted in determining Tier 1 capital)	**(75.0)**	(77.9)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**45,727.0**	42,189.6
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**82.2**	102.2
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**146.9**	109.9
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(80.1)**	(116.2)
11	**Total derivative exposures (sum of lines 4 to 10)**	**149.0**	95.9
	Securities financing transaction exposures		
14	Counterparty credit risk exposure for SFT assets	**1,711.1**	869.3
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**1,711.1**	869.3
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**1,737.5**	1,480.7
18	(Adjustments for conversion to credit equivalent amounts)	**(1,378.6)**	(743.9)
19	**Other off-balance sheet exposures (sum of lines 17 to 18)**	**358.9**	736.8
	Capital and total exposures		
20	Tier 1 capital	**2,011.7**	1,868.5[1]
21	**Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**47,946.0**	43,891.6
	Leverage ratio		
22	**Leverage ratio**	**4.2%**	4.3%
	Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Fully phased in**	Fully phased in

Note:
1. Tier 1 capital in the prior year has been restated from £1,800.8 million to £1,868.5 million to remove the £67.7 million constraint on the inclusion of AT 1 capital under the UK leverage ratio framework that does not apply to the CRR leverage ratio calculation. A summary presentation of the calculation of both the CRR and UK leverage ratios is in section 3.4.

Template C: Table LRSpl: - Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempt exposures)

		CRR leverage ratio exposures	
		2018 £m	2017 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**45,802.0**	42,267.5
EU-3	Banking book exposures, of which:	**45,802.0**	42,267.5
EU-4	Covered bonds	**8.2**	9.7
EU-5	Exposures treated as sovereigns	**5,886.1**	5,733.0
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	**75.1**	-
EU-7	Institutions	**406.0**	434.6
EU-8	Secured by mortgages of immovable properties	**39,233.0**	35,893.0
EU-9	Retail exposures	**23.3**	27.7
EU-10	Corporate	**1.5**	2.6
EU-11	Exposures in default (standardised)	**6.7**	9.1
EU-12	Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	**162.1**	157.8

Template D: Table LRQua – Qualitative information on risk of excessive leverage and factors impacting the leverage ratio

1: Description of the processes used to manage the risk of excessive leverage

How the Society manages the risk of excessive leverage is set out in section 3.4 Leverage ratio.

The maximum theoretical CRR leverage ratio requirement is 3.0%. The Board is confident that the Society will meet this requirement with an appropriate level of headroom.

2: Description of the factors that had an impact on the leverage Ratio during the period to which the disclosed leverage Ratio refers

The leverage ratio has remained broadly static at 4.2% (2017: 4.3%) 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.

Appendix 5: Countercyclical Capital Buffers - Disclosure Templates

The countercyclical buffer is an additional requirement introduced by CRD IV, calculated by applying a weighted average of country countercyclical buffer rates based on the geographical distribution of relevant exposures to the overall capital requirements of the Society. The following templates disclose information relevant for the calculation of the countercyclical buffer as at 31 December 2018 in accordance with Regulation (EU) 2015/1555 on a consolidated basis.

Template A: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Society's aggregate risk weighted exposures, all exposures have been allocated to the UK. Exposures are as defined in Regulation (EU) 2015/1555 and in particular exclude exposures to sovereigns and supranationals.

Table 1: Geographical distribution of credit exposures relevant for the calculation of the countercyclical capital buffer

2018		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	Breakdown by country UK	**785.0**	**42,274.4**	**-**	**-**	**8.2**	**-**	**311.0**	**-**	**0.1**	**311.1**	**1.0**	**1%**
020	**Total**	**785.0**	**42,274.4**	**-**	**-**	**8.2**	**-**	**311.0**	**-**	**0.1**	**311.1**	**1.0**	**1%**

2017		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	Breakdown by country UK	873.6	38,536.5	–	–	10.7	–	286.2	–	0.2	286.4	1.0	0.0
020	**Total**	873.6	38,536.5	–	–	10.7	–	286.2	–	0.2	286.4	1.0	0.0

Table 2: Amount of institution specific countercyclical capital buffer

Row		2018 Column	2017 Column
			010
010	**Total risk exposure amount**	**£4,548.5m**	£4,213.1m
020	**Institution specific countercyclical buffer rate**	**1%**	0%
030	**Institution specific countercyclical buffer requirement**	**45.5**	Nil

Appendix 6: Abbreviated Liquidity Coverage Ratio (LCR) disclosures

This Appendix sets out abbreviated Liquidity Coverage Ratio (LCR) disclosures in the format prescribed in European Banking Authority Guidelines (EBA/GL/2017/01).

The LCR is a measure 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. A binding minimum LCR of 100% applied to the Society from 1 January 2018.

These disclosures complement the disclosure of liquidity risk management under the CRR which are included in the accounts Risk Management Report in the Liquidity and Funding risk section.

As prescribed by the EBA Guidelines:

- The Liquidity buffer represents the amount of the Society's liquidity resources for regulatory purposes. Substantially all of the Society's liquidity buffer is made of up balances with the Bank of England and UK Government securities.
- The Total net cash outflow represents the total expected cash outflow on a stressed basis minus total expected contractual cash inflows for the subsequent 30 days.
- The values at each quarter end date are a simple average of month-end observations over the 12 months preceding the end of each quarter.

Liquidity Coverage Ratio (LCR)

	12 month average			
	31-Mar-18	30-Jun-18	30-Sep-18	31-Dec-18
	£m	£m	£m	£m
Liquidity buffer	5,097.1	5,056.3	5,192.7	5,244.4
Total net cash outflow	2,680.2	2,687.7	2,639.7	2,632.6
Liquidity Coverage Ratio (LCR)	192%	189%	198%	201%

Throughout the year the Society has continued to meet all its internal and regulatory liquidity requirements

Glossary

The following glossary defines terminology within the Pillar 3 disclosures to assist the reader and to facilitate comparison with publications by other institutions:

Accounts	The Society's Annual Report & Accounts
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 III	The Basel Committee on Banking Supervision issued proposals for a strengthened capital regime in response to the financial crisis, which are referred to as Basel III. These standards were implemented in the European Union via CRD IV, which came into force on 1 January 2014.
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.
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 Regulations (CRR) leverage ratio	A ratio defined by the Capital Requirement Regulations (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 (FVOCI) reserve, Additional Tier 1 capital less all required regulatory adjustments.
Central clearing	The process by which parties to an OTC derivative contract replace this with a separate contract with a central counterparty, which takes over each party's positions under the original contract.
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 (FVOCI) 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.
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).
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

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 quality step	A credit quality assessment scale as set out in CRD IV.
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.
Credit risk mitigation	Techniques used to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, set off or netting.
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.
Default	Circumstances in which the probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with CRD IV. This is defined as when an account reaches a pre-defined past due status or where, on accounts that are up to date or in arrears by less than the pre-defined status, certain unlikeliness to pay indicators have been met. The unlikeliness to pay indicators are those that the Society has determined as having a higher propensity to eventually reaching the pre-define arrears status.
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.
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.
EEA parent institution	A parent financial institution situated in a Member State of the European Economic Area which is not a subsidiary of another financial institution also situated in the EEA.

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 (EBA)	An independent European Union authority which works to ensure effective and consistent financial regulation and supervision across the European banking sector.
Expected credit loss (ECL)	The present value of all cash shortfalls over the expected life of the 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 used in IRB approaches and under IFRS 9 to estimate the amount outstanding at the time of default.
External Credit Assessment Institution (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's and Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
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) reserve	Financial assets held at fair value on the Balance Sheet with changes on the fair value recognised through other comprehensive income.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
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.
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.
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).
Gilts Government investment securities (gilts)	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
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 ECL 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.
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 on 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	International Swaps and Derivatives Association 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 Regulations (CRR) leverage ratio and UK leverage ratio.
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.
Loan to value	The amount of mortgage loan as a percentage of the value of the property.
Loss Given Default (LGD)	A parameter used under IRB approaches and IFRS 9 to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
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.
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.

Term	Definition
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.
Netting	The ability to reduce credit risk exposures through entering into ISDA master netting agreements (whereby outstanding transactions with the same party can be settled net following a default or other predetermined event) and the receipt of financial collateral.
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.
Over-the-counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
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.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. 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. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Pillar 1	The part of the Basel Framework which sets out the regulatory minimum capital requirements for credit, market and operational risk.
Pillar 2	The part of the Basel Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – TCR (see below) is an outcome of Pillar 2.
Pillar 3	The part of the Basel Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.

Point in Time (PiT)	A modelling approach which assesses the credit risk of an exposure at a single point in time.
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.
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.
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.
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.
Residential Mortgage Backed Securities (RMBS)	Securities issued with interest and principal backed by that it represent 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 who is responsible for taking charge, recapitalising and restructuring a firm; on account of the firms realised or expected failure.
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	The 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 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.
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.
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.
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.
Supervisory Review and Evaluation Process (SREP)	The PRA assessment of a firm's own capital assessment (ICA) under Pillar 2.

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 Buffer.
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	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.
The Standardised Approach: operational risk	The standardised approach to operational risk, calculated using three year historical net income multiplied by a percentage factor depending on the underlying business being considered.
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 AT1 capital that can be included in Tier 1 capital and to exclude eligible central bank holdings from leverage ratio exposures.
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.
Wrong way risk	Defined by the PRA as a situation where there is an adverse correlation between the counterparty's probability of default and the mark-to market value of the underlying transaction.

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COVENTRY
Building Society