Annual Report & Accounts

For the year ended
31 December 2019

Welcome to our

Annual Report & Accounts

Your Society was 135 years old in 2019 and it is still as committed to Putting Members First today as it was when it was founded.

Visit us here
www.thecoventry.co.uk

The photography in this Annual Report & Accounts features some of our amazing colleagues and members.

The term 'Society' is used in this Annual Report & Accounts pages 1 to 108 to refer to the activities of the Society and its subsidiaries, except where the context indicates otherwise. Coventry Building Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority (firm reference number 150892 www.fca.org.uk).

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

Welcome to our

Strategic Report

This section outlines our 2019 performance in the context of our overall business model. All of the important messages in this Annual Report and Accounts are included here.

The Strategic Report has been approved by the Board of Directors and signed on its behalf by:

Mark Parsons
Chief Executive
27 February 2020

Our Performance Highlights

We continued to provide superior long term value to members.

We paid **1.49%** average interest on savings

Market average[1] **0.84%** interest on savings

£228m

Value given to members by paying above market interest on savings[1]
(our 2018 result: £227m)

We delivered sustainable growth, ahead of market growth rates.

7.6%

Mortgage balance growth against market growth of 3.1%[2]
(our 2018 result: 9.3%)

8.9%

Savings balance growth against market growth of 4.1%[2]
(our 2018 result: 7.2%)

Our products continued to be simple, transparent and valued by our members.

8/10

Customers would recommend us to others[3]
(our 2018 result: 8/10)

97%

Complaints upheld in the Society's favour by the Financial Ombudsman against the financial services average of 54%[4]
(our 2018 result: 94%)

In 2019 we received external recognition for our products and services including:

Rated **No.1** for savings

Fairer Finance AUTUMN 2019 1ST PLACE GOLD RIBBON CUSTOMER EXPERIENCE Savings accounts

Recommended Mortgage Provider

Which? Recommended Provider Mortgages September 2019

Rated **No.1** Most Transparent Savings Provider

Fairer Finance AUTUMN 2019 1ST PLACE GOLD RIBBON MOST TRANSPARENT Savings accounts

Putting Members First is at the heart of what we do. We have a balanced set of key performance indicators (KPIs) that make sure we continue to Put Members First both now and in the future.

Our 2019 performance highlights against our KPIs are summarised here:

We remained safe and secure.

32.0%
Capital strength
Common Equity Tier 1 ratio
(our 2018 result: 33.9%)[5]

4.4%
Leverage ratio[6]
(our 2018 result: 4.6%)

214%
Liquidity strength
Liquidity Coverage Ratio
(our 2018 result: 202%)

2019

0.08%
% of mortgage balances where arrears are more than 2.5% of the balance
(our 2018 result: 0.10%)

We continued to spend our members' money carefully whilst investing for the long term.

0.48%
Total costs as a percentage of average assets
(our 2018 result: 0.50%)

0.31%
Operational run costs as a percentage of average assets
(our 2018 result: 0.32%)[7]

27%
Total branches redesigned in 2019, bringing our total to date to nearly 40%

We engaged our colleagues and made a difference to the communities we serve.

2nd in the 25 Best Big Companies to Work For listing 2020

THE SUNDAY TIMES 25 BEST BIG COMPANIES TO WORK FOR 2020

90%
Of colleagues are proud to work for the Society
(our 2018 result: 92%)

82%
Of colleagues engaged in charitable or community activities
(our 2018 result: 79%)

1. The Society's average month end savings rate compared with the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
2. Source: Bank of England.
3. Source: Average number of members scoring 9 or 10/10 across 6 surveys totalling 56,745 responses.
4. Source: Financial Ombudsman Service latest available information 1 January 2019 to 30 June 2019.
5. 2018 Risk Weighted Assets (RWA) numbers and CET 1 ratio have been restated – See page 34 in CFO review.
6. UK leverage ratio calculation as set out in the Glossary.
7. Administrative expenses less change costs, depreciation and amortisation/Average total assets.

Welcome to your Chair's Statement

Our mission of putting you, our members, first is as important today as 135 years ago when the Society was founded.

Gary Hoffman
Chair of the Board

Our CARES values

Caring – Helpful, thoughtful and kind

Attentive – Listening, engaging and improving

Reliable – Trustworthy, dependable and consistent

Ethical – Fair, honest and principled

Straightforward – Simple, easy and clear

Our mission of putting you, our members, first is as important today as 135 years ago when the Society was founded.

This mission is underpinned by our CARES values which guide our decision making and are lived out daily by colleagues across the Society.

As I reflect on the current political and economic environment and the changing landscape of financial services, I believe that the Society's consistency gives our members reassurance in a changing world.

Consistency in a changing world

The building society model continues to be a strong foundation on which to base a sustainable and growing business. We have a deliberately simple business, focused on savings and residential mortgages. This, and our mutual ownership structure, make it easier to align our goals to provide our members with security, long term value and excellent service. It also means we can take a longer term view, investing to enhance future service whilst offering attractive pricing to our members, even when margins are tighter as they are now, without undue concerns about maintaining profitability to sustain a share price.

This long term view means the core of our strategy is unchanged:

- We are a low risk residential mortgage lender. Our prudent approach to lending protects both individual borrowers and all of our members.
- We pay the best savings rates we can afford, and support the value we create for members by carefully managing our costs.
- We recruit people with a passion to provide excellent service and give them the tools and encouragement they need to make a difference to members and to their communities.

Diversity and opportunity for everyone is important to us and we have made significant progress in developing new opportunities for graduates and apprentices. However, despite our policy of paying equal amounts for the same role, our gender pay gap, at 33% (2018: 32%), is higher than we would like. We have plans in place which seek to reduce this over time.

Whilst we are focused on Putting Members First, we recognise our role in supporting our local communities and in reducing our environmental impact. As a responsible building society, we need to work effectively with a range of stakeholders to deliver quality of service and value to our members. Whilst our colleagues are first among these stakeholders, we also focus on our relationships with our mortgage intermediaries, investors and suppliers.

This year's Strategic Report reflects our thinking on building these relationships in support of Putting Members First. It demonstrates our ongoing commitments to supporting the communities we serve and our home city of Coventry and shows how we are stepping up to the challenge of supporting environmental sustainability.

Embracing change that delivers value to members

Putting Members First means adapting what we do to stay relevant and meet expectations of members today and in the future.

Today change is happening faster than ever. New technologies are increasing competition and transforming service expectations. Regulations, designed to protect consumers and increase the resilience of the financial services sector, can also add cost and complexity. In addition, there is an bigger risk of fraud or interruption to service.

To address this we are making significant investments to ensure we stay relevant for both current and future members. We are upgrading our core technology platform, enhancing the resilience of our IT infrastructure and redesigning our branch network. In addition, we are developing new ways of providing savings accounts, such as through our partnership with Hargreaves Lansdown, improving our range of savings and mortgage accounts and enhancing the way members can access our products digitally.

The level of external and internal change inevitably brings risk and, as we have seen in the market, there are serious consequences of getting it wrong. I, and my colleagues on the Board, recognise that continuing to manage these risks and implement change successfully is critical to the Society's future.

Balancing consistency and change

I am confident that our strategy is the right one. It delivers solid and sustainable results as we have shown once again this year. More importantly, it provides the right balance of consistency and change. Our plans build on the strength of the Society's long-held mission, of Putting Members First, and its values, whilst recognising that we need to adapt to deliver a long term sustainable business.

Change and consistency apply equally to our Board. In May 2019 I was very pleased to welcome Shamira Mohammed, who joined us as non-executive director. In December, following our Chief Executive, Mark Parsons' decision to retire, we announced that Steve Hughes will be joining us as our new Chief Executive. Steve will join us in the coming months. I believe he is an excellent fit for the Society, a qualified accountant, who was until recently Chief Executive of the Principality Building Society, he is passionate about the benefits of mutuality and the positive impact that organisations should have on customers, colleagues and the communities they serve.

I would like to finish by thanking all of my colleagues at the Society for their ongoing hard work, commitment and service. They are the ones who deliver the results summarised in this report.

However, this year my biggest thanks go to Mark, who, over his five years as Chief Executive, has protected and built on the Society's heritage whilst laying the foundations for its successful future. His total commitment to Putting Members First and the energy he has put into engaging colleagues has defined his time at the Society. On behalf of the Board, our colleagues and our members, I would like to wish him a healthy and fulfilling retirement.

Gary Hoffman

Gary Hoffman
Chair of the Board
27 February 2020

Welcome to your

Chief Executive's Review of the Year

I feel privileged and proud to have led an organisation that is different, and that makes a difference.

Mark Parsons
Chief Executive

This is my last review before retiring as Chief Executive of the Society. I feel privileged and proud to have led an organisation that is different, and that makes a difference.

Throughout the last five years, we have maintained our mission of Putting Members First and pursued this through a consistent strategy. We have assessed our performance against that strategy through a balanced scorecard with no single component more important than another, and we have set ourselves ambitious goals.

It is against this scorecard that I am pleased to report further good results for 2019.

We are a growing business, with more members joining us than leaving. In 2019, we grew well above the market as a whole again. We grew our mortgage balances by 8% (2018: 9%), compared with market growth of 3%[1], and our savings balances by 9% (2018: 7%) against market growth of 4%[1].

7.6%

Mortgage balance growth against market growth of 3.1%[1]
(our 2018 result: 9.3%)

8.9%

Saving balance growth against market growth of 4.1%[1]
(our 2018 result: 7.2%)

Growth in mortgages was achieved in a highly competitive market, with borrowers actively switching at the end of fixed rate deals. Across the market this has led to borrowers moving from higher margin deals written two or more years ago to lower rates. In addition, there continues to be a move from higher margin Standard Variable Rates (SVR). These factors result in a continuation of the squeeze in overall margin seen in recent years. We benefit from high levels of retention, reflecting our proposition which includes making all products available to all customers, high levels of borrower and broker satisfaction, and the fact that we have a low proportion of borrowers on SVR.

£228m

Value given to members by paying above market interest on savings[2]
(our 2018 result: £227m)

This mortgage margin squeeze and low base rate have seen savings providers lowering rates still further through 2019. Against this background our average savings rate was 1.49% (2018: 1.50%), significantly above the market average rate of 0.84%[2] (2018: 0.78%). As a result our savings members received £228 millon[2] (2018: £227 million) more interest than they would have received at average market rates.

Delivering superior value is only part of our commitment of Putting Members First. We believe it has to be underpinned by excellent service and simple, transparent products that deliver good outcomes for all our members.

In 2019, we continued to receive external recognition for both our mortgages and savings products, with Fairer Finance ranking us number one for savings for the fourth year running, being rated highest for transparency as part of this. We were also one of only three providers to be recognised by Which? as a Recommended Provider for Mortgages.

Rated

No.1

for savings

Fairer Finance
AUTUMN 2019
1ST PLACE
GOLD RIBBON
CUSTOMER EXPERIENCE
Savings accounts

Our overall Experience Net Promoter Score[3] at +74 remained very high. At the same time, our Relationship Net Promoter Score, which reflects wider perception of our brand and propositions, reached its highest ever level and is among the very best of our peers. Furthermore, in 2019, fewer complaints were referred to the Financial Ombudsman Service and 97% of these cases were found in our favour, indicating that we had treated our member's complaints fairly. This position is among the very best in the sector[4].

A key part of our strategy is investing in our future to deliver the savings and mortgage products our members will need. In 2019, we saw further growth in savings on the Hargreaves Lansdown platform after launching the first easy access product on the platform.

1. Source: Bank of England.
2. The Society's average month end savings rate compared with the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.
3. Net Promoter Score (NPS) is a measure of customer advocacy that ranges between -100 and +100 which represents how likely a customer is to recommend our products and services.
4. Source: Financial Ombudsman Service latest available information 1 January 2019 to 30 June 2019.

Chief Executive's Review continued

Reflecting both member feedback and our belief in promoting a savings habit, we launched a Regular Saver product this year with account openings exceeding expectations. We took an important strategic step in simplifying our product range by streamlining our MoneyManager offering and withdrawing overdrafts and debit cards, removing the substantial cost and regulatory overhead associated with the current account market.

We have a number of significant investment programmes in place to upgrade our core technology platform, enhance our infrastructure resilience and redesign our branch network. These are complex programmes which have to be managed well to deliver them safely. I am delighted that we are successfully delivering our branch redesign programme in line with expectations, refurbishing 27% of our branch network in 2019 to excellent feedback from members and colleagues alike. We have delivered a number of upgrades that enhance our security and IT resilience and we expect to substantially complete our data centre programme next year. However, progress on this and some other IT investment initiatives has been slower than we planned and we are continuing to enhance our delivery capability, balancing speed, risk and cost.

0.48%
Total costs as a percentage of average assets
(our 2018 result: 0.50%)[5]

0.31%
Operational run costs as a percentage of average assets
(our 2018 result: 0.32%)[6]

Reflecting this investment, our total management expense ratio was 0.48%[5], slightly below the 2018 ratio of 0.50%. Our operational run cost ratio[6], which excludes both change costs and depreciation, was 0.31%, also lower than in 2018 (0.32%). These ratios demonstrate both the scale of the investment we are making in the future of the business and our commitment to spend our members' money carefully, which in turn enables us o provide the superior rates to members I described earlier.

Our financial strategy is focused on being low risk, with strong capital and low costs, while paying the best rates to members that we can afford. The average indexed loan to value[7] of our mortgages of 55% continues to be well below the market average and our mortgage arrears at 0.08% of total balances are one eighth of the industry average[8]. Our liquidity has remained strong throughout the year with a Liquidity Coverage Ratio of 214% at the 2019 year end (2018: 202%). In 2019, we delivered profit before tax of £147 million which was 27% down on 2018 (£202 million). This reflected a one-off gain on sale of some mortgage assets in 2018, the squeeze on net interest margin and the impact of volatility in the financial markets on the fair value of financial instruments used to manage interest risk exposures. Despite this fall we have maintained our capital ratios in line with our financial strategy.

In December 2019, we announced that we needed to correct a part of our capital calculation. This was disappointing and we are taking steps to improve our internal controls and systems to prevent something like this happening again. Despite this, our core risk based capital ratio (CET 1) remains amongst the highest reported in the UK at 32.0% (2018: 33.9%)[9]. Our capital strength is a fundamental part of being safe and secure and we are one of the most highly capitalised financial institutions in the UK.

32.0%
Capital strength
Common Equity Tier 1 ratio
(our 2018 result: 33.9%)[9]

4.4%
Leverage ratio[10]
(our 2018 result: 4.6%)

As I said at the start, this is my last review as your Chief Executive and I would like to finish by reflecting on the last five years.

Over this time, the Society has repeatedly grown two to three times faster than the market, becoming the second largest building society along the way. This has happened because we have a track record of providing good pricing to members, supported by a low cost of operating which is consistently the best in the sector, and very high and increasing customer satisfaction.

5. Administrative expenses, depreciation and amortisation/Average total assets.
6. Administrative expenses less change costs, depreciation and amortisation/Average total assets.
7. Indexed loan to value weighted by balance.
8. Source PRA – latest available information September 2019. Percentage of mortgages in arrears by 2.5% or more.
9. 2018 RWA numbers and CET 1 ratio have been restated – See Risk Management Report.
10. UK leverage ratio calculation as set out in the Glossary.

This in turn has been underpinned by our principles of being simple and transparent. We have remained a low risk lender with strong risk weighted capital. This approach stands us in good stead whatever happens in our markets. Finally, we have consistently supported our wider society, with four out of five of my colleagues actively engaged with charitable and community causes. All of these have been strategically deliberate outcomes.

Critically, these outcomes have been delivered by my colleagues across the Society, who now number over 2,600. It is their passion, their commitment, their energy and their belief in Putting Members First that makes us different and makes the difference. We are a people business and I am delighted to announce we have recently been ranked second in The Sunday Times 25 Best Big Companies to Work For list. With this level of colleague engagement I know the Society is in very good hands for the future.

I am delighted to be passing on the reins of this special organisation to Steve Hughes and wish him the very best. I thank our strong Board for the support they have provided me. Above all, I thank each and every one of my colleagues for their continued commitment to putting you, our members first.

Mark Parsons
Chief Executive
27 February 2020

CARES in ACTION

Our 2019 CARES ‘super hero’ award winners pictured with our Chief Executive Mark Parsons

Our Business Model

This section outlines our purpose, 'why we do things', and our business model, 'what we do'. It sets out what is important to us both strategically and in the values that underpin our delivery of Putting Members First.

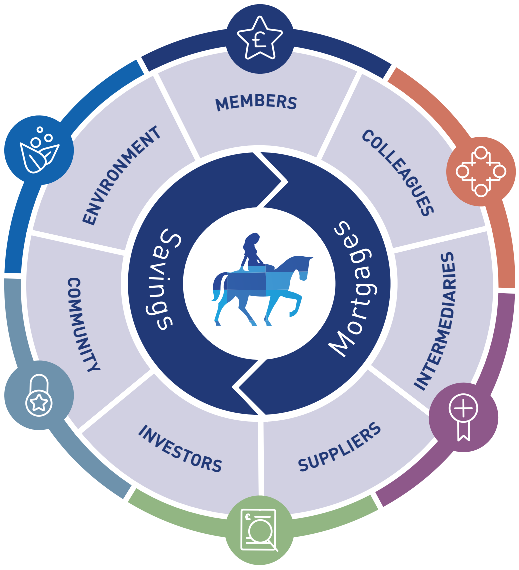
Our mission is Putting Members First

Why we do things – Our purpose

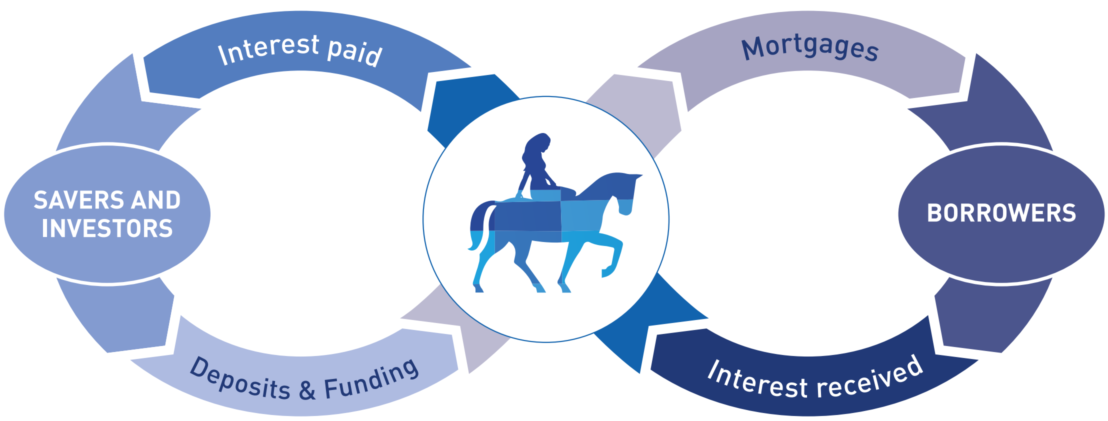
Our purpose is giving people the power to be better off through life. As a mutual organisation, we exist first and foremost for our savings and borrowing members. We seek to make them better off, in the long term, by providing straightforward and transparent products that offer superior value, coupled with great service.

As a member owned business without shareholders, we are completely focused on Putting Members First. We do this best by engaging constructively with all of our key stakeholders' including our colleagues who work for the Society. We seek to benefit both the communities we serve and the wider environment.

In this way we create a virtuous circle of mutually beneficial long term relationships in support of our mission of Putting Members First.



What we do – our simple business model



We take deposits from our savings members and lend these out as mortgages to borrowing members. The interest received on these mortgages pays for the costs of operating the Society and leaves profits to maintain our capital base, supporting future growth and keeping us secure. Our low cost of operations and low risk lending enable us to provide superior returns to savers. We use wholesale funding to reduce funding risks and lower our funding costs, improving the value we give to members.

What is important – Our strategic priorities

Our strategic priorities support our mission and purpose. They guide our plans and are aligned to our KPIs. In short they are summarised as:

- A commitment to remaining an independent mutual, owned by and serving our members.
- Driving long term sustainable growth in mortgages and savings demonstrating the value of our products and giving us economies of scale.
- Returning superior value to members through products which are simple and transparent.
- Providing a service which is easy to use and valued by our members whether in a branch, by telephone or online.
- Running our business cost effectively to allow us to invest in future services whilst providing enhanced returns to our members.
- Being one of the safest and most secure UK financial institutions.
- Working effectively with all our stakeholders to deliver our mission.

What is important – Our values

Our values guide how we behave on a daily basis and are central to all our decision making.

We are:

Caring – Helpful, thoughtful and kind

Attentive – Listening, engaging and improving

Reliable – Trustworthy, dependable and consistent

Ethical – Fair, honest and principled

Straightforward – Simple, easy and clear

These CARES values are at the heart of everything we do. There are countless examples of how our colleagues put these into practice every day to make sure we achieve our mission of Putting Members First.

Our CARES Awards scheme is designed to recognise colleagues who exemplify the CARES values in action, reinforcing their importance.

CARES in ACTION

Ruth, a Financial Crime Investigator with the Society, was recognised with a CARES 'super hero' award for supporting a vulnerable customer who was a victim of solicitor fraud.

The case, which took two years to be resolved, involved tens of thousands of pounds. Ruth knew the customer had been a victim of financial abuse before. She did lots of investigation and worked closely with the police and branch staff whilst making sure she kept the customer's trust. As a result of her patience, she helped bring to light that a solicitor, who was in debt, appeared to be taking advantage of our member.

The case went to court and Ruth continued to support our member throughout, as well as writing a witness statement detailing her findings. As a result of Ruth's actions the case was won, and most importantly our member's savings were protected.

Ruth, Financial Crime Investigator

Engaging our Stakeholders

This section sets out those stakeholder groups that are strategically important in delivering our mission, how the Board engages with each group and how it addresses governance requirements. The following pages explain how this works in practice and demonstrate how engaging our stakeholders has impacted our strategy.

Why stakeholders are important

As directors we work to promote the success of the Society for the benefit of its members overall. In doing so we voluntarily comply with Section 172 of the UK Companies Act 2006 (UKCA).

The UKCA focuses on five key areas[1]:

- The likely consequences of decisions in the long term;
- How we engage with and take account of employees' interests;
- How we foster effective working relationships with wider stakeholders such as suppliers;
- How we impact our communities and the environment; and
- The need to embrace high standards of professional conduct.

At the Society, we fully support governance in this area as we believe that to deliver on our mission of Putting Members First we need to engage a range of stakeholders. In addition:

- Our strategy is built on delivering long term value and our ownership model lets us take a long term view;
- Employee engagement and involvement is a way of life for the Society as we believe that engaged people are the key to great customer service and Putting Members First;
- Similarly, we think that it is good business and good for our members to operate in a way that works for us and the third parties we work with;
- Supporting the communities we serve has always been an intrinsic part of what we do and is something that engages both our colleagues and our members. As a responsible Society, we are committed to working to reduce our impact on the environment; and
- High standards of conduct are critical in our day-to-day business and ensure good relationships with our regulators. We seek to comply with both the letter and spirit of regulation. We manage our tax affairs in the same way we that we manage everything else, with transparency and simplicity.

Details of non financial reporting statements and explanations of alternative performance measures are included at the end of this Strategic Report.

1. That apply to the Society as a mutually owned business.

Who are our stakeholders?

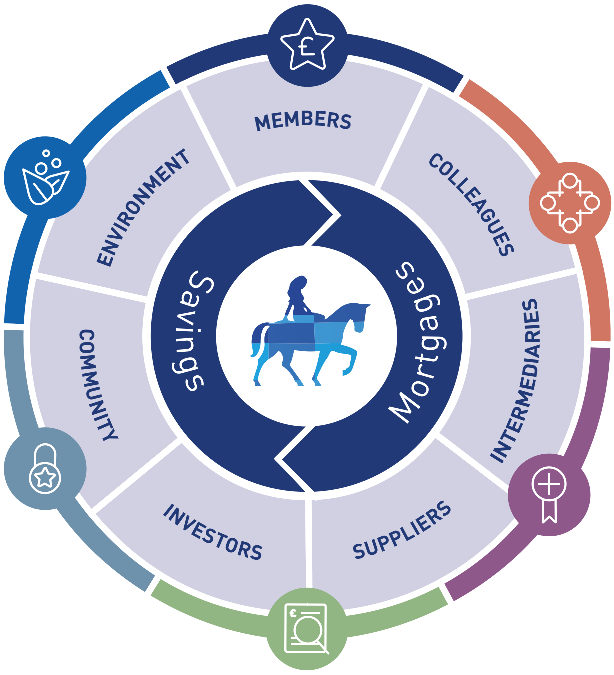
In 2019, we developed our thinking on the main stakeholder groups we need to engage, foster good relations with or support.

Each of these groups is an important part of delivering our mission of Putting Members First.

Our engagement map and how each group relates to delivering our mission is summarised below:

Stakeholder		Why they are important
Savings and Borrowing Members		Members, as owners of the Society, are at the heart of everything we do.
Colleagues		Engaged colleagues are productive and passionate about delivering great member service and outcomes as well as supporting our communities.
Third Parties	Intermediaries	The third parties we work with all form an integral part of our business model. We need to foster great, mutually beneficial relationships with them to deliver on our strategy.
	Suppliers	
	Investors	
Community		Supporting the communities in which we operate is a fundamental part of what we do. It engages our colleagues and members alike.
Environment		As a responsible business we believe it is our duty to minimise the impact we have on the environment.

Our Stakeholders



Our commitments

We treat members fairly and give them market-leading service with simple and transparent products that lead to good outcomes and long term value.

We **listen** to what our members tell us and **act on what they say**.

We provide a positive working environment, focusing on wellbeing, belonging and opportunity.

We **understand** and **act** on the views of our people.

We treat intermediaries with the same respect as members, **committing to transparency, long term value and superior service.**

We consider **broader factors than price and quality** when deciding who we partner with, recognising the **impact suppliers have on the Society.**

We treat our investors as **long term partners**, we are **transparent, straightforward** and **consistent in all our dealings** with them.

We work with our local communities, using our **skills and resources,** to **create opportunities for people to have better lives.**

We seek to make a **positive difference** to the environment.

We send **no waste to landfill** and we will have **net zero carbon emissions[2] by 2021.**

2. Scope 1 and 2 emissions.

How the Board works with stakeholders

As a Board we undertook **training** in 2019 to ensure we understand the requirements of the UK Corporate Governance Code in respect of stakeholders. We hold a number of **Strategy Days** where instead of focusing on current business performance we consider carefully the strategic plan for the Society including how it impacts the stakeholders of our business.

We spend time **listening to member feedback** either directly at events such as the Annual General Meeting or by visiting branches and contact centres or through reports from management, including customer experience survey results and communications with the Member Panel.

We listen to **colleague feedback** through our employee forum, My Society, which our Deputy Chairman attends, through the results of the annual independent employee opinion survey and through Colleague Talkbacks and branch and department visits which both executive and non-executive directors attend. Twice in 2019, members of My Society attended sessions at formal Board meetings to share their views.

In respect of our intermediaries, community and environment, we receive **briefings** from the relevant executives on survey results and other feedback. Board members have the opportunity of **engaging with intermediaries** at an annual event hosted by the Society.

Our balanced scorecard includes **KPIs** which not only deal with financial outcomes but also measure engagement with stakeholders, such as employee engagement survey scores, member satisfaction scores and the level of community involvement by colleagues at the Society.

Being accountable to

Our members

Members, as owners of the Society, are at the heart of everything we do. We treat members fairly and give them market-leading service, simple and transparent products that lead to good outcomes and long term value. We listen to what our members tell us and act on what they say.

As a Board we are accountable to members of the Society as the owners of the business.
This responsibility means we work hard to understand how members feel about their Society; we stay in touch with them throughout the year and constantly seek to provide ways to ensure their voices are heard and factored into our decision making.

Actively listening to our members is a way of life for us.
Listening to our members goes beyond surveys. We actively monitor all our member interactions, including complaints, compliments and social media mentions. All of these are analysed by management to get a rounded picture of what our members are saying. We also compare the experiences of our members with those seen at competitors to make sure we keep up with ever changing customer expectations.

Our online Member Panel is a valuable way to communicate with members and understand their opinions. We set up the Panel four years ago and, today, over 5,500 members have registered. The Panel allows us to keep in touch with topics that are important to our members and most conversations are started by them.

Online member events enable Panel members to meet with senior management to air their views and understand the decisions we take and in 2019, there were over 1,000 forum comments.

We carry out surveys during the year tailored to typical member experiences such as branch visits, opening a savings account or bond maturity to understand how members feel about these.

All of this adds up to give us a rich picture of what our members value and what they would like to see changed.

Acting on what we are told is asimportant as listening

Whilst it is important to listen to members' feedback, we also need to act on what they tell us. Examples of this have included changes we made to the new design for our branches as well as launching a quarterly online member newsletter.

Working closely with our members helps us to communicate well. We regularly test letters, emails, leaflets and brochures before publishing them, to make sure they are clear and easy to understand, making changes based on what we are told. This demonstrates how members benefit from the time we spend listening and acting on feedback.

How our members' views have impacted our actions in 2019

Some examples of how we have acted on member feedback in 2019 are given here:

- In September 2019, we launched our Regular Saver product following feedback from members both in-branch and through our online Member Panel. By December 2019 we had opened over 20,000 new accounts for members who are saving for something important to them.
- In 2019, we started working on new online authentication procedures to comply with new regulatory requirements. We tested both our planned solution and communications with members and their views modified our plans.
- Although we do not receive many complaints, we treat them seriously. Following feedback, we have trained our response teams in communicating more clearly with members and adjusted resourcing levels. As a result, average complaint handling times reduced from 16 to 14 days.

over **5,500**

members on our Member Panel

(2018: over 3,800)

8/10

members say they would recommend us to friends and family

(2018: 8/10)

Case study

Listening to our members as we simplified MoneyManager

In 2018, as part of our process of simplifying our products, we were considering removing debit card and overdraft facilities from our MoneyManager accounts.

Removing product features that we know members use is a very rare step for us to take and so it was important for us to understand the potential implications before making a final decision.

We spent 10 months engaging our members in one of the largest and most detailed pieces of customer research we have completed to date. We consulted with nearly 100 members through face to face meetings, to find out how they used their MoneyManager accounts and what their attachment to them was. We sought to engage with the widest range of account holders as possible to understand the full range of issues.

What we learned influenced our plan for delivering the change and communicating it. Our members told us that they wanted very clear communications on what was happening and when, together with clear comments on what they needed to do. We joined the Current Account Switch Service to make it easier for affected members to transfer their accounts and we tested several draft communications to make sure that they were clear and comprehensive.

We knew that many of our members would want to talk through their options with colleagues working in our branches and contact centres so we made sure these teams were given all the relevant information they needed to help them understand their options and take the necessary actions.

Whilst inevitably some members have been disappointed at the changes, we made the experience as easy as possible. We believe this is as a direct result of spending time listening to and acting on what our members had to tell us before we made the changes.

Our focus for 2020

- Making it easier for members to manage their accounts online, over the telephone and in person.
- Growing our Member Panel to increase feedback.
- Increasing our analytics to gain extra insight into customer experience improvements.

Our colleagues

Understanding Our colleagues

Engaged colleagues are productive and passionate about delivering great member service as well as supporting our communities. We provide a **positive working environment**, focusing on wellbeing and opportunity and we embrace diversity. We seek to **understand and act** on the views of our people.

Engaging our people lets us see work from their perspective. At its heart the Society is a people business and taking account of colleagues' needs is strongly embedded in the way we work.

Our employee forum, My Society, is an important two way communication route. Peter Ayliffe, our Deputy Chair, leads the Board engagement with My Society, updating the forum on issues being discussed at the Board and seeking their views, which are fed back into Board meetings. During 2019, My Society members joined Board discussions on member experience and on the results of the 2019 employee opinion survey.

Executive and non-executive directors regularly visit teams and branches and participate in 'talkback' events giving colleagues the chance to ask questions and to give insights. In addition we receive regular feedback from our union, Unite.

One of the main ways we listen to our people is through the independent employee opinion survey which is delivered through Best Companies. This allows us to benchmark our employee engagement against leading UK companies, and in 2019 we received the highest 3 Star accolade for "Extraordinary engagement." 88% of employees took part, telling us what they love about working for the Society and also where we can improve things for them. This feedback shapes our priorities.

We want the Society to be 'a place to belong' for all employees and our wellbeing, diversity and inclusion initiatives help achieve this. We have expanded the range of support we offer to promote physical, financial and mental wellbeing among colleagues. In 2019 we introduced free on-site cancer checks, Mental Health First Aiders and we provided paid time off for carers at critical moments in their lives. Diversity and inclusion are important to our colleagues and they give the Society a more balanced workforce, reflecting our membership and the communities we serve.

Feedback also tells us that opportunity matters and we are creating more opportunities and increasing mobility across the Society. In 2019 we welcomed over 300 new starters, including apprentices and people returning to work, and nearly 10% of our people moved to new roles with us, expanding their horizons. We continue to develop a range of development options from our in depth classroom training for new customer facing colleagues to online resources that our people can use to drive their own development.

Recognition such as being 'Private Sector Employer of the Year' from the Employers' Network for Equality & Inclusion, accreditation as a Disability Confident Employer, and receiving a 'Champion of Inclusion Award' from Business in the Community, demonstrate that our diversity and inclusion initiatives are delivering real results.

Similarly, we received the 2019 Award for Wellbeing from the Employers Network for Equality & Inclusion. We have been in the Sunday Times 100 Best Companies to Work For, for the past three years, and were recently ranked at number two in the Sunday Times 25 Best Big Companies to Work For.

Case study

Our colleagues' input has shaped and enhanced our branch refurbishment programme.

A major part of the success of our branch refurbishment programme is what happens behind the scenes.

Right at the start we built a prototype test branch in our training facility. We asked colleagues to try out and comment on the counters, the furniture and the lighting and we made changes to our plans as a result. We provided training at the test branch which meant colleagues could make the most of the new design and feel comfortable with the new features.

Our Cheylesmore branch was our first redesigned branch in Coventry. Six months before the refit started we met with the branch team to understand what they needed to provide a warm and welcoming service for our members. In addition, they were able to choose finishes for their new staff area such as kitchen facilities, flooring and colour schemes. We also arranged where they would work during the refurbishment. Many chose to work at local branches which meant that when 'Cheylesmore regulars' used alternative branches, they saw a familiar face, particularly important for our more vulnerable customers.

Seven weeks later the refurbishment was complete, including features such as interactive smart screens showing product information and a community book swap, and the Cheylesmore team returned to get everything ready before re-opening on 22 May. Today, the new design is popular with both our colleagues and our members.

"This has been a real team effort, based on lots of consultation with members, accessibility groups, and of course the people who work in our branches. We've placed the 'human touch' at the heart of the experience."

Paul
Project leader

"It's easier to complete transactions for customers now the branch is open plan."

Colleague
Coventry Building Society

43%

of vacancies have been filled internally **(2018: 41%)**

1/3

of board members are female in line with our target for 2019 **(2018:1/3)**

Our focus for 2020

- Expanding our Wellbeing offerings to focus on things that matter most to our people.
- Improving technology and tools to aid better collaborative working.
- Increasing the opportunities for learning and development.

Diversity & Inclusion (D&I)

D&I is important to our colleagues and gives us a more balanced workforce. In 2019, colleagues from Black, Asian and Minority Ethnic (BAME) backgrounds represented 19% (2018: 26%) of all new joiners. 31% of new joiners did not declare their ethnic background on joining (2018:7%).

We continue to see more women taking up development and career opportunities and in 2019 women gained 55% (2018: 57%) of internal recruitment and took 57% (2018: 67%) of places on internal development programmes. We are committed to the Women in Finance Charter and, with a third of directors now women, we have ambitions for equal representation on the Board in the next five years.

Gender Pay Gap

Our median gender pay gap this year is higher than we would like it to be at 33% (2018: 32%) because of an imbalance in the number of senior and technical roles held by men and women.

As an employer, we offer flexibility and family friendly working practices to all employees regardless of level. However, this approach makes us particularly attractive to people looking for customer facing roles. Typically for us, this tends to be women. Whilst this approach contributes to making the Society a great place to work, it adds to our gender pay gap. We remain determined to see the gap reduce and have plans in place which seek to do this over time.

Chief Executive (CEO) Pay ratio

Our CEO pay ratio, based on the total income (including all pay and benefits) of the CEO compared with the median income for colleagues is 27:1 in line with last year (2018: 27:1). Further details are set out in the Directors' Remuneration Report.

Our intermediaries

Working with
Our intermediaries

Mortgage intermediaries are an integral part of our business. We treat intermediaries with the same respect as members, committing to transparency, long term value and superior service.

Distributing mortgages through intermediaries remains a cornerstone of our strategy with over 90% of mortgages originated by brokers. We value their role in providing mortgage advice to customers. Their reach and scale means we can continue to grow our mortgage book cost effectively and benefit from geographical diversification throughout the UK, reducing risk to the Society.

Intermediaries are trusted partners. We work hard to forge long term relationships, understanding what they value and how our service impacts their business. Central to our relationships with intermediaries is our service, underpinned by the pledges which have remained unmatched in the industry for over ten years, namely:

- We give at least 48 hours' notice of product withdrawals.
- We do not cross-sell insurance to intermediary customers.
- We have no 'direct customer only' deals.
- We publish our turnaround times and service levels.

Our suppliers

Working with
Our suppliers

Our suppliers play an essential part in delivering our mission, from outsourcers who help us deliver critical services to our members to advisors who we rely on to help us stay safe and secure. We seek to create mutually beneficial relationships with the partners who can best deliver for us.

We consider broader factors than price and quality when deciding who we partner with, recognising the impact suppliers have on the Society.

Making the right choice of supplier is fundamental to delivering on our mission. This is particularly important for critical outsourced services or delivery of major parts of our investment programme.

We operate a transparent and open sourcing process designed to ensure both ourselves and our prospective partners are clear on what is required and what really matters to us.

Regular feedback from intermediaries comes from active relationship management, benchmarking studies and an annual intermediary event attended by directors and senior business leaders. This feedback shapes our thinking and we work effectively with brokers to improve the service to borrowing members and our joint efficiency.

Examples of this in 2019 were:

- We spent more time making sure that intermediaries had up to date understanding of our products, lending policy and service levels. This enhanced the overall experience given to borrowing members and improved efficiency for us and our intermediaries.
- Based on survey results we automated more of the mortgage application process, reducing processing time and easing exchange and completion deadlines.
- Our plans for implementing our new mortgage origination system have been shared with and informed by feedback, particularly on broker self service product switch capability.

10.5

average number of days to produce a mortgage offer
(2018: 12.8 days)

+85

average broker advocacy (NPS)[1]
(2018: +81)

Our focus for 2020

- Continued delivery of excellent products and service.
- Making sure the transition to our new mortgage platform works for our intermediaries.

When making sourcing decisions, we consider ethical impacts as well as quality and value and strive to create sustainable long term relationships. Every year we ask our suppliers for feedback on how we can improve our systems and processes.

In return, by working closely with suppliers we obtain good value for our members. We expect our suppliers to respect the Society's values, in particular to have reasonable and lawful policies regarding payments and taxation, to reduce their environmental impacts, protect human and workers' rights, and keep our data and intellectual property safe and secure.

Feedback from suppliers during the year and through our annual survey informs what we do

Examples of this in 2019 were:

- The introduction of our new Supplier Due Diligence process makes it simple to become a supplier and ensures our suppliers comply with important legal and regulatory standards.
- We have clear and fair terms of payment for our suppliers. Standard terms are 30 days. In 2019 our average creditor term was 8 days, 13% of supplier payments were made outside of our standard terms and the proportion of suppliers payments within 30, 60 and 90 days were as follows against last year:

	2019	2018
Paid within 30 days	87%	83%
Paid 31 to 60 days	10%	10%
Paid 61 to 90 days	2%	3%
Paid 91 days or more	1%	4%
Total	100%	100%

Our focus for 2020

- Continue to enhance our ethical sourcing and deepen supplier engagements.
- Greater use of local suppliers where possible.

Human rights and modern slavery

We have zero tolerance of slavery and human trafficking in any of our own operations or in our supply chain. Due to the nature of the Society's business, the chance that slavery or human trafficking will occur is low; however, we are not complacent on these issues. More information is in our Modern Slavery and Human Trafficking statement at: www.thecoventry.co.uk

Anti-corruption and anti-bribery

Our values include being ethical and we expect all colleagues and individuals acting on the Society's behalf to act with integrity in all dealings relating to our business. As a result we have no tolerance of bribery and corruption.

Our anti-bribery policy reflects our internal zero tolerance approach and legal requirements.

All colleagues, contractors, directors and suppliers are aware of their responsibilities in this area. Annual anti-bribery training, together with monitoring and enforcement tools, ensure compliance with our policy is continuously assessed.

1. Net Promoter Score (NPS) is a measure of broker advocacy that ranges between -100 and +100 which represents how likely a broker is to recommend our products and services.

Our investors

Working with
Our investors

Wholesale investors support the delivery of our mission. They provide diversity of funding and capital which complements funds raised through member savings and reduces overall funding costs. This enables the Society to thrive and grow even in uncertain markets. To ensure that we optimise wholesale funding we treat our investors as long term partners and we are straightforward, transparent and consistent in all our dealings with them.

We have a diverse range of investors both in the UK and overseas, increasing our ability to raise funding when we need it. On average, each wholesale funding deal is the equivalent of us acquiring over 25,000 new savings customers and maintaining an effective wholesale funding franchise is a key part of supporting our growth plans, providing us with good value long term funding.

We pride ourselves on the way we treat our members and for us our investors are no different. We offer investors the opportunity to invest in a transparent organisation with a low risk model and consistent strategy.

Access to a group of funding sources has been improved by keeping up a regular dialogue with our wide network of investors, getting the best outcome for everyone.

We meet investors on a regular basis, at the time of our half year and full year results announcements, when issuing funding transactions and at investor events. These face-to-face meetings, with a wide range of current and potential future Society investors, provide opportunities for the investor community to understand our business and for us to understand their needs.

Our investors range from asset managers who invest on behalf of pensions or insurance companies to central banks across the world. They look for steady returns on their investment and recognising our simple low risk business as well as our consistent and straightforward reporting.

The investment world is increasingly focusing on Environmental Social and Governance (ESG) issues as well as pure financial results. As a result we are expanding our ESG disclosures both in this Annual Report & Accounts and also on our website by improving the visibility of website disclosures.

The benefits of having regular investor engagement have been demonstrated in 2019 with the Society raising over £1.5 billion of long term wholesale funding from over 65 investors. The capital raised from investors in 2019 supported over £10 billion of mortgage lending.

In March 2019 we refinanced our Additional Tier 1 (AT 1) capital instrument in a way which balanced the short terms needs of the Society and maintained long term relationships with our investor base (see below).

Case study: How we refinanced our AT 1 investment

The Society first raised Additional Tier 1 Capital (AT 1) in 2014 and it is an important part of our capital base, supporting our leverage ratio. The AT 1 instrument had a 'call' date in November 2019 allowing the Society to terminate it at that stage.

We started work on refinancing in 2018, prompted by the fact that market prices for AT 1 instruments were very volatile and knowing that we would need to refinance by autumn 2019 which could have clashed with Brexit uncertainty.

After significant planning, we combined a new AT 1 issue with an offer to buy back the existing bonds. The route for refinancing was new to the market. Taking this approach gave our investors certainty and allowed them to participate in the new instrument without doubling their exposure to the Society during transition. For us, it reduced the double interest cost of having both the old and the new bonds in place at the same time, reduced funding risk and gave us certainty over cost.

This arrangement struck a good balance between short term benefits (cost of funding) and longer term benefits (maintaining and enhancing our reputation with investors).

"We believe that the announcement by Coventry Building Society yesterday afternoon is a novel solution, which we expect will be strongly welcomed by many borrowers who would be looking at the potential refinancing of their AT 1 capital. This is a smart and novel approach and another welcome development in this sector."

24 Asset Management

Our focus for 2020

- Continuing to diversify our investor base.
- Increasing the transparency and visibility particularly of ESG policies and developments.

Supporting
Our communities

Making the communities in which our members and colleagues live and work better off is a part of our heritage that we are proud to keep alive today. We work with our local communities, using our skills and resources to create opportunities for people to have better lives.

As a building society, we were built on the support and trust of the people in our community. The city of Coventry is our home and, as we grow, we want to give more back to the city that we were established to serve. That is why we are so excited about our role as a sponsor of Coventry City of Culture 2021 and what this will offer the people of Coventry. We are looking forward to working with the project team in the lead up to 2021.

As well as supporting our local communities, we are delighted to continue to contribute to our national charity partners: Comic Relief, Children in Need, and The Royal British Legion.

In 2019, we saw our colleagues involved in more community activity than ever before, with more than four in five colleagues giving their time to support local and national causes. As well as donating their time, our people raised approximately £250k for our Community Partners. Each of these partners is selected by an individual department or team and this helps create a strong bond between them.

The projects we supported covered funding a Digital Financial Inclusion Manager for Coventry Citizens Advice, providing refugees with insight into the UK world of work and advice on recruitment processes on behalf of Business in the Community. We also continued to work with schools to support children in maths and money management skills.

"Coventry Building Society aims to make a positive difference and there is a really strong link between the attitude we bring to serving members and doing the right thing for local communities."

Darin
Distribution Director – Community Sponsor

82%
staff engagement in community activity
(2018: 79%)

£1.9m
total Community Investment[1]

1. includes community fundraising and donations.

Our focus for 2020

- Build on our programme of community activity and deepen our understanding of local issues.
- Planning for Coventry City of Culture 2021.

Case study

Delivering opportunity with Employability UK

As a building society, we believe in creating opportunities for people. In 2019, we continued to work with the charity, Employability UK, whose mission is to enhance aspirations, opportunities and career prospects for enthusiastic and committed young people. The programme, based in our home city of Coventry, was aimed at building the skills and confidence needed to succeed in the workplace.

In 2019 over 140 Year 12 students from nine local schools completed a seven month learning journey including topics such as CV writing, interview techniques and presentation skills.

Over 100 colleagues delivered workshops, conducted mock interviews and held one-to-one sessions. Our apprentices organised half day workplace visits to our Head Office, where students interacted with many of our departments and heard career stories from the volunteer team. Our volunteer team leaders each worked directly with a school to ensure the programme ran smoothly, supported by nine of our senior leaders.

The programme ended with a networking event and celebration, where all of the participating schools came together to reflect on what had been learned and to celebrate our 'Employability Student of the Year'.

"From a young age, I have had a stutter which has affected my communication and confidence. This programme has been very beneficial to me as even with my stutter, I am able to communicate with confidence, whether it is talking to employers in an interview, or my friends".

Mandeep
Employability Student of the Year

"The great thing about this programme is that we all, students and volunteers, learn so much. It is fantastic to see the students grow in confidence and put into practice what they have learned – that goes for the volunteers too!"

Chris
Coventry volunteer

Our environment

Looking after
Our environment

The Society has always taken a longer term view, driven by serving current and future members. Environmental sustainability naturally aligns with the Society's long term view in preserving our world for future generations. We seek to make a positive difference to the environment. As a first step towards this we send no waste to landfill and have plans in place to make sure we have net zero carbon emissions[1] by 2021.

"The environment matters. It matters to our members, our people, and to the future sustainability of our business. As such, we are working at all levels of the organisation to address our current impacts and also looking forward to a low carbon future."

Peter Frost
Sponsor, Environmental Sustainability

We have previously made changes such as committing to renewable energy, installing electric charging points and using only recycled paper. In 2019 we stepped up our efforts and are starting to make a real difference through a proactive focus on the environmental impact we ourselves have and through engagement with our colleagues and suppliers.

Our focus in 2019 on reducing our carbon footprint has seen it reduce by 18.5%. Examples of what we have done include:

- Removing single use plastic cutlery and cups internally and issuing colleagues with sustainable alternatives; and
- Continuing to ensure our branch refurbishment programme improves energy efficiency.

In 2019 we were accredited by the Forest Stewardship Council (FSC) for making sure that all the paper we use internally and in communications with members is harvested in a responsible manner, promoting the responsible management of the world's forests.

18.5%
reduction in carbon footprint

11.2%
average reduction in energy in refurbished branches

Environmental Policy

Our Environmental Policy setting out how we intend to reduce our negative environmental impact and make a positive contribution to environmental sustainability, can be found at www.coventrybuildingsociety.co.uk/corporate-governance.

Financial risks associated with climate change

This year the PRA set out its expectation for all firms in the sector to assess the impacts of climate change in their internal capital assessments. More information on how we are responding to this can be found in the Strategic Risk section of our Risk Management Report.

Our focus for 2020

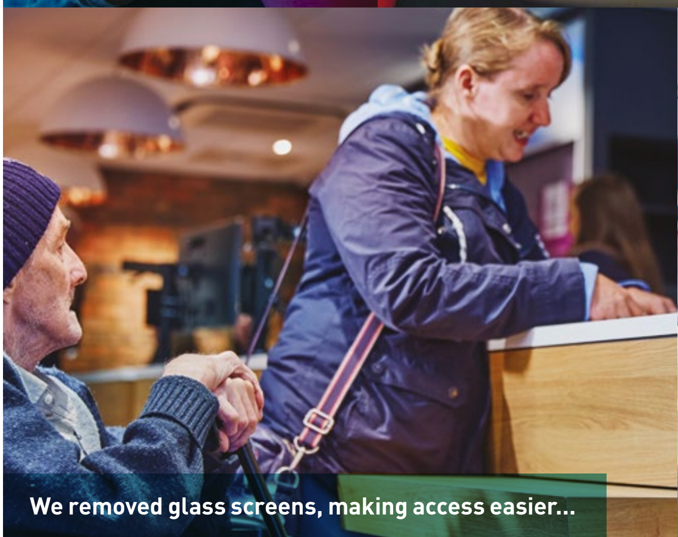
- Progress towards net zero carbon in our own emissions.
- Consider further ways to make our business model more environmentally sustainable.
- Adopt proposals from the Task Force on Climate-related Financial Disclosures.

1. Scope 1 and 2 emissions.

Our new branches use interactive technology...

which reduced paper waste...

We are proud of our refurbished branches.
The new design has been welcomed by members and colleagues. We created flexible spaces for conversations and seminars with room for community hubs. In making the changes, we reduced our environmental impact too.


We removed glass screens, making access easier...


and created spaces for conversations with our members...


for team briefings...

and our communities...

Our External Environment and Principal Risks

This section explains the external environment we operate in and sets out the principal and inherent risks for the Society going forward.

External environment

Economic environment

The 2019 UK economic environment, to the extent it is relevant for the Society's business model, was subdued with GDP growth at 1.4% (2018: 1.3%). Nonetheless it has proved resilient in the face of both political and Brexit uncertainty.

Low unemployment levels of 3.8% (2018: 4.0%) and above inflation real wage increases created favourable credit conditions. House price growth was sluggish again in 2019. For the country as a whole, the House Price Index (HPI)[1] increased by only 1.4% (2018: 0.5%), with falls of up to 1.8% (2018: 0.8%) in London. Reflecting this and economic uncertainty, the property market remained subdued during 2019 with the number of UK property completions staying flat compared to 2018[2].

1. Nationwide House Price Index.
2. UK Government National Statistics. Property transactions completed with a value over £40,000.

Market environment

Savings market

Savings rates remained low, reflecting the low bank base rate, with the average market rate marginally increasing from 0.78% to 0.84%; whilst savings balances in the UK grew by 4.1%[1] (2018: 2.8%). In the savings market there has been an increase in the choice of savings products and platforms available.

Mortgage market

Borrowers in the UK mortgage market continued to benefit from lower rates in 2019 as the low bank base rate and price competition kept mortgage rates low. Low rates increase the demand for fixed rate products and the remortgage market remained strong. UK home ownership has been increasing slowly in recent years and the mortgage market grew by 3.1%[1] in 2019 (2018: 3.0%). The average age of UK homeowners is also increasing along with the average term of new mortgages.

Rental market

The UK rental market has remained stable. Recent tax changes in buy to let have resulted in a lower level of new investment but the remortgage market remained resilient.

1. Source: Bank of England.

Regulatory change

Regulatory change continued to focus on the operational resilience of firms to ensure good customer outcomes and on improving both data protection and security over financial transactions. The implementation of the General Data Protection Regulation (GDPR) and Payment Services Directive 2 (including Strong Customer Authentication) have had significant impacts on the market and the way businesses operate.

Prudential regulators are also focusing on the need for resilience beyond a firm's standard operational activities with examples being capital resilience through changing MREL[1] regulation, and resilience while in recovery and into resolution through focused regulation on Operational Continuity in Resolution and the Resolvability Assessment Framework.

1. Minimum Requirement for own funds and Eligible Liabilities

Technology

Technology is changing the way that customers access and interact with their financial services provider. Alongside increased online banking use, customers generally are more demanding of round the clock availability and a user experience in line with the best online retailers. Data needs to be kept secure and free from cyber attack. Challenger banks continue to focus on digitising traditional banking processes, adding popular functionality, which to date has focused more on current accounts, although online mortgage switching platforms are starting to emerge.

Climate change

As evidence of increased climate change risk builds, consumers and regulators are attentive to environmental issues and the UK's commitment to a zero carbon economy by 2050. Recent PRA requirements for banks and building societies on the financial risks arising from climate change further increase focus in this area.

Principal risks

Whilst the Society's risk categories under its Enterprise Risk Management Framework tend to be stable over time, principal or main risks, which could impact our financial performance, vary over time. These principal risks and the Society's mitigation of them are outlined below:

Our Principal Risks	Mitigation
UK political and economic uncertainty The political environment could impact the wider economy. Whilst the outcome of the General Election provided some clarity over the path of Brexit, uncertainty remains over future trading relationships. This, and weak global economic growth, could indirectly impact our business model, creating strategic, credit or funding risks for the Society. For example, if access to the wholesale funding market is disrupted or a combination of falling house prices and rising unemployment impacts mortgage demand and increases credit risk.	Our simple, low risk, business model is resilient to both economic and credit downturns. Regular stress testing informs the Board and management that this remains the case even in extreme stress scenarios. Robust lending affordability assessments protect against deterioration in the credit environment, as does our geographically diversified and low loan to value mortgage book. Strong levels of risk based capital (CET 1) and liquidity (LCR) mean that we have enough resources to deal with financial and funding challenges that may emerge. We have taken steps in 2019 to diversify our wholesale funding arrangements to ensure that we have more funding options available ahead of sector wide repayment of Term Funding Scheme balances by 2022.
Market environment risk There are a number of factors which could put pressure on our net interest margin or our ability to provide superior value to members, creating strategic risk. These include a continuation of the pricing pressures in the mortgage market, the impact of persistently low interest rates, or a prolonged slowdown of house purchases.	Our low cost operating model means that we can operate effectively in a low margin environment whilst still returning value to our members and maintaining our capital ratios as we have demonstrated again in 2019. Our financial planning process includes rigorous tests for a number of scenarios, including continued market pricing pressures. All these scenarios demonstrate the capacity to operate at low margin levels whilst accommodating planned investment spend.

Our external environment and principal risks continued

Our Principal Risks	Mitigation
Change and execution risk The Society continues to invest in significant levels of technology and business change and we expect this to continue for a number of years. Whilst our change programmes will deliver additional resilience and flexibility and reduce risk once implemented, much of the change is complex and the extent of the change creates a number of operational risks. These include dependency risk from the need to make changes to legacy systems alongside managing a number of other change initiatives in parallel. In addition, there is a risk that change costs increase or that the change activity needed is underestimated, increasing both project costs and delivery timescales. Whilst using trusted third parties to help deliver change projects can protect against this risk, a greater reliance on third parties also raises security and other risks, such as risks of supplier failure.	In 2019, we embarked on a programme of uplifting change capability to improve both change delivery and management of execution and cross dependency risks. We have enhanced our procurement and supplier management processes to make sure we work with the right partners and have controls in place which mitigate third party reliance risks. Finally, we are enhancing risk oversight of change programmes. Taken together, these measures are designed to ensure change is delivered safely, without disruption to core operations and within expectations, reducing the execution risk of change.
Keeping pace with changing customer demands Customer expectations and the increased use of technology are changing the way in which both savings and mortgage products are designed and delivered. Whilst the Society has a significant number of change programmes under way, external factors, such as regulatory development could require further change investment. There is a risk that the scale of change the Society could face leaves us with insufficient capacity to develop new products and services in an increasingly digital world or could jeopardise our low cost operating model and our ability to return superior value to members.	We focus on the need to develop our products and services to meet changing needs, whilst preserving our purpose and heritage. We continually engage with our members to identify product and service enhancements that they need and value in order to make sure we focus on the right changes. In 2019, we developed a roadmap of strategic change, setting out how we would deliver the resilient and flexible operating environment and service and product enhancements we need. Our strategic plan continues to balance shorter term change with longer term strategic investment requirements within our low cost operating model.

Our Inherent risks

The main categories of risk to which our business model is inherently exposed are set out below. More details are included in our Risk Management Report.

Risk categories	Mitigation
Credit risk The risk that borrowers or counterparties do not meet their financial obligations.	We operate robust underwriting and affordability assessments which, together with appropriate credit policies, results in the Society lending responsibly and remaining low risk.
Market risk The risk of a reduction in earnings and/or value as a result of financial market movements.	We operate within Board approved limits and use interest rate swap agreements to mitigate the impact of changes in interest rates.
Liquidity and Funding risk The risk of insufficient funds to meet obligations falling due or the inability to access funding at reasonable cost or risk.	We hold sufficient liquidity to withstand a severe but plausible stress and operate within limits set by the Board. We maintain a diversified funding base to avoid any overreliance on any funding source, type or term.
Conduct risk The risk that the Society's activities fail to deliver good customer outcomes.	We place good customer outcomes at the heart of our decision making. In line with Putting Members First, this reduces conduct risk. This ethos is embedded in product design, services, and people and communication strategies.
Operational risk The risk of loss arising from inadequate internal processes, systems or people, or from external events.	We actively identify, assess and manage the risks to which the Society is exposed. We have built in business continuity capability to ensure operational resilience.
Model risk The risk of an ineffective or incorrectly interpreted model leads to a loss, reputational damage or regulatory censure.	We operate robust model governance protocols including sensitivity analysis on key assumptions, independent model validation and regular model monitoring. We are enhancing our approach to data governance.
Strategic risk The risk that the business model or strategy becomes inappropriate given changes to macroeconomic, geopolitical, regulatory or other factors.	We have a simple business model which focuses on well understood opportunities. We have a robust strategic planning process which includes capital and liquidity stress testing. The strategic planning assumptions are regularly reviewed to ensure these continue to focus on risks which could become threats to the business model over the medium to long term.

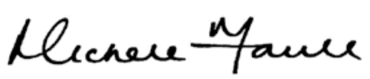
Welcome to your Chief Financial Officer's Review

2019 performance is in line with our financial goals.

We seek to retain only the profit the Society needs to maintain our capital ratios, whilst investing to improve services and providing favourable pricing for members. In 2019, we delivered on this goal, growing mortgage and savings balances ahead of the overall UK market and investing in the future of the business.

Although, profit before tax has fallen to £147 million (2018: £202 million), reflecting two one-off items[1] and a continuation of falling mortgage market prices, we have maintained a strong capital position. Despite tighter mortgage margins we returned £228 million of value to savings members[2], in line with the £227 million we returned in 2018, with average member savings rates 65 basis points above the market average.

We continued to invest in the business, spending £52 million on strategic change initiatives during the year (2018: £54 million). This kept our cost to mean assets ratio elevated at 0.48%[3] (2018: 0.50%), whilst our operational run cost ratio (excluding change, depreciation and amortisation costs) of 0.31%[4] (2018: 0.32%) demonstrates our commitment to maintaining a cost operating model amongst the lowest in the industry.



Michele Faull
Chief Financial Officer
27 February 2020

£42.2bn
Mortgages

2019	42.2
2018	39.3
2017	35.9
2016	32.9
2015	29.4

£36.2bn
Savings

2019	36.2
2018	33.3
2017	31.0
2016	28.1
2015	25.4

0.48%
Cost to mean assets ratio[3]

2019	0.48
2018	0.50
2017	0.42
2016	0.41
2015	0.42

0.31%
Operating run cost ratio[4]

2019	0.31
2018	0.32
2017	0.32

£228m
Value given to members[2]

2019	228
2018	227
2017	210

£121.7m
Profit after tax

2019	121.7
2018	163.0
2017	191.5
2016	189.6
2015	176.5

0.08%
Arrears
% mortgage balances 2.5% or more in arrears, including possessions

2019	0.08
2018	0.10
2017	0.13
2016	0.17
2015	0.26

32.0%
Common Equity Tier 1 ratio[5]

2019	32.0
2018	33.9
2017	33.4
2016	30.8
2015	28.1

1. One off items were a £15 million gain on sale of a mortgage portfolio in 2018 and significant hedge accounting volatility (£17.2 million) in 2019.
2. The Society's average month end savings rate compared with the Bank of England average rate for household interest bearing deposits on the Society's mix of products.
3. Administrative expenses, depreciation and amortisation/Average total assets.
4. Administrative expenses less change costs, depreciation and amortisation/Average total assets.
5. CET 1 comparatives have been restated incorporating the 6% scalar on Internal Ratings Based model outputs. See Regulatory capital below for more information.

Income statement

Overview

This year, profits have fallen as a result of two one-off items, a reduction in margin as a result of a continued drop in mortgage market pricing, combined with our strategy of paying the best possible interest rates to members. As a result, we have seen a decline in net interest income and an increase in costs as we continued to invest to improve our services.

After taxation and costs related to refinancing and servicing our AT 1 capital instrument, we added £85 million (2018: £138 million) to the general reserve. This was sufficient to allow us to maintain our strong capital position and we expect our risk adjusted capital ratio (Common Equity Tier 1) to be one of the strongest in the industry at 32.0% (2018: 33.9%[1]).

A summarised Income Statement is set out below.

	2019 £m	2018 £m
Interest receivable	1,010.5	976.3
Interest payable	(613.8)	(550.5)
Net interest income	396.7	425.8
Other income	0.1	(1.2)
Losses on derivatives and hedge accounting	(17.2)	(0.3)
Total income	379.6	424.3
Management expenses	(229.1)	(221.7)
Impairment (charge)/credit	(2.1)	0.4
Provisions	–	–
Charitable donation to Poppy Appeal	(1.2)	(1.4)
Profit before tax	147.2	201.6
Tax[1]	(25.5)	(38.6)
Profit for the year[1]	121.7	163.0

1. 2018 Tax and Profit for the year have been restated following changes to IAS 12. More information is in note 1 to the accounts.

Net interest income

Net interest income has decreased to £397 million (2018: £426 million). Interest received in 2018 included a one-off gain of £15 million relating to the sale of a £351 million buy to let loan portfolio. Excluding this, interest receivable on assets grew more slowly than asset balances reflecting higher margin mortgages transferring onto lower margin fixed rate deals as market pricing continues to fall and as members continue to move away from Standard Variable Rate (SVR) mortgages. The Society's exposure to future reductions in SVR income is limited as only 2.0% of its mortgage book is currently on SVR (2018: 3.0%). In addition, the liquidity book was increased to protect against Brexit uncertainty and these assets earn comparatively low levels of interest.

Interest payable increased by more than the growth in the retail and wholesale funding balances reflecting the Society's commitment to pay the highest rates it can afford together with a move in the wholesale funding mix towards more stable, but more expensive, long term funding.

Net interest margin

Net interest margin has decreased by 13 basis points to 0.83% with three basis points of the reduction relating to the portfolio sale in 2018. The remaining reduction reflects the impacts of market pricing and holding additional liquidity ahead of Brexit uncertainty as discussed above. This margin has been sufficient to fund expenditure and support capital.

	2019 £m	2018 £m
Net interest income	397	426
Average total assets	47,801	44,322
	%	%
Net interest margin	0.83	0.96

Our comparatively low net interest margin demonstrates our ability to realise value from our strategy to be both low risk and low cost, whilst paying above market rates to members. We do not believe that our net interest margin will reduce significantly in 2020.

Derivatives and hedge accounting

The Society uses derivative financial instruments solely for risk management purposes to manage interest rate and currency risk arising from its mortgage and savings activity and from non-sterling, fixed rate wholesale funding. During 2019, there has been considerable market volatility impacting swap valuations. Whilst the Society's derivative financial instruments have remained effective in economically hedging risks as they were designed to do, hedge accounting relief has not been fully obtained, creating accounting volatility. As a result, losses of £17 million have been recognised in the year (2018: £0.3 million loss).

These losses represent timing differences and are expected to reverse over the remaining life of the derivatives and do not reflect the economic reality of the hedge. An analysis of the net loss from derivatives and hedge accounting is set out in note 8 to the accounts.

Management expenses

Our strategic investment programmes continued to progress during 2019 and overall management expenses have increased by £7 million or 3%, well below the 8% growth in the Society's assets, resulting in a reduction in our cost to mean assets ratio to 0.48%[2] (2018: 0.50%).

Our day to day operating cost ratio, excluding both the costs of change and depreciation, was 0.31%[3] (2018: 0.32%), demonstrating our continued focus on maintaining a low cost operating model.

Day to day operating costs increased by 2%, or £3 million, to £149 million (2018: £146 million), principally the result of salary and cost inflation and higher IT costs as change programmes deliver. £3.9 million of cost previously recognised in property costs have been reclassified as depreciation from 1 January 2019 as a result of the adoption of IFRS 16 Leases, partially offsetting cost inflation.

1. CET 1 ratio in 2018 is restated following a correction to the risk weighted asset calculation during 2019. More information is contained within the Risk Management Report.
2. Administrative expenses, depreciation and amortisation/Average total assets.
3. Administrative expenses less change costs, depreciation and amortisation/Average total assets.

Chief Financial Officer's Review continued

Spending on our strategic investment programmes continued in 2019, with costs largely in line with 2018. Investment activity has focused on four principal areas:

- Branch redesign: 19 branches, or 27% of our total estate, have been remodelled as planned during the year, bringing the total number of branches refurbished to 26 (37%). This programme will continue through 2020 and 2021.
- Enhanced technology infrastructure: this programme continues to progress, with migrations to both cloud and co-located data centres taking place. The remaining migrations are expected to complete during 2020, ahead of the project closing in 2021.
- Core technology platform upgrade: the re-plan activity reported at the end of 2018 progressed during the first half of 2019, resulting in a more modular and lower risk programme of activity which will see this programme of works continue over a number of years.
- Regulatory change: these programmes are focused on ensuring the Society continues to comply with new regulatory obligations. This includes the development of new online authentication solutions required by the Payment Services Regulations 2017.

The Society's major change programmes extend over our five year strategic planning horizon and we expect to maintain an elevated level of investment over this period. The action we have taken to ensure that change execution risks are appropriately mitigated means that activity in some areas has been rescheduled, resulting in broadly stable change costs compared to 2018.

Remaining a low cost operation is key to the Society's strategy, enabling us to provide better value to our members. For some time, we have enjoyed one of the lowest cost to mean assets ratios in the UK building society sector and the competitive advantage it provides. We expect to maintain this position despite our ongoing investment in change delivery.

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

Arrears and impairment charge

The strong credit performance of the Society's loan books was maintained in 2019. Impairments continued to be low and arrears reduced further from historically very low levels. This is a consequence of our low risk lending which has never included commercial or second charge lending[4], and a negligible exposure to unsecured lending (less than 0.1% of total loan book in 2019).

There was an impairment charge of £2.1 million in 2019 (2018: £0.4 million credit). This charge reflects an improvement in underlying performance offset by the impact of updated expectations of forward looking performance (required under IFRS 9) and the application of management prudence to provision levels.

As a result of continued economic and political uncertainty, and the more subdued HPI profile seen in 2019, we have increased the weighting given to our most severe economic scenario, and updated our other forward looking scenarios. We have also raised additional post model adjustments in relation to potential future losses. The impact of these overlays has increased our impairment provision by £2.8 million compared to 2018, which is included in the £2.1 million charge. In future years we will look to reflect these in models where possible.

Impairment losses before recoveries in the year were £2.7 million (2018: £2.1 million) and include an unusually large single loss of £0.4 million. As a result total impairment provisions at 31 December 2019 of £12 million represent 4.4 years' loss coverage (2018: 5.5 years) based on current year losses. Excluding the unusual loss case, impairment provisions represent 5.2 years' loss coverage.

IFRS 9 requires the loan book to be split into 'stages' which identify whether the loan quality is performing (stage 1), deteriorating (stage 2) or in default (stage 3). The split of the Society's loan book by stage has been maintained during the year, with 97% of our loans assessed as performing at 31 December 2019 (2018: 97%).

Loans which are in stage 2 are those loans which do not meet our current, very prudent, underwriting standards. 3% of the loan book was in this stage at the year end (2018: 3%), although all but £94 million were fully paid up to date.

A further 0.5% of loans were classified as in default. This includes loans which are three months or more in arrears, or have other risk factors associated with them. A total of £80 million of these loans were up to date at the year end. Provision coverage as a percentage of stage 3 loans rose to 6.1% in the year (2018: 5.6%).

More information on impairment is included in note 13 to the accounts and in the Risk Management Report.

Provisions

There is no charge for provisions for liabilities in line with 2018. We received an increase in PPI claims ahead of the August deadline, but have not needed to raise any additional provisions to cover PPI settlements.

Charitable donation to the Poppy Appeal

The Society donated over £1 million to The Royal British Legion's Poppy Appeal during the year, which is consistent with 2018, bringing the total donated over the Society's relationship with the Legion to almost £18 million.

Taxation

In 2019, the corporation tax charge was £26 million (2018: £39 million[5]), an effective tax rate of 17% (2018:19%). This is below the statutory corporation tax rate of 19% (2018: 19%) due to changes to IAS 12 in respect of tax deductions for distributions to holders of the Society's AT 1 instruments of £7 million (2018: £7 million) previously

4. Other than as a result of small books acquired as part of the merger with Stroud & Swindon Building Society in 2010.
5. 2018 corporation tax charge has been restated following amendments to IAS 12 changing the location of recognition of tax credits from Equity to Income Statement, see note 1 to the accounts for more information.

shown within Members interests and equity[5]. This is partly offset by a charge of £3 million (2018: £8 million) for the 8% surcharge on the profits of banking companies. Further information is included in note 14 to the accounts.

Balance Sheet

Overview

Mortgage balances and liquidity have grown during the year by £3.0 billion and £0.5 billion respectively. Mortgage growth was funded by growth in savings balances.

A summarised Balance Sheet is set out below:

	2019 £m	2018 £m
Assets		
Loans and advances to customers	42,234.7	39,264.6
Liquidity	6,854.7	6,401.9
Other	441.4	404.4
Total assets	49,530.8	46,070.9
Liabilities		
Retail funding	36,238.1	33,281.6
Wholesale funding	10,605.4	10,313.7
Subordinated liabilities and subscribed capital	67.1	67.1
Other	417.4	288.1
Total liabilities	47,328.0	43,950.5
Equity		
General reserve	1,773.3	1,693.5
Other equity instruments	415.0	396.9
Other	14.5	30.0
Total equity	2,202.8	2,120.4
Total liabilities and equity	49,530.8	46,070.9

Loans and advances to customers

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

In 2019, we advanced £8.6 billion of mortgages (2018: £8.9 billion) and mortgage balances grew by £3.0 billion (2018: £3.4 billion) increasing our market share of stock to 2.9%[6] (2018: 2.8%). The year on year growth in mortgages of 7.6% was significantly above mortgage market growth of 3.1%[6].

New lending continued to be supported by strong remortgage levels overall. 75% of new buy to let loans (2018: 77%) and 46% of new owner occupier loans were remortgages (2018: 42%). Owner occupier loan growth increased relative to buy to let with 67% of total new lending being in the owner occupier market (2018: 57%).

The balance weighted indexed loan to value of the mortgage book at 31 December 2019 increased marginally to 55.4% (2018: 54.6%). Arrears continued to improve, remaining significantly better than the industry as a whole. As at 31 December 2019, 0.08% of mortgage balances were 2.5% or more in arrears (2018: 0.10%) compared with the latest available industry average of 0.67%[7]. Possessions and forbearance both remained low with 33 cases in possession at the year end (2018: 34) and forbearance levels down by 18% year on year in value terms and 20% in number of cases.

In 2019 we continued our strategy of sustainable growth without extending our very low risk lending profile, and this delivered a robust performance despite the competitive mortgage market throughout the year.

Liquidity

On-balance sheet liquid assets have increased to £6.9 billion (2018: £6.4 billion) as we maintained a prudent buffer given the uncertain economic backdrop. The Liquidity Coverage Ratio (LCR) continued to be very strong at 214% (2018: 202%), considerably above the minimum regulatory requirement.

Liquid assets are principally held in deposits at the Bank of England and UK Government investment securities. This means that asset quality remains very high with 96% of the portfolio rated Aaa–Aa3 (2018: 95%). 99% of liquid assets are held in UK sovereign or UK financial institutions (2018: 98%).

Included in liquid assets are £1.3 billion of assets held at fair value through other comprehensive income (FVOCI). As at 31 December 2019, the balance on the FVOCI reserve was a £4 million gain, net of tax (2018: £6 million gain, net of tax).

Retail funding

Retail savings increased in the year by £2.9 billion to £36.2 billion (2018: £33.3 billion), representing growth of 8.9%, compared with market growth of 4.1%[8]. The Society's savings market share increased to 2.6%[8] (2018: 2.5%).

The Society has continued to support the cash ISA market increasing our share of this market to 6.3%[8] (2018: 5.4%).

In 2019 we supported our growth in savings by partnering with Hargreaves Lansdown to be the first provider of an easy access savings account on its Active Savings platform and increased our own savings product range to include a regular Saver product.

We opened over 330,000 new savings accounts in the year (2018: 176,000), with over 86% of mortgage loans now funded by retail savings (2018: 84%).

The growth in savings reflects the quality of our products and service and the superior interest rates we pay compared with the market average. We are focused on providing superior returns to savers for as long as we can despite market back book rates remaining suppressed. In 2019, this meant that we returned £228[9] million of value to savings members compared with market average rates, broadly in line with 2018 (£227 million), the equivalent of 0.48% of net interest margin returned to members (2018: 0.51%).

6. Source: Bank of England, household sector.
7. Source: Prudential Regulation Authority – latest available information at 30 September 2019.
8. Source: Bank of England, household sector.
9. The Society's average month end savings rate compared with the Bank of England average rate for household interest-bearing deposits on the Society's mix of products.

Chief Financial Officer's Review continued

Wholesale funding

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

In 2019, we issued total wholesale funding of £1.65 billion including a €500 million covered bond, £525 million bi-lateral funding arrangements and a £400 million unsecured funding which, net of maturities and a reduction in short term funding, resulted in an increase in wholesale funding of £0.3 billion to £10.6 billion (2018: £10.3 billion). Included in wholesale funding balances is £4.25 billion of funding under the Term Funding Scheme (2018: £4.25 billion). These funds are repayable over 2021 and 2022 and our plans to refinance these amounts are well advanced and include further diversification of funding sources and instruments.

Equity

It is important to increase equity in order to provide the capital we need to support future investment and growth.

The Society's equity is predominantly made up of its general reserve and AT 1 capital. The Society's total equity increased by £0.1 billion to £2.2 billion, reflecting retained profits generated during the year and a modest increase in AT 1 capital.

In March, the tender for the 2014 AT 1 resulted in the repurchase of £385 million of the £400 million AT 1 capital instruments. At the same time, we issued a further £415 million of new instruments, with a first call date of 2024, and in November, the remaining £15 million of the 2014 AT 1 was called bringing total AT 1 to £415 million (2018: £397 million).

Pension fund

In 2019 we took steps to transfer the defined benefit pension fund to a Master Trust operated by TPT Retirement Solutions. This secures ongoing professional trustees and provides the fund with access to enhanced buying power and investment management capability. The Society's aim for the pension fund is for it to reach self sufficiency in the medium term which benefits members of the pension fund whilst reducing risk for the Society and improving capital efficiency.

Regulatory capital

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

The Society's CRD IV capital position[10] as at 31 December 2019 is summarised below. During the year capital available for CET 1 or 'capital resources' increased by £76 million, primarily driven by profit after tax of £122 million.

In December the Society announced a correction to its calculation of risk weighted assets (RWAs) caused by the 6% scalar not being applied to the core IRB model outputs. This resulted in a £212 million increase in risk weighted assets and a corresponding reduction in the CET 1 ratio of 1.6% to 33.9% as at 31 December 2018. We have presented the 2018 CET 1 ratio and RWAs at the corrected amount throughout this Annual Report & Accounts.

During 2019, the underlying RWAs increased by 11% which was driven by mortgage growth of 8% and a marginal increase in the loan to value of mortgages.

The net impact of this is that our CET 1 ratio reduced slightly to 32.0% (2018: 33.9%). We expect this to continue to be among the highest reported in the UK.

We are not currently bound by regulatory leverage ratios but we monitor leverage ratios on both a CRR[11] and UK basis. The UK ratio differs from the CRR basis in that it includes a restriction on the amount of AT 1 capital that can be included in leverage capital and excludes central bank claims with a maturity less than three months from leverage exposure.

Both the CRR and UK leverage ratios have been broadly maintained at 4.1% and 4.4% respectively (2018: 4.2% and 4.6% respectively). This is because the increase in available capital was matched by the increase in leverage ratio exposures (non-risk based) largely driven by growth in the mortgage book.

	End-point 31 Dec 2019 £m	End-point 31 Dec 2018 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	1,691.0	1,614.8
Total Tier 1 capital	2,106.0	2,011.7
Total capital	2,106.0	2,011.7
Risk weighted assets	5,283.6	4,760.7
Capital and leverage ratios:	%	%
Common Equity Tier 1 (CET 1) ratio[1]	32.0	33.9
CRR leverage ratio[2]	4.1	4.2
UK leverage ratio[3]	4.4	4.6

1. CET 1 ratio in 2018 is restated following a correction to the risk weighted asset calculation during 2019. More information is contained within the Risk Management Report.
2. The CRR leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation.
3. The UK leverage ratio includes a restriction on the amount of Additional Tier 1 capital and excludes central bank reserves from the calculation of leverage exposures.

The Prudential Regulation Authority (PRA) provides the Society with a Total Capital Requirement (TCR). In 2019, the Society's TCR equated to 11.2% of RWAs, or £590 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.

10. Excluding any IFRS 9 transitional provisions which were negligible.
11. Capital Requirements Regulation.

We are in the process of updating our IRB models used to calculate RWAs following regulatory changes. Once the Society has received permission from the PRA these models will be used to assess RWAs and therefore the CET 1 ratio. We expect the impact of their adoption to be a very modest decrease in the CET 1 ratio as our current model is already a hybrid model which reflects a degree of 'through the cycle' assessment.

In addition, from 2022, Basel IV RWA floors are being phased in and will reduce the Society's reported CET 1 ratio further, as they do not give full credit for our very low risk mortgage book. We currently expect the end point CET 1 ratio on full transition in 2027 to be approximately 17%.

Additional information

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

Alternative Performance Measures

The Society reports its results using a number of financial measures which are not driven by accounting standards (non-IFRS measures). These measures are used to understand our performance, and they are measures which are used internally when assessing the Society's results.

More information on each alternative performance measure is set out below:

Measure	Calculation
Member value A measure of the additional interest paid to our savings members as a result of the Society's interest rates being superior to the market average.	The Society's average month end savings rates are compared with the Bank of England average rates for household interest-bearing deposits. This calculation is adjusted to reflect the Society's mix of products.
Cost to mean assets ratio A measure of cost efficiency used throughout the building society sector.	Administrative expenses, depreciation and amortisation/ Average total assets.
Operational run cost ratio A measure of cost efficiency used internally to measure day to day operating costs.	Administrative expenses less change costs/Average total assets. This calculation excludes depreciation and amortisation.

Non-financial information

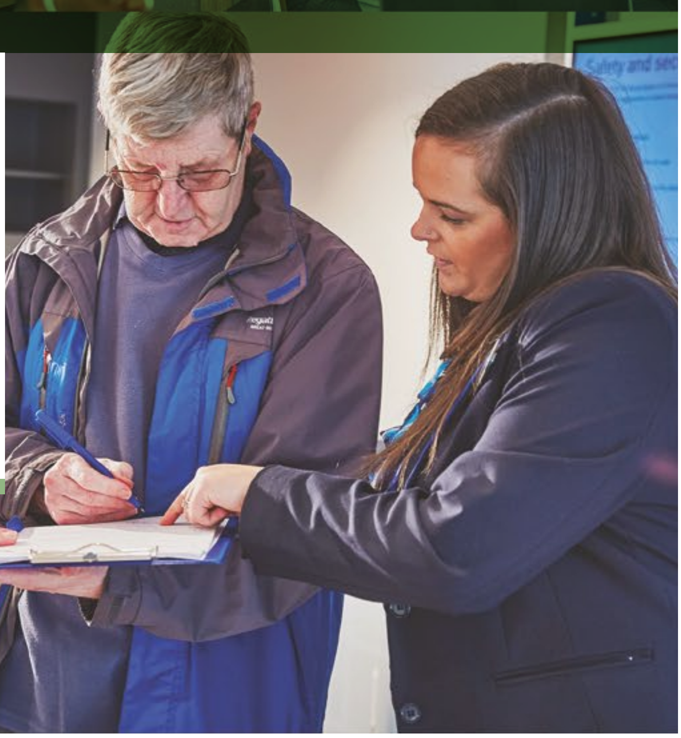
The table below contains information relating to the key non-financial matters which impact the Society. We aim to comply with the non-financial reporting requirements within sections 414CA and 414CB of the Companies Act 2006.

Non-financial reporting category	More information
Business model and risks	
A description of our business model and our principal risks is included in the Business Model section.	See page 10
Key performance indicators	
Our performance highlights are presented within this Strategic Report.	See page 2
Our remuneration scorecard and targets are included in the Directors' Remuneration Report.	See page 101
Our key alternative performance measures are explained above.	
Our colleagues	
Information relating to colleague engagement is included in the Colleagues section of this report.	See page 16
We are committed to creating a balanced and diverse workforce. More information on diversity and inclusion is included on our website.	www.coventrybuildingsociety.co.uk/corporate-governance
We aim to reward our people fairly and we have programmes in place to improve our Gender Pay gap. More information on this is in the Colleagues section of this report.	See page 17. More information is available at www.coventrybuildingsociety.co.uk/corporate-governance
Disclosures relating to our CEO pay ratio are included in this Strategic Report.	
The Society has a Code of Conduct which sets out the behaviour which is expected from all our colleagues. We aim to operate in a fair and honest way, and recognise that openness and trust are essential to creating mutually rewarding relationships and delivering excellent service to members.	
Human rights	
Information on the policies we have in place to address the risk of Modern Slavery is published on our website.	www.coventrybuildingsociety.co.uk
Anti-corruption and bribery	
Information on our anti-bribery and corruption policy is included in this Strategic Report.	See page 19
Our communities	
Information on how we interact with our communities is included in the Communities section of this report.	See page 22
Our environment	
We are committed to reducing our impact on the environment and improving environmental sustainability. We will be Net Carbon Neutral by 2021 for scope 1 and 2 GHG Emissions, and aim to be entirely Net Carbon Neutral by 2030. More information is in the Environment section of this report.	See page 24
Our full Environmental Policy is published on our website.	www.coventrybuildingsociety.co.uk

Welcome to our

Risk Management Report

This section outlines the risks that the Society is exposed to and how they are managed.



Introduction

This Risk Management Report sets out the inherent risks to which the Society is exposed and how it manages these, it also summarises the Society's principal and main risks which may impact the delivery of its Strategic Plan and the Society's capital position as holding capital is one of the ways that the Society protects members from the impact of a risk materialising.

Principal risks

Whilst the Society's inherent risk categories tend to be stable over time, prevailing conditions and specific business activities result in principal or main risks that vary over time. The Society's principal risks are outlined in more detail in the Strategic Report but these risks and the key mitigations are summarised below:

Risk	How this risk is mitigated
UK political and economic uncertainty could impact the wider economy and have indirect impacts on the Society's business model. It may create strategic, credit or funding risks for the Society if access to the wholesale funding markets is disrupted or if a combination of falling house prices and rising unemployment impacts mortgage demand or increases credit risk.	The Society's simple low cost and low risk business model is positioned to remain resilient to both economic and credit downturns. Strong levels of risk based capital (CET 1) and liquidity (LCR) mean that the Society has resources to deal with financial and funding challenges that may emerge. In 2019, the Society has diversified its wholesale funding arrangements which provides protection against any restricted access to wholesale funding markets.
A number of factors in the current **market environment** could put pressure on net interest margin or the ability to return superior value to savings members, creating strategic risk. These include a continuation of the pricing pressures in the mortgage market, the impact of a persistently low interest rate environment and a continued slowdown of house purchases.	The Society's low cost operating model means that it can operate effectively in a low margin environment whilst still returning value to members and maintaining capital ratios as demonstrated again in 2019. The Society's financial planning process tests for a number of scenarios, including continued market pressure which ensures that plans are supportable.
The Society continues to invest in significant levels of change exposing it to **change and execution risk** and expects this exposure to continue for a number of years. Whilst these change programmes will deliver additional resilience and flexibility and reduce risk once implemented, much of the change is complex and the extent of the change creates a number of operational risks. These include dependency risk from the need to make changes to legacy systems alongside managing a number of other change initiatives in parallel. There is a risk that change activity is underestimated increasing both project costs and the time needed to deliver major programmes. A greater reliance on third parties also raises security and other risks, such as risks of supplier failure.	The Society is uplifting its change capability to allow it to improve both change delivery and the management of execution and dependency risks. It has also enhanced procurement and supplier management processes and has controls in place which mitigate third parties' reliance risks. Finally, it is enhancing risk oversight of change programmes. Taken together these measures are designed to ensure change is delivered safely, without disruption to core operations and within expectations, whilst reducing execution and cost risk.

Risk	How this risk is mitigated
The Society operates in a competitive market where **changing customer demands** and the increased use of technology are changing the way in which savings and mortgage products are designed and delivered. At the same time, regulatory change and the ongoing need to maintain legacy systems could increase the level of change further. There is a risk that the scale of change the Society could face leaves it with insufficient capacity to develop new products and services in an increasingly digital world, or that the level of change required puts pressure on its low cost operating model and threatens the value that can be delivered to members.	The Society is focused on the need to develop products and services to meet the changing needs in an increasingly digital world. It engages with members to identify the product and service enhancements that they are looking for to ensure that they remain relevant and valued. The Society has a roadmap of strategic change, setting out how the Society will deliver the resilient and flexible operating environment and service and product enhancements required. The Strategic Plan continues to balance shorter term change requirements with longer term strategic investment requirements within a low cost operating model.

Controlling and managing risk

The Society operates a simple business model. One of its key principles is to stay safe and secure by taking risks it understands and can manage. It manages risk through its Enterprise Risk Management Framework (ERMF). The ERMF sets out the Board's approach to managing and overseeing risk by: defining risk strategy; risk appetite; governance and control; and risk management in light of the Society's strategy. The ERMF is approved annually by the Board and continues to operate effectively. The Society will continue to enhance the ERMF, as required, to ensure it identifies and manages risk within its low risk tolerance.

Three lines of defence

The Society operates within a 'three lines of defence' model, recognised as an industry standard for risk management.

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

First line of defence	Second line of defence	Third line of defence
The business	**Risk oversight**	**Internal Audit**
• Owns and manages the Society's risks. • Is responsible for compliance with relevant regulation and legislation. • Identifies, manages and mitigates the risks of the Society. • Defines and operates controls. • Assesses key risk indicators and market conditions. • Produces management information and reports on risk.	• Designs, interprets and develops the Enterprise Risk Management Framework, and monitors business as usual adherence to the framework. • Provides oversight, challenge and assurance over the management of risks. • Develops compliance policies, supports delivery of regulatory change and monitors and reports on regulatory issues. • Is responsible for overseeing effective compliance with relevant regulation and legislation. • Identifies, manages and mitigates the risks of the Society.	• Conducts independent testing and verification of the efficiency of the Society's business model, controls, policies, processes and business line compliance. • Provides assurance that the risk management process is functioning as designed. • Is responsible for providing assurance over compliance with relevant regulation and legislation.

Risk Management Report continued

Risk management

The Society's risk management objectives are to:

- Identify risks to the Strategic Plan and to the Society's 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 progress against agreed management action plans.

Risks are identified, assessed, managed, monitored, escalated and reported. Management information captures risk metric information against risk indicators, triggers and limits as appropriate.

Risk strategy

The Board sets the Society's risk strategy and risk management approach. The strategy includes establishing a robust risk culture, setting the Board's risk appetite and ensuring that the 'three lines of defence' model operates effectively.

Risk culture

Risk culture is reflected in the behaviour and approach of the Board and all employees to risk awareness, risk taking and risk management. A strong risk culture helps the Society to achieve its strategy within acceptable risk levels.

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

- Tone from above – the Board and executive management act, and encourage employees to act, with openness and integrity, especially in the fair treatment of members. Employees are encouraged to report observed non-compliance, risk incidents and 'near misses'.
- Accountability – employees understand both 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 sets standards for those working within financial services.
- Incentives – the Society makes sure that its performance management and reward frameworks promote its desired risk management behaviours and attitudes. In particular, the Society does not pay any sales incentives to employees.

Board risk appetite

The Board articulates the risks it is willing to take in delivering the Strategic Plan through its risk appetite statements which create a framework for business decision making.

The Board's strategy continues to be that the Society operates as a below median risk building society. This generates a number of risk appetite statements and limits. Where management can meet strategic objectives without using the full extent of the Society's risk appetite, the Board expects it to do so.

The Executive Risk Committee (ERC), the Board Risk Committee (BRC) and the Board all review performance and adherence to Board limits.

Stress testing and planning

Stress testing, for both internal and external shocks, is used to understand the potential impact of risks crystallising and options to manage them. This includes scenario and contingency planning.

Stress testing is a key part of the Society's capital and liquidity assessments and allows the Board to be satisfied that the Society has sufficient capital and liquidity resources even under a range of severe forward looking scenarios.

More detail on the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) is set out in the sections that follow covering capital, and liquidity and funding risk.

Governance and control

The Society has a number of committees which oversee and monitor risk as set out below. The Board delegates to BRC oversight of the Society's risk management arrangements as a whole. The Chief Risk Officer (CRO) has an independent reporting line directly to the Chair of the BRC in addition to reporting to the Chief Executive.

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

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

The Board

Board Risk Committee (BRC) Chair: Martin Stewart, Non-executive Director	Board Audit Committee (BAC) Chair: Iraj Amiri, Non-executive Director
See BRC report	See BAC report

Chief Executive

Executive Risk Committee (ERC)	Chair: Mark Parsons, Chief Executive
• Oversees and monitors strategic risk. • Ensures that risk is being identified and managed effectively across the Society. • Exercises executive risk oversight for each of the Society's principal risks. • Ensures that the Society's Risk Management Framework remains effective.	• Considers any emerging risks which may impact the Society's Strategic Plan. • Considers reports from the various Risk Committees and CRO. These reports are also submitted directly to BRC to ensure independent non-executive committee oversight of the Society's risk exposures.

Risk Oversight Committee (ROC) Chair: Fraser McNeill, Chief Risk Officer	Conduct Risk and Compliance Committee (CRCC) Chair: Mark Parsons, Chief Executive	Asset and Liability Committee (ALCO) Chair: Michele Faull, Chief Financial Officer	Retail Credit Risk Committee (RCRC) Chair: Fraser McNeill, Chief Risk Officer	Operational Risk Committee (ORC) Chair: Peter Frost, Chief Operating Officer
• Provides independent oversight of the management of risk throughout the Society and ensures that risks are identified, assessed, managed, monitored and reported effectively and consistently.	• Oversees and monitors the Society's delivery of good customer outcomes consistent with the conduct risk appetite statement approved by the Board. • Oversees the management of conduct risk and the Society's compliance with applicable conduct regulation.	• Oversees the Balance Sheet risks faced by the Society. • Oversees market risk, treasury credit risk and liquidity and funding risk. • Ensures the robustness of capital and liquidity stress testing. • Oversees financial model risk management. • Oversees prudential regulatory risk and treasury conduct risk.	• Monitors the management of retail credit risk across the Society and the performance of the mortgage book to ensure compliance with risk limits approved by the Board. • Oversees management of model risk through its subcommittee, the Models and Ratings Committee, which is chaired by Michele Faull.	• Provides primary oversight of all operational risk categories. • Ensures compliance with limits approved by the Board.

Risk categories

Credit risk

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

Maximum exposure to credit risk

The maximum exposure to credit risk for on-balance sheet and off-balance sheet financial exposures is set out below, allowing for impairment where appropriate. The maximum exposure to loss for off-balance sheet financial exposures is considered to be the contractual nominal amounts. Maximum exposure to credit risk has grown broadly in line with the increase in the Society's Balance Sheet.

(Audited)	On-balance sheet carrying value 2019 £m	Off-balance sheet exposures[1] 2019 £m	Maximum credit risk exposure 2019 £m	On-balance sheet carrying value 2018 £m	Off-balance sheet exposures[1] 2018 £m	Maximum credit risk exposure 2018 £m
Cash and balances with the Bank of England	5,226.0	–	5,226.0	5,219.4	–	5,219.4
Loans and advances to credit institutions	336.1	–	336.1	231.3	–	231.3
Debt securities	1,292.6	–	1,292.6	951.2	–	951.2
Loans and advances to customers	42,234.7	1,675.9	43,910.6	39,264.6	1,737.5	41,002.1
Hedge accounting adjustments	149.7	–	149.7	6.5	–	6.5
Derivative financial instruments	137.9	–	137.9	268.9	–	268.9
Total	49,377.0	1,675.9	51,052.9	45,941.9	1,737.5	47,679.4

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

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

Retail credit risk

Credit risk in the Society's mortgage book only crystallises in the event that a borrower is unable to repay the mortgage and, as a result, the property on which the mortgage is secured has to be repossessed and sold at a price which is insufficient to allow the borrower to repay the loan.

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 those acquired as a result of the merger with Stroud & Swindon Building Society in 2010, continue to fall, comprising just 0.6% (2018: 0.7%) of total gross balances.

During 2019, arrears continued to fall from the already low levels seen in 2018, reflecting continued low unemployment and strong affordability derived from the Society's prudent underwriting. The Society expects that its mortgage book will continue to perform well even if there are pressures on affordability from increased unemployment or inflation.

The Society withdrew from interest only lending in the owner-occupier sector in 2012. As a result exposure to this type of business continued to reduce in 2019 and only 5.4% of the owner-occupier portfolio was on interest only terms as at 31 December 2019 (2018: 6.8%) with an average loan to value of 39.4% (2018: 39.1%). The Society has operated a contact programme for members nearing the end of term on interest only owner-occupier loans for a number of years, which helps members assess their ability to repay the loan when due or, if needed, seek suitable solutions. At the end of 2019, there were 200 owner-occupier interest only loans that were past term (2018: 268).

Buy to let lending continues to be provided mainly on an interest only basis reflecting the underlying investment nature of buy to let properties which can be sold to repay the capital amount.

Loans and advances to customers are shown below. The effective interest rate (EIR) asset and fair value and other adjustments have been presented separately from gross balances in order to aid understanding. Previously these were apportioned within gross balances. Where relevant, comparative information has been adjusted to reflect this.

Loans and advances to customers (Audited)	2019 £m	2019 %	2018[2] £m	2018[2] %
Residential mortgages: owner-occupier	**25,198.9**	**59.7**	23,177.0	59.0
Residential mortgages: buy to let	**16,732.6**	**39.6**	15,738.3	40.1
Total traditional residential mortgages	**41,931.5**	**99.3**	38,915.3	99.1
Residential near-prime mortgages	**59.2**	**0.1**	66.3	0.2
Residential self-certification mortgages	**156.3**	**0.4**	184.2	0.4
Commercial mortgages[1]	**2.0**	**–**	2.2	–
Total non-traditional mortgages	**217.5**	**0.5**	252.7	0.6
Unsecured personal loans[1]	**20.0**	**–**	23.8	0.1
Total gross balance	**42,169.0**	**99.8**	39,191.8	99.8
Impairment	**(12.0)**	**–**	(11.6)	–
EIR asset	**75.8**	**0.2**	84.2	0.2
Fair value and other adjustments	**1.9**	**–**	0.2	–
Total net balance	**42,234.7**	**100.0**	39,264.6	100.0

1. Legacy books of unsecured personal loans and commercial mortgages. The credit risk for these is immaterial and therefore not considered further in this report.
2. Comparative information has been adjusted to remove EIR and fair value and other adjustments which were previously apportioned across gross balances.

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 and has remained broadly stable:

Region (Audited)	2019 %	2018 %
London	**27.6**	27.1
South East England	**18.7**	18.5
Central England	**14.2**	14.6
Northern England	**13.1**	13.4
East of England	**11.7**	11.5
South West England	**8.9**	9.0
Scotland	**3.4**	3.5
Wales and Northern Ireland	**2.4**	2.4
Total	**100.0**	100.0

Loan to value and income multiples (Unaudited)

The Society updates the estimated value of the properties securing the mortgage portfolio on a quarterly basis using regional house price indices. The low loan to value (LTV) 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) LTV cases. Any lending at or above 4.5 times income is closely monitored and 3.4% (2018: 3.4%) of advances were made at or above this level in 2019, which is well below the maximum limit of 15% set by the Bank of England's Financial Policy Committee (FPC). The Society reduces maximum income multiples offered if the loan term extends significantly into retirement to ensure it remains affordable.

The Society is a responsible lender and operates robust affordability checks before advancing any loans. 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 key part of this. For buy to let loans the Society sets minimum interest coverage ratios which reflect amongst other things the tax status of borrowers. The Society's actual average interest coverage ratio at the end of the year using a stressed 5% interest rate was 175.4% (2018: 175.7%), significantly above its lending criteria. The Society also lends to portfolio landlords within the buy to let segment and takes a prudent approach to assessing portfolio LTV and income coverage ratios. There are also limits on the number of properties in the portfolio both in total and those which the Society will lend on. Each loan in a portfolio is assessed on a standalone basis and no allowance is made in the affordability assessment for other income of the borrower.

Risk categories continued

The LTV distribution of the mortgage book as at 31 December 2019 remained broadly stable as shown below.

The following tables calculate LTV based on the weighted average loan balances unless stated otherwise:

Total mortgage book profile by number of accounts (Audited)	2019 %	2018 %
Indexed loan to value:		
< 50%	49.7	50.2
50% to 65%	25.0	25.9
65% to 75%	14.7	14.2
75% to 85%	7.4	6.7
85% to 95%	3.1	2.9
> 95%	0.1	0.1
Total	100.0	100.0
Average indexed loan to value of stock (simple average)	48.0	47.6
Average indexed loan to value of stock (balance weighted)	55.4	54.6

The average indexed LTV of loan stock in London is slightly higher than last year at 54.1% (2018: 52.3%) with small house price falls seen in London in the year and for regions outside of London it is broadly stable at 55.9% (2018: 55.2%).

The LTV profile of gross new lending in 2019 is shown below. In 2019 there has been a continuation of the trend towards remortgaging with the percentage of new owner-occupier lending relative to buy to let lending increasing after very strong buy to let lending in 2018. The average LTV of the new lending book has increased marginally but remains within the Society's risk appetite.

Gross lending by balance – new business profile (Audited)	2019 %	2018 %
Owner-occupier purchase	33.9	31.6
Owner-occupier remortgages	30.7	24.1
Owner-occupier further advances	2.0	1.7
Buy to let purchase	7.7	9.3
Buy to let remortgages	25.0	32.8
Buy to let further advance	0.7	0.5
Total	100.0	100.0
Average loan to value (simple average)	59.6	59.7
Average loan to value (balance weighted)	63.7	62.6

Retail credit risk management – mortgages

The Retail Credit Risk Committee (RCRC) and ultimately the Board oversee the Society's credit risk management supported by a specialist retail credit risk department reporting to the Chief Risk Officer.

The Board sets prudent credit risk limits within the context of the Society's overall risk appetite and these are reflected in the Society's lending policy and credit controls.

All mortgage applications are assessed against the Society's lending policy criteria to ensure consistent credit decision making, and lending within the Society's credit risk appetite. This assessment uses stressed interest rates to ensure affordability even if interest rates increase.

The lending criteria remained consistent in 2019, and included the following additional items:

- Lower LTV limits on some types of property such as new build flats.
- An expansion to lending limits for portfolio landlords allowing the Society to lend on up to 5 properties while continuing to apply prudent income coverage and LTV limits to remain within the Society's risk appetite.

The Society also ensures that there is no overexposure to any geographical region or counterparty and that its mortgage portfolio as a whole can withstand a range of macroeconomic and specific stress scenarios.

The Society's track record of above market growth means that a relatively large proportion of its mortgage book may not have had sufficient time for its performance to be established. However, the quality of the mortgage book remains very high and arrears from new lending are negligible.

The Society's approach to payment difficulties

Inevitably, despite the Society's prudent lending approach, on occasion members experience financial difficulty. In these cases, the Society seeks to work with each borrower to reach a sustainable and fair arrangement to regularise the position in a timeframe which is acceptable to both the Society and the borrower.

The Society proactively contacts borrowers most at risk of experiencing potential payment difficulties to minimise the risk of future affordability issues, seeking to protect the interests of individual borrowing members whilst at the same time mitigating the risk of credit losses to the membership as a whole.

The Society will only seek repossession of a property when all reasonable efforts have failed or where the mortgage is unsustainable in the longer term.

The arrears position has improved from historically low levels. Arrears for accounts which are three months or more past due have decreased to £1.7 million (2018: £1.9 million) and the gross balance of these accounts has also reduced to £54.0 million (2018: £60.7 million).

(Audited)	2019 Gross balance £m	2019 Arrears balance £m	2018 Gross balance £m	2018 Arrears balance £m
Greater than three months	54.0	1.7	60.7	1.9
Greater than six months	22.3	1.0	21.5	1.1
Greater than one year	5.1	0.4	5.1	0.4
In possession	4.6	0.2	6.7	0.4

The accounts in arrears as a percentage of loans and advances to customers has also improved in 2019 and remains significantly lower than the UK Finance average, as shown below:

(Audited)	2019 Society %	2019 UK Finance[1] %	2018 Society %	2018 UK Finance[1] %
Greater than three months	0.16	0.72	0.18	0.79
Greater than six months	0.06	0.43	0.06	0.47
Greater than one year	0.01	0.22	0.01	0.25
In possession	0.01	0.02	0.01	0.02

1. UK Finance data as at 31 December 2019 (31 December 2018).

Extent and use of forbearance (Unaudited)

The Society exercises forbearance if it is in the best interests of both the borrower and the Society and may offer:

- 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, arrears may be capitalised or the Society may agree to change repayment mortgages to interest only terms for a temporary period as a means of exercising forbearance.

Risk categories continued

Where a loan is up to date, the Society may agree a short-term payment holiday as a way of allowing borrowers to resolve financial difficulties, in which case this 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 are only given where the borrower can afford the post-holiday monthly repayments.

Details of loans subject to forbearance are shown below:

	2019		2018	
(Unaudited)	No. of accounts	Carrying value £m	No. of accounts	Carrying value £m
Forbearance: Accounts past due				
Arrangements	542	58.0	656	72.9
Concessions	20	3.7	38	5.8
Term extensions[1]	6	0.9	4	0.5
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	191	22.7	286	33.1
Term extensions[1]	154	30.0	164	28.7
Capitalisation of arrears[1]	5	0.6	2	0.2

1. Granted in the last 12 months.

The number of loans in forbearance has fallen compared with 2018 reflecting the improved economic environment and credit risk profile of the Society's borrowers. The Society has continued to issue term extensions on customers not past due, reflecting ongoing proactive engagement with interest only borrowers unable to repay interest only loans at the end of the original term.

In 2019 arrears were capitalised five times (2018: twice) and temporary transfer to interest only terms was agreed 10 times (2018: nil).

Accounts subject to forbearance are assessed as either stage 2 or 3 under IFRS 9 and the Society recognises a lifetime expected credit loss for these as an impairment provision. More information on expected credit losses is included below.

Identifying impaired loans (Audited)

Under IFRS 9 the Society calculates impairment provisions on loans and advances to customers on an expected credit loss (ECL) basis and not 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.

IFRS 9 requires the Society to categorise customer loans 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 credit impaired or in 'default' are in stage 3. Under IFRS 9, loans are generally treated as being in 'default' if they are three or more months in arrears, have been three or more months in arrears in the last 12 months or have other specific unlikeliness to pay indicators. Equity release loans are treated as being in default once the loan is twelve months past the term date. IFRS 9 requires a 12 month ECL provision on all stage 1 assets and a lifetime ECL provision on all stage 2 and 3 assets. At 31 December 2019, 97.0% of the Society's loans and advances to customers were within the stage 1 'performing' category which is slightly better than in 2018 (96.6%), reflecting improved arrears. Further staging profile analysis is set out below and information on how the Society has applied the requirements of IFRS 9, including the calculation of ECLs, is set out in note 1 to the accounts.

The table below shows gross loans and advances to customers split by IFRS 9 stage at 31 December 2019 and at 31 December 2018. For loans in stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

2019 (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Of which Not past due £m	Of which Past due £m	Stage 3 'Default' £m	Of which Not past due £m	Of which Past due £m	Total £m
Residential mortgages								
Owner-occupier	**24,433.1**	**644.5**	588.5	56.0	**121.3**	48.2	73.1	**25,198.9**
Buy to let	**16,350.4**	**340.7**	307.9	32.8	**41.5**	19.7	21.8	**16,732.6**
Total traditional residential mortgages	**40,783.5**	**985.2**	896.4	88.8	**162.8**	67.9	94.9	**41,931.5**
Non-traditional mortgages								
Residential near-prime	**26.5**	**16.3**	14.2	2.1	**16.4**	5.2	11.2	**59.2**
Residential self-certified	**63.5**	**75.2**	72.0	3.2	**17.6**	6.7	10.9	**156.3**
Commercial lending	**–**	**1.6**	1.6	–	**0.4**	0.4	–	**2.0**
Total non-traditional mortgages	**90.0**	**93.1**	87.8	5.3	**34.4**	12.3	22.1	**217.5**
Unsecured loans	**19.6**	**0.3**	–	0.3	**0.1**	–	0.1	**20.0**
Total gross loans	**40,893.1**	**1,078.6**	984.2	94.4	**197.3**	80.2	117.1	**42,169.0**
	%	**%**	%	%	**%**	%	%	**%**
Total gross loans	**97.0**	**2.5**	2.3	0.2	**0.5**	0.2	0.3	**100.0**

2018 (Audited)[1]	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Of which Not past due £m	Of which Past due £m	Stage 3 'Default' £m	Of which Not past due £m	Of which Past due £m	Total £m
Residential mortgages								
Owner-occupier	22,363.8	682.3	628.1	54.2	130.9	49.8	81.1	23,177.0
Buy to let	15,324.1	375.6	353.0	22.6	38.6	14.6	24.0	15,738.3
Total traditional residential mortgages	37,687.9	1,057.9	981.1	76.8	169.5	64.4	105.1	38,915.3
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	–	1.8	1.6	0.2	0.4	0.4	–	2.2
Total non-traditional mortgages	142.4	71.3	62.3	9.0	39.0	13.6	25.4	252.7
Unsecured loans	23.3	0.4	–	0.4	0.1	–	0.1	23.8
Total gross loans	37,853.6	1,129.6	1,043.4	86.2	208.6	78.0	130.6	39,191.8
	%	%	%	%	%	%	%	%
Total gross loans	96.6	2.9	2.7	0.2	0.5	0.2	0.3	100.0

1. Comparative information has been adjusted to remove EIR and fair value and other adjustments which were previously apportioned across gross balances.

At the reporting date, 97.0% of loans are in stage 1 with only 2.5% in stage 2 and 0.5% in stage 3 (2018: 96.6%, 2.9% and 0.5%). Cure periods are applied to accounts in stages 2 and 3 that have hit certain quantitative triggers such as arrears. These cure periods 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.

At the reporting date of the balances in stage 2, only £94.4 million or 8.8% are in arrears by 30 days or more, continuing to demonstrate that the major drivers for stage 2 classification continue to be factors other than arrears (2018: £86.2 million or 7.6%).

Of the £197.3 million of loans which are classified as stage 3 at the reporting date, only 29.8% or £58.7 million were greater than three months in arrears, and 40.2% (£80.2 million) of stage 3 assets were paid up to date. This is an improvement compared with the position in 2018 when 32.4% (£67.7 million) of the £208.6 million of loans which were classified in stage 3 at 31 December 2018 were greater than three months in arrears and 37.4% (£78.0 million) were up to date.

At 31 December 2019, £58.7 million of loans were more than three months in arrears and subject to litigation or in possession, a decrease of £8.9 million on 2018.

Possession levels have remained low and only £4.6 million of stage 3 loans are in possession (2018: £6.7 million). This represents 33 individual cases and only 0.01% of the total mortgage book (or 2.3% of the stage 3 book) by balance, a decrease on 2018 when there were 34 possession cases representing 0.02% of the total mortgage book and 3.2% of

Risk categories continued

stage 3 loans. As at 31 December 2019, properties in possession were valued at £5.4 million (2018: £6.2 million) against balances net of provisions of £4.2 million (2018: £4.7 million).

The table below shows total impairment provision split by IFRS 9 stage at 31 December 2019 and the previous year. For stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

Impairment provision as at 31 December 2019 (Audited)	Stage 1 12 month ECL £m	Stage 2 lifetime ECL £m	Of which Not past due £m	Of which Past due £m	Stage 3 lifetime ECL £m	Of which Not past due £m	Of which Past due £m	Total £m
Residential mortgages								
Owner-occupier	**0.5**	**2.0**	1.8	0.2	**3.7**	2.3	1.4	**6.2**
Buy to let	**0.2**	**0.8**	0.7	0.1	**3.5**	2.1	1.4	**4.5**
Total traditional residential mortgages	**0.7**	**2.8**	2.5	0.3	**7.2**	4.4	2.8	**10.7**
Non-traditional mortgages								
Residential near-prime	**–**	**0.1**	0.1	–	**0.1**	–	0.1	**0.2**
Residential self-certified	**–**	**0.1**	0.1	–	**0.2**	–	0.2	**0.3**
Commercial lending	**–**	**0.2**	0.2	–	**0.2**	0.2	–	**0.4**
Total non-traditional mortgages	**–**	**0.4**	0.4	–	**0.5**	0.2	0.3	**0.9**
Unsecured loans	**0.2**	**–**	–	–	**0.1**	–	0.1	**0.3**
Mortgage pipeline	**0.1**	**–**	–	–	**–**	–	–	**0.1**
Total impairment provision	**1.0**	**3.2**	2.9	0.3	**7.8**	4.6	3.2	**12.0**
	%	**%**	%	%	**%**	%	%	**%**
Total impairment provision	**8.3**	**26.7**	24.2	2.5	**65.0**	38.3	26.7	**100.0**

Impairment provision as at 31 December 2018 (Audited)	Stage 1 12 month ECL £m	Stage 2 lifetime ECL £m	Of which Not past due £m	Of which Past due £m	Stage 3 lifetime ECL £m	Of which Not past due £m	Of which 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 2019 is as follows:

	Stage 1		Stage 2		Stage 3		Total	
(Audited)	Gross balance £m	Provision 12 month ECL £m	Gross balance £m	Provision lifetime ECL £m	Gross balance £m	Provision lifetime ECL £m	Gross balance £m	Provision £m
At 1 January 2019	37,853.6	1.4	1,129.6	3.9	208.6	6.3	39,191.8	11.6
Movements with Income Statement impact								
Transfer from stage 1 to stage 2	(570.0)	(0.1)	570.0	1.1	–	–	–	1.0
Transfer from stage 1 to stage 3	(39.6)	–	–	–	39.6	1.1	–	1.1
Transfer from stage 2 to stage 3	–	–	(49.9)	(0.3)	49.9	0.3	–	–
Transfer from stage 3 to stage 2	–	–	38.2	0.5	(38.2)	(0.5)	–	–
Transfer from stage 3 to stage 1	11.8	–	–	–	(11.8)	(0.1)	–	(0.1)
Transfer from stage 2 to stage 1	465.2	0.1	(465.2)	(0.5)	–	–	–	(0.4)
Net movement arising from transfer of stages	(132.6)	–	93.1	0.8	39.5	0.8	–	1.6
New loans originated[1]	8,582.4	0.6	4.2	–	0.1	–	8,586.7	0.6
Remeasurement of ECL due to changes in risk parameters	–	(0.1)	–	(0.3)	–	0.6	–	0.2
Increase/(decrease) in post model adjustments	–	–	–	(0.3)	–	3.1	–	2.8
Remeasurement of ECL due to model refinements[2]	–	(0.4)	–	(0.6)	–	(0.1)	–	(1.1)
Loans derecognised in the period	(3,752.7)	(0.4)	(103.4)	(0.3)	(40.6)	(0.7)	(3,896.7)	(1.4)
Other items impacting Income Statement reversal	–	–	–	–	–	(0.3)	–	(0.3)
Net write offs directly to Income Statement	–	0.1	–	–	–	(0.4)	–	(0.3)
Income Statement (credit)/charge for the period		(0.2)		(0.7)		3.0		2.1
Repayment and charges	(1,657.3)	–	(44.9)	–	(7.9)	–	(1,710.1)	–
Net write offs and other ECL movements	(0.3)	(0.2)	–	–	(2.4)	(1.5)	(2.7)	(1.7)
At 31 December 2019	40,893.1	1.0	1,078.6	3.2	197.3	7.8	42,169.0	12.0

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.
2. A number of refinements to the Society's ECL models have been made during 2019. These include an update to the calculation of the Probability of Default and an enhancement to the regional House Price Index modelling capability. In the year these refinements decreased ECLs by £1.1 million at Group level and £0.4 million within the Society.

The impact of post model adjustments on the impairment provision has increased by £2.8 million to £4.0 million during 2019.

Risk categories continued

(Audited)	Stage 1 Gross balance £m	Stage 1 Provision 12 month ECL £m	Stage 2 Gross balance £m	Stage 2 Provision lifetime ECL £m	Stage 3 Gross balance £m	Stage 3 Provision lifetime ECL £m	Total Gross balance £m	Total Provision £m
At 1 January 2018[2]	34,391.1	1.3	1,235.0	3.9	232.9	8.3	35,859.0	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]	9,164.5	0.6	26.0	–	0.2	–	9,190.7	0.6
Remeasurement of ECL due to changes in risk parameters	–	(0.1)	–	(0.3)	–	0.4	–	–
Increase/(decrease) in post model adjustments	–	–	–	(0.4)	–	–	–	(0.4)
Loans derecognised in the period	(4,089.8)	(0.4)	(131.6)	(0.2)	(42.1)	(1.0)	(4,263.5)	(1.6)
Net write offs directly to Income Statement	–	0.1	–	–	–	(0.4)	–	(0.3)
Income Statement charge/(credit) for the period		0.2		–		(0.6)		(0.4)
Repayment and charges	(1,540.8)	–	(45.1)	–	(6.3)	–	(1,592.2)	–
Net write offs and other ECL movements	(0.1)	(0.1)	(0.1)	–	(2.0)	(1.4)	(2.2)	(1.5)
At 31 December 2018	37,853.6	1.4	1,129.6	3.9	208.6	6.3	39,191.8	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.
2. Comparative information has been adjusted to remove EIR and fair value and other adjustments which were previously apportioned across gross balances.

The LTV distribution of the mortgage book by IFRS 9 stage has remained broadly stable during 2019 with 85.0% of the mortgage book having an LTV of 75% or lower (2018: 87.1%). This is shown by IFRS 9 stage below:

As at 31 December 2019 Indexed loan to value (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
< 50%	15,352.0	403.7	70.7	(1.0)	15,825.4
50% to 65%	12,112.9	326.1	61.9	(1.7)	12,499.2
65% to 75%	7,272.0	195.5	29.2	(1.4)	7,495.3
75% to 85%	4,098.4	102.2	21.0	(2.5)	4,219.1
85% to 90%	1,720.2	39.9	7.2	(1.2)	1,766.1
90% to 95%	309.5	7.0	1.4	(0.8)	317.1
95% to 100%	5.9	1.9	1.7	(0.9)	8.6
> 100%	2.6	2.0	4.0	(2.0)	6.6
Unsecured loans	19.6	0.3	0.2	(0.4)	19.7
Mortgage pipeline	–	–	–	(0.1)	(0.1)
Total	40,893.1	1,078.6	197.3	(12.0)	42,157.0

As at 31 December 2018[1] Indexed loan to value (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
< 50%	14,713.9	383.7	77.8	(0.6)	15,174.8
50% to 65%	11,791.9	347.9	62.7	(1.3)	12,201.2
65% to 75%	6,487.8	222.7	26.8	(1.7)	6,735.6
75% to 85%	3,242.1	108.4	20.9	(2.1)	3,369.3
85% to 90%	1,199.4	47.3	6.1	(1.2)	1,251.6
90% to 95%	381.7	12.1	6.2	(1.2)	398.8
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	37,853.6	1,129.6	208.6	(11.6)	39,180.2

1. Comparative information has been adjusted to remove EIR and fair value and other adjustments which were previously apportioned across gross balances.

The credit quality of the mortgage book in 2019 has improved compared with 2018 as shown by lifetime probability of default (PD) by stage set out below. This table reflects the PD of a given loan over its life (e.g. PD of less than or equal to 0.25 indicates a 0.25% or lower chance of default). Default includes cases which are three or more months in arrears, have been three or more months in arrears at some point in the last 12 months and cases which have triggered a specified unlikeliness to pay indicator. This shows that the mortgage book has a very low underlying risk of default, with 95.6% of the book having a PD of 0.5% or less compared with 91.7% last year.

As at 31 December 2019 Probability of default (%) (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
<=0.25	**39,482.1**	**58.7**	**–**	**(0.4)**	**39,540.4**
0.26 to 0.50	**698.3**	**63.9**	**–**	**(0.1)**	**762.1**
0.51 to 1.50	**313.2**	**114.7**	**–**	**(0.1)**	**427.8**
1.51 to 5.00	**62.5**	**261.9**	**–**	**(0.1)**	**324.3**
5.01 to 20.00	**51.9**	**396.5**	**–**	**(0.5)**	**447.9**
20.01 to 100.00	**49.4**	**176.2**	**–**	**(0.7)**	**224.9**
Other[1]	**235.7**	**6.7**	**3.1**	**(5.5)**	**240.0**
Default	**–**	**–**	**194.2**	**(4.5)**	**189.7**
Mortgage pipeline	**–**	**–**	**–**	**(0.1)**	**(0.1)**
Total	**40,893.1**	**1,078.6**	**197.3**	**(12.0)**	**42,157.0**

1. Includes equity release mortgages and other loans where credit risk is assessed using alternative calculation methods.

As at 31 December 2018[2] Probability of default (%) (Audited)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
<=0.25	33,601.0	19.1	–	(0.3)	33,619.8
0.26 to 0.50	2,258.7	40.9	–	(0.2)	2,299.4
0.51 to 1.50	1,392.3	136.9	–	(0.2)	1,529.0
1.51 to 5.00	234.2	329.4	–	(0.3)	563.3
5.01 to 20.00	57.0	404.3	–	(0.7)	460.6
20.01 to 100.00	46.6	192.3	–	(1.0)	237.9
Other[1]	263.8	6.7	3.1	(2.9)	270.7
Default	–	–	205.5	(5.9)	199.6
Mortgage pipeline	–	–	–	(0.1)	(0.1)
Total	37,853.6	1,129.6	208.6	(11.6)	39,180.2

1. Includes equity release mortgages and other loans where credit risk is assessed using alternative calculation methods.
2. Comparative information has been adjusted to remove EIR and fair value and other adjustments which were previously apportioned across gross balances.

Credit risk outlook

The Society is committed to operating a low risk business model and will continue to advance only high credit quality, low risk loans within segments of the mortgage market it understands and where it can assess and manage risks effectively within its risk appetite. This approach, together with maintaining a mortgage portfolio which is geographically spread throughout the UK, protects the Society from falls in house prices or affordability pressures generally or in specific regions. As a result the Society expects to continue to experience very low levels of credit losses despite potential pressures from Brexit and the wider global economy.

Risk categories continued

Treasury credit risk

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

Management of treasury credit risk

The Society has a low appetite for treasury credit risk and restricts exposures to good quality counterparties with a low risk of failure.

Treasury investments in financial institutions are restricted to highly rated UK banks, with additional credit limits extended to a small number of highly rated and systemically important institutions in Europe, Australia, Canada and the United States and multilateral development banks (MDBs). In addition, the Society invests in covered bonds and Residential Mortgage Backed Securities (RMBS). The treasury credit limits are reviewed annually by BRC and the Board and reflect internal analysis, external credit ratings and any other relevant factors. Within the risk framework, detailed limit setting is delegated to the Asset and Liability Committee (ALCO) with oversight from the Risk function.

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

The Society has no exposure to emerging markets, hedge funds, non-UK RMBS, non-UK covered bonds or credit default swaps.

Treasury credit exposure profile (Audited)

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities. Whilst the majority of liquidity continues to be held in UK central bank reserves and Government securities, during 2019 the Society increased its investment in MDBs, UK covered bonds and UK RMBS and entered into bi-lateral funding arrangements that required additional collateralisation. All of the Society's treasury exposures remain at investment grade as set out below:

	Exposure value by Moody's rating				
2019 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated £m	Total £m
Central banks and sovereigns	5,736.1	–	–	–	5,736.1
Multilateral development banks (supranational bonds)	165.5	–	–	–	165.5
Financial institutions	678.9	197.0	56.9[1]	–	932.8
Mortgage backed securities	20.3	–	–	–	20.3
Total	6,600.8	197.0	56.9	–	6,854.7

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

1. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities. The Baa1-Baa3 exposure relates to a single counterparty that was downgraded in 2018.

The majority of treasury assets continue to be held within the UK. The geographical domicile of the Society's treasury assets is shown below:

2019 (Audited)	Liquid assets: Sovereign £m	Supranationals £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Of which, debt securities: Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	5,736.1	–	839.1	20.3	6,595.5	1,110.5	16.6	1,127.1
Supranationals	–	165.5[1]	–	–	165.5	165.4	0.1	165.5
France	–	–	90.2[2]	–	90.2	–	–	–
Switzerland	–	–	0.2[2]	–	0.2	–	–	–
Australia	–	–	0.5[2]	–	0.5	–	–	–
Canada	–	–	2.8[2]	–	2.8	–	–	–
Total	5,736.1	165.5	932.8	20.3	6,854.7	1,275.9	16.7	1,292.6

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

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

Counterparty credit risk mitigation

The Society enters into derivative transactions for risk management purposes. It undertakes sale and repurchase (repo) transactions to manage liquidity and raise longer term funding, 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.

The Society manages this risk by undertaking credit assessments of all counterparties and by exchanging collateral to mitigate any exposure. Daily collateralisation of repo transactions is carried out 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 Bond LLP). These allow the Society to settle exposures 'net' in the event of a default or other predetermined event.

The Society is subject to mandatory central clearing of derivatives through a third party regulated central clearing counterparty to reduce systemic and operating risk. Under this, 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 Bond LLP undertakes swaps under a separate ISDA agreement. Each agreement includes a CSA which provides for collateralisation of the swap exposure. The £6.6 million derivative net credit exposure in note 32 to the accounts includes £3.6 million in respect of an arrangement which will only be fully collateralised if the counterparty is downgraded to below specified credit ratings.

The derivative exposures can only be settled net following a default or other predetermined event, and therefore exposures are presented gross on the Balance Sheet.

Risk categories continued

Analysis of treasury assets by IFRS 9 stage and impairment

Under IFRS 9 the calculation of impairment on treasury assets is performed on an ECL 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, stress testing. Exposures are monitored by the Treasury Credit 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 2019. Impairment is calculated by applying an externally published PD for the applicable credit risk rating to the treasury exposure value. The resulting ECL remains immaterial at 31 December 2019 as it was at 31 December 2018. As at 31 December 2019, no treasury assets were past due.

Treasury credit risk outlook

The Society's consistent low risk approach to treasury credit risk protects the Society and its members from credit risk arising on its treasury portfolio. This is expected to be maintained in future periods.

Market risk

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

Management of market risk

The main sources of market risk to which the Society is exposed are mismatches between the re-pricing profiles of mortgages and savings products, and certain characteristics embedded within these products.

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

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

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

Interest rate risk

The Society is inherently exposed to a risk that its margin narrows as a result of changes in interest rate. For example, where the Society has originated fixed rate mortgages, an increase in the interest rates it pays on deposits or wholesale funding would leave the Society facing a higher interest expense on its funding, without a compensating increase in interest income from fixed rate mortgages.

The Society manages this risk by natural offset where available or by entering into interest rate swaps.

Interest rate risk lasts for the term of a fixed rate mortgage, it is particularly relevant for the long term equity release mortgages held by the Society. At 31 December 2019, £128.9 million of the £223.9 million equity release mortgage balances are economically hedged with interest rate swaps (2018: £130.4 million, of £248.4 million).

The Society maintains sufficient discretionary variable rate savings and mortgages on its Balance Sheet to give it flexibility to manage different interest rate environments.

The Society operates within a series of Board approved limits which:

- Specify the minimum amount of variable rate products it must hold.
- Limit the amount of foreign exchange exposure.
- Limit the exposure on both net interest income and the present value of the Balance Sheet for a parallel interest rate shock.

The impact on the present value of assets and liabilities for a 100bps and 200bps shock, and impact of a 100bps shock on net interest income is monitored by the Society. The Society is implementing a structural hedge to reduce interest income volatility from its reserves and low interest saving accounts.

The Balance Sheet continues to be positioned so that net interest income benefits from rising interest rates in the medium term, as shown by the impact of an upward rate shock on the net interest income measure, albeit that the structural hedge has reduced the extent of this bias.

The impact on the present value of the assets and liabilities remains limited relative to the overall Balance Sheet size as shown below. In these calculations, interest rates and yields are floored at zero, and, as a result, the shock from a fall in rates is limited given current interest rates. If this constraint was removed the impact of the falling rate shock would be similar but opposite to that of the rising rate shock.

Shock applied (Unaudited)	+100bps 2019 £m	-100bps 2019 £m	+100bps 2018 £m	-100bps 2018 £m
PV100 results (impact on present value of assets and liabilities at year end)	(9.6)	6.8	(2.9)	6.1
Impact on net interest income for the year	23.7	(19.8)	34.3	(25.0)

Shock applied (Unaudited)	+200bps 2019 £m	-200bps 2019 £m	+200bps 2018 £m	-200bps 2018 £m
PV200 results (impact on present value of assets and liabilities at year end)	(18.3)	6.8	(6.6)	5.0

Risk categories continued

Product option risk

Savings and mortgage products include options which create interest rate risks for the Society.

There is a risk that between the point of mortgage application and completion, customers choose not to complete on the mortgage. If this occurs during a period in which interest rate expectations have changed, this could leave the Society with a funding imbalance. This mortgage pipeline risk is managed by limits on the overall size of the pipeline and at an individual product level. The risk is mitigated further by hedging a proportion of the pipeline.

The Society's fixed rate savings and mortgage customers have options to reduce either their mortgage or savings balances earlier than the contract term. These access risks are managed through:

- Appropriate redemption or early withdrawal charges.
- Offering products which encourage more predictable behaviour under anticipated future interest rate outcomes.
- Matching swaps to the expected attrition profile.

Basis risk

Where the Society executes swaps at a market rate, for example Sterling Overnight Index Average (SONIA), which does not exactly match the Society's administered variable rate, it is exposed to basis risk.

The risk is managed through ensuring that potential basis shock impacts remain within Board defined limits.

Interbank Offered Rate (IBOR) reform means that interest rate benchmarks such as LIBOR are expected to cease after 2021, requiring the Society to replace or update any derivatives linked to them. The impact of this is limited for the Society, as the majority of its derivatives are already linked to SONIA, the preferred near risk free rate administered by the Bank of England. The Society has a small portfolio of mortgages with balances of £23.7 million which are linked to LIBOR and will also need to be updated. More information on the impact of IBOR reform is included in note 1 to the accounts.

Credit spread risk

The Society diversifies its liquidity holdings by maintaining part of its liquidity portfolio in assets whose price is sensitive to movements in the cost of credit. The Society manages this exposure through Board limits which monitor the present value of a shock to credit spreads. Credit spread risk also encompasses swap spread risk.

Foreign currency risk (Audited)

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

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

Market risk outlook

Interest rates are expected to remain low for some time, which may add pressure to overall margins. The Society expects to be able to continue to generate additional capital to support growth within this environment.

The structural hedge being implemented will smooth earnings volatility arising from changes in interest rates over the longer term.

The Society is satisfied that this and the controls outlined above will mean that market risk remains within appetite.

Liquidity and Funding risk

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

Both risks are managed on a Group basis (including all subsidiary entities) with day-to-day responsibility delegated to the Chief Financial Officer and Treasurer and oversight by ALCO, BRC and the Board.

Management of funding risk

The Society ensures that it is not reliant on any single source or funding provider to manage funding risk. It maintains a strong and diversified funding base with access to a range of wholesale funding markets. This reflects the Society's strategy and the traditional building society model.

Retail funding forms the bulk of the funding base and consists of a mix of variable rate products, fixed rate bonds and ISAs. The Society has a strong record of attracting and retaining savings balances and continues to organically grow its savings book. The Society raises deposits from a broad customer base which is spread throughout the UK and offers a range of retail savings products to diversify retail funding. New channels are being developed to diversify this further.

The Society has previously accessed Bank of England programmes such as the Term Funding Scheme (TFS) to further reduce funding costs and diversify exposures andas at 31 December 2019, the Society had £4.25 billion of TFS (2018: £4.25 billion).

The Board sets limits to avoid both over reliance on wholesale funding and funding concentration by type, counterparty or tenor. These limits comply with the Building Societies Act 1986 and follow the Prudential Regulation Authority's (PRA) supervisory guidance.

Management of liquidity risk

The Society's ensures it holds sufficient quality and quantity of liquidity to remain a going concern after a severe but plausible stress. In turn this ensures that it meets regulatory requirements set by the PRA. The level of stress applied is dynamically assessed based on an assessment of risks run by the Society and the prevailing economic and market liquidity backdrop.

The Society's business inherently involves 'maturity transformation' as it borrows, or takes deposits, for shorter terms than its mortgage lending. This mismatch could, in certain stressed circumstances, give rise to liquidity risk if the Society was unable to raise new funding or replace existing funding at maturity because of either a liquidity crisis in the capital markets, or a loss of member confidence that causes a 'run' on retail funds at that time.

The annual Internal Liquidity Adequacy Assessment Process (ILAAP) is completed to ensure that the Society holds sufficient liquidity to cover this risk. The ILAAP is approved by the Board and confirms the Society's liquidity risk appetite including limits that determine the mix and amount of liquidity it must hold.

The Society's Recovery Plan outlines a menu of actions that can be undertaken to stop the Society from failing in extreme stress situations covering both capital and liquidity stresses. In line with regulatory requirements the Society has put in place actions to ensure there are no material barriers to resolution.

The Society completes regular stress testing including reverse stress testing and tests both the current balance sheet and the latest projections to ensure that actual and forecast liquidity remain within appetite. The forecast and actual liquidity levels are monitored by ALCO, and overseen by the Board.

Liquidity resources

The Society's liquidity resources include funds in cash accounts held in the Bank of England reserve account and other easily realisable liquid assets and contingent liquidity. They are managed based on the prudent estimation of the expected time taken to convert them into cash in a stress. These limits ensure that the Society meets its risk appetite which is consistently higher than regulatory requirements.

The Society monitors compliance against Liquidity Coverage Ratio (LCR) requirements on a daily basis and as at 31 December 2019, the Society's LCR was 214% (2018: 202%), significantly above the regulatory minimum.

Net Stable Funding Ratio (NSFR) is a measure of stable funding which is expected to be implemented in June 2021. The Society holds sufficient stable funding to meet the future regulatory requirement of 100% NSFR.

Risk categories continued

The Society's liquidity resources at 31 December 2019 are set out in the following table. The amount of liquid assets has remained elevated in 2019 as the Society took prudent risk management steps against any funding risk arising from Brexit uncertainty.

The amounts differ from those in the accounting Balance Sheet as this analysis excludes any encumbered assets such as cash held in the Society's covered bonds and RMBS programmes, and balances posted with counterparties as collateral under swap agreements.

(Audited)	2019 £m	2018 £m
Cash balances with the Bank of England	4,778.8	4,948.7
UK Government securities and other qualifying securities	1,284.8	313.7
Sub-total high quality liquid assets	6,063.6	5,262.4
Other securities – on-balance sheet	7.8	8.2
Contingent liquidity	2,325.9	3,301.4
Total	8,397.3	8,572.0

Contingent liquidity includes Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS. These are approved portfolios of mortgage collateral that could be used to access Bank of England liquidity facilities or sold to and repurchased from third parties under repo agreements to realise contingent liquidity. Contingent liquidity decreased by £1.0 billion, reflecting repayments and redemptions in the approved mortgage portfolios, and the use of collateral in bi-lateral funding transactions during the year.

Liquidity adequacy and stress testing

The ILAAP ensures that the Society holds sufficient liquidity to meet both minimum regulatory requirements such as the LCR and to comply with the Internal Liquidity Adequacy Assessment (ILAA) Rules, including the Overall Liquidity Adequacy Rule.

The ILAAP reviews the underlying assumptions to stress tests used. These assumptions are specific to the Society and reflect the main risks. The stress tests consider the potential causes of liquidity risk for the Society in a severe but plausible stress and the management actions that may be taken to ensure that the Society remains a going concern. The Society's business model means that the main liquidity risks would relate to significant unexpected withdrawals of retail deposits, the impact of any credit risk downgrade and lack of access to wholesale funding markets when wholesale funding matures.

The ILAAP is reviewed by the PRA. Following this, the PRA provides Individual Liquidity Guidance which sets out the liquidity that the PRA requires the Society to hold, including any add-ons for liquidity risks that are not captured by the LCR.

The Society has continued to meet all regulatory liquidity requirements and has done so throughout the year.

Wholesale funding

The Society's wholesale funding at 31 December 2019 has increased by £0.3 billion to £10.6 billion. The increase was driven by the issuance of €500 million and £100 million of covered bonds, £400 million senior unsecured debt and £525 million of bi-lateral funding arrangements, offset by funding maturities.

(Audited)	Notes to the accounts	2019 £m	2019 %	2018 £m	2018 %
Deposits from banks, including repo agreements	22	1,060.6	10.0	1,195.8	11.6
Amounts drawn under the Term Funding Scheme	22	4,258.0	40.2	4,258.0	41.3
Other deposits and amounts owed to other customers		471.2	4.4	506.0	4.9
Debt securities in issue					
Medium-term notes	23	2,158.4	20.4	2,144.2	20.8
Covered bonds	23	2,517.3	23.7	2,047.3	19.8
Residential Mortgage Backed Securities	23	139.9	1.3	162.4	1.6
Total		10,605.4	100.0	10,313.7	100.0

Wholesale funding outstanding at 31 December 2019 remains primarily denominated in sterling as shown below:

(Audited)	GBP £m	EUR £m	Total £m
Deposits from banks, including repo agreements	1,018.4	42.2	1,060.6
Amounts drawn under the Term Funding Scheme	4,258.0	–	4,258.0
Other deposits and amounts owed to other customers	471.2	–	471.2
Debt securities in issue			
Medium-term notes	1,606.3	552.1	2,158.4
Covered bonds	1,249.4	1,267.9	2,517.3
Residential Mortgage Backed Securities	139.9	–	139.9
Total as at 31 December 2019	8,743.2	1,862.2	10,605.4
Total as at 31 December 2018	8,757.8	1,555.9	10,313.7

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

The expected maturity analysis for wholesale funding is shown below, based on the earlier of first call date or contractual maturity. This shows that the overall maturity of funding has shortened primarily as the majority of the TFS drawings repayable in 2021 have moved into the 'one to two years' banding.

(Audited)	2019 £m	2019 %	2018 £m	2018 %
Less than one year	2,580.7	24.3	2,077.9	20.2
One to two years	3,562.1	33.6	1,582.3	15.3
Two to five years	4,043.0	38.1	6,205.9	60.2
More than five years	419.6	4.0	447.6	4.3
Total	10,605.4	100.0	10,313.7	100.0

Risk categories continued

Contractual maturity profile of financial assets and liabilities

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

At 31 December 2019 (Audited)	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1- 5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England[1]	5,226.0	–	–	–	–	5,226.0
Loans and advances to credit institutions	336.1	–	–	–	–	336.1
Debt securities	–	319.7	236.5	457.0	279.4	1,292.6
Loans and advances to customers	32.6	782.9	2,224.6	10,749.9	28,444.7	42,234.7
Hedge accounting adjustment	–	9.0	78.4	19.8	42.5	149.7
Derivative financial instruments	–	–	24.3	103.4	10.2	137.9
Investment in equity shares	–	–	–	–	4.1	4.1
Total financial assets	5,594.7	1,111.6	2,563.8	11,330.1	28,780.9	49,381.1
Liabilities						
Shares	33,069.1	541.8	1,510.7	1,116.5	–	36,238.1
Sale and repurchase agreements[2]	–	101.3	350.0	524.9	–	976.2
Amounts drawn under TFS[2]	–	8.0	–	4,250.0	–	4,258.0
Deposits from banks – other	82.7	1.7	–	–	–	84.4
Other deposits	–	8.5	–	–	–	8.5
Amounts owed to other customers	–	325.8	136.9	–	–	462.7
Secured debt securities in issue – RMBS and covered bonds	–	653.5	0.7	1,583.4	419.6	2,657.2
Senior unsecured debt funding	–	7.7	903.9	1,246.8	–	2,158.4
Hedge accounting adjustment	–	1.7	42.2	0.1	–	44.0
Derivative financial instruments	–	1.0	21.5	124.6	134.7	281.8
Subordinated liabilities	–	0.6	–	10.0	14.9	25.5
Subscribed capital	–	1.6	–	–	40.0	41.6
Total financial liabilities	33,151.8	1,653.2	2,965.9	8,856.3	609.2	47,236.4
Net liquidity gap (contractual)	(27,557.1)	(541.6)	(402.1)	2,473.8	28,171.7	2,144.7

1. Includes £111.7 million mandatory reserve with the Bank of England.
2. Included in Deposits from banks on the Balance Sheet.

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

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

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

This analysis differs from the analysis of residual maturity as it includes interest accrued for the period to maturity on the balance outstanding at the Balance Sheet date. Principal payments are included based on the earlier of first call date or contractual maturity. The undated Subscribed capital is included in the 'more than five years' column but with no accrued interest after this date. The profile has remained broadly similar to the prior year.

For the year ended 31 December 2019, leasing commitments are presented within Other liabilities and adjustments following transition to IFRS 16. More information is included in note 1 to the accounts.

At 31 December 2019 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	33,610.9	1,544.3	1,139.6	–	36,294.8
Deposits, amounts owed to other customers and debt securities in issue	1,148.6	1,520.4	7,784.1	451.4	10,904.5
Other liabilities and adjustments	40.0	81.6	147.1	57.5	326.2
Subordinated liabilities	0.9	0.9	15.2	18.4	35.4
Subscribed capital	2.4	2.4	19.4	40.0	64.2
Total liabilities	34,802.8	3,149.6	9,105.4	567.3	47,625.1
Undrawn loan facilities	34.3	–	–	–	34.3

Risk Management Report

Risk categories continued

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

Asset encumbrance

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

Asset encumbrance at 31 December 2019 is set out in the table below. Assets pledged as collateral have increased reflecting the bi-lateral funding transactions undertaken in the year and a greater balance of loans being used in the covered bond programme to support the issuances in 2019 and those planned in early 2020.

	Encumbered		Unencumbered		
(Unaudited)	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total £m
Cash and balances with the Bank of England	–	438.0	4,788.0	–	5,226.0
Loans and advances to credit institutions	336.1	–	–	–	336.1
Debt securities	125.0	–	1,167.6	–	1,292.6
Loans and advances to customers	11,946.2	–	2,741.3	27,547.2	42,234.7
Derivative financial instruments	–	–	–	137.9	137.9
Hedge accounting adjustment	–	–	–	149.7	149.7
Other assets	–	–	–	153.8	153.8
Total as at 31 December 2019	12,407.3	438.0	8,696.9	27,988.6	49,530.8
Total as at 31 December 2018	10,794.2	262.2	8,920.5	26,094.0	46,070.9

1. Assets that have been used to support interest rate swap collateralisation agreements, third party secured funding operations, central bank operations or third party repo transactions and cannot be used for any other purpose.
2. Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. This includes cash and assets supporting secured funding vehicles.
3. These assets are readily available as collateral to secure funding. Loans and advances to customers in this category comprise Bank of England approved portfolios, and those that although technically encumbered are held in respect of retained self-issued notes in the Society's covered bond and securitisation programmes.
4. Unencumbered other assets are therefore conservatively defined as not readily available for use as collateral. The Loans and advances to customers in this category include £20.0 billion at 31 December 2019 (2018: £18.9 billion) which would be eligible for use to support future external or self-issuance under the Society's covered bond and securitisation programmes. A proportion of the remaining balance would also be suitable for such purpose subject to amending the programme structures.

External credit ratings

The Society's long term and short-term credit ratings were unchanged by Moody's in the year. During the year Fitch removed the negative watch on the Society and downgraded the credit rating from 'A' to 'A-'.

Short and long term credit ratings as at 27 February 2020 are set out below:

(Audited)	Long term	Short term	Subordinated	Outlook	Date of last credit opinion
Moody's	A2	P-1	Baa1	Negative	January 2020
Fitch	A-	F1	n/a	Stable	January 2020

Liquidity and Funding risk outlook

In 2019, the liquidity and funding markets were impacted by the political and economic concerns in respect of Brexit; however, the Society remained committed to prudent liquidity levels and funding in wholesale markets throughout the year despite the volatility in pricing. The Society expects that volatility could continue as a result of continued Brexit related and economic uncertainty together with the run-up to repayment of the TFS drawings across the sector by February 2022. The Society has £4.25 billion of TFS drawings which are due to be repaid across 2021 and 2022. The Society's plans to replace these funds are well advanced and have seen the Society extend the range of wholesale funding options it utilises to ensure that it can access sufficient funds.

The Minimum Requirement for own funds and Eligible Liabilities (MREL) regulation is also likely to impact the Society's wholesale funding plan. During 2019 there have been continued market issuances of senior non preferred instruments which give building societies the ability to raise MREL qualifying debt relatively cost efficiently compared with capital issuances.

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

Risk categories continued

Conduct risk

Conduct risk is the risk that the Society's behaviour and decision making fail to deliver good customer outcomes. The Society is committed to making a positive difference and delivering good outcomes for customers.

Conduct risk profile

The Society's mutual ownership, its culture and values and its mission of Putting Members First all actively support delivery of good customer outcomes. As a result, the Society meets its conduct risk responsibilities and ensures the fair treatment of members. This is evidenced through the Society's low level of customer complaints and the positive response from the Financial Ombudsman Service on complaints that are referred to them, both of which remain consistently below industry averages. In 2019, 97%[1] of complaints referred to the Financial Ombudsman Service were decided in the Society's favour (2018: 94%) compared with an industry average of 54%[2] (2018: 66%).

The Society's annual colleague engagement survey demonstrates positive endorsement of the Society's products and services by people who work at the Society. 8/10[3] members say they would recommend the Society's products and services to family and friends, indicating the underlying fairness of the Society's products.

Management of conduct risk

The Society's mission of Putting Members First remains the guiding principle in setting both strategy and day-to-day decision making. The Society's approach to conduct risk is grounded in six key principles:

1. **Putting Members First** from both an individual and a total membership perspective.
2. **Products and services** are based on **good customer outcomes** now and in the future.
3. **Complaints are resolved fairly** with effective action taken on root causes to improve member experience.
4. The **systems and partners** the Society uses are **within its risk appetite** and balance the needs of members and the Society.
5. The **literature and advice** provided by the Society are **straightforward, easy to understand** and unbiased.
6. **Strategy** and **governance** promote and evidence **good customer outcomes**.

Good customer outcomes are only delivered by people and these principles underpin the Society's internal communications, and its recruitment and reward strategies. In particular, recruitment processes are designed to make sure that colleagues understand and share the Society's values, whilst the reward policy does not incentivise sales and positively reward customer service.

Employees understand and share the focus on Putting Members First and this is a major part of the Society's high employee engagement score. The Society's corporate induction is tailored to ensure that all new colleagues are trained on Putting Members First, with additional training on day to day decision making provided regularly to all managers. In this way the Society ensures that all managers understand the importance of their team's role in delivering good customer outcomes.

Day to day management of conduct risk is the responsibility of all of the Society's senior management. Oversight is provided by the Conduct Risk and Compliance Committee (CRCC), chaired by the CEO.

The Society actively designs products to be fair and transparent, with their features and terms and conditions explained simply and clearly. This has been independently endorsed by Fairer Finance. All major product developments are reviewed and approved by CRCC before launch.

Quality assurance activities across operational processes specifically check customers have received the right advice and levels of service for their particular needs.

The Society uses a Conduct Risk Framework to ensure that potential conduct risks arising from the products, services and documentation it provides to its members are identified and that there are adequate control measures in place to manage, mitigate and monitor such risks.

There is a dedicated Conduct Risk Oversight and Compliance function which provides second line oversight of business activity focused on the delivery of positive customer outcomes, as well as assessing adherence to the Society's compliance and regulatory obligations.

During 2019, the Society has undertaken a number of initiatives aimed at further improving customer outcomes:

- **Supporting vulnerable customers.** The Society recognises that members in vulnerable circumstances are at greater risk of poor outcomes when dealing with their finances. As a result, the Society has invested heavily in training and process improvements to allow colleagues to identify and provide appropriate support to members who may be more vulnerable, thereby enabling those members to make positive outcome decisions.

  The Society supports the Banking Protocol to protect vulnerable and, in particular, elderly members from fraudulent activity and scams. The Society has simplified the bereavement process to make the process for relatives and representatives of deceased members as human, simple and pain-free as possible at such a difficult time. It is working on similar improvements to the Power of Attorney process.

1. Source: Financial Ombudsman – complaints upheld in the Society favour for the 6 months to 30 June 2019.
2. Source: Financial Ombudsman – complaints upheld in the Banking and Credit sector for the 6 months to 30 June 2019.
3. Average number of members scoring 9 or 10/10 across 6 surveys totalling 56,745 responses.

- **Product simplification.** In 2019 the Society made changes to some products, and withdrew debit card and overdraft functionality. Whilst this was an important part of simplifying the Society's business model, it also recognised that for the members directly affected this action represented a significant change that, handled badly, had the potential to generate poor customer outcomes. The programme of change was designed to avoid poor customer outcomes and, specifically, communication content was tested with affected members, to ensure that it was clear and provided sufficient time for members to review their options. Where possible the Society spoke personally with affected customers to understand their concerns and explain their options.
- **Strong Customer Authentication.** The Society is developing new online authentication solutions as required by the Payment Services Regulations 2017. In implementing the changes, the Society has been mindful of the conduct implications and the need to make the transition work well for its members. The Society engaged member research groups to test and comment on the proposed authentication processes and accompanying communications. Further testing will be part of the final implementation work to ensure that good member outcomes are delivered alongside regulatory compliance.

Complaints and redress (including Payment Protection Insurance)

While the Society seeks good customer outcomes, from time to time things can go wrong.

The Society positively encourages members to identify poor outcomes or service that does not meet their expectations and has recently enhanced its online complaints facility to ensure this works as well for members as other contact options. The Society seeks to resolve complaints as soon as possible. In addition, whilst complaint levels are modest, analysis of the more common issues raised is used to improve services and customer outcomes.

Customer redress payments have been a feature of the financial services sector for many years. Against this background the Society's low level of redress is a strong indicator of its focus on avoiding customer harm and delivering good member outcomes.

In particular, Payment Protection Insurance (PPI) has driven significant complaint activity in 2019 as a result of the August 2019 claims deadline. Similar to the rest of the industry, the Society saw unprecedented levels of PPI complaints in the run up to the claims deadline albeit total PPI liabilities are significantly lower than those experienced in the sector overall. The majority of complaints received continue to relate to cases where the Society had not even sold a PPI policy.

Despite the increase in complaint levels no further PPI provision has been needed.

Conduct risk outlook

The Financial Conduct Authority's (FCA) continuing focus on conduct risk and delivery of good customer outcomes is clear in its 2019/20 Business Plan, and the Society does not expect this focus to change. In line with this, the Society expects continuing focus on culture and governance, the fair treatment of existing customers, and the implications of technological innovation and demographic change. In particular, awareness and focus on meeting different intergenerational needs as well as those of vulnerable customers.

The Society also expects to be impacted by the FCA's interest in the fairness of pricing practices including proposals for tackling price discrimination in the cash savings market, and by greater product switching opportunities enabled by technology advances.

The Society has considered the five conduct questions for firms recently set out by the FCA. It is satisfied that it addresses these by:

- Taking proactive steps to identify inherent conduct risks in the business.
- Encouraging colleagues working in control and support functions to be responsible for managing conduct risks.
- Providing training and support to enable colleagues to improve customer outcome.
- Active Board and Executive oversight of conduct issues.
- Assessing strategies that could inadvertently undermine good customer outcomes.

The Society's commitment to Putting Members First and its effective engagement with colleagues in this area will continue to support delivering good customer outcomes. This will assist the Society in reducing conduct risk from its current low level.

Risk categories continued

Operational risk

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

Operational risk profile

One of the Society's principles is to be safe and secure, which means managing operational risk on behalf of members to mitigate the risk of:

- Disruption to services.
- Loss of customer data or other forms of information security incidents.
- Financial losses.

Operational risk appetite is driven internally by the Society's mission of Putting Members First, and externally by consumer expectations and regulatory standards that increasingly focus on business resilience.

Management of operational risk

Operational risk is a main risk category in the Society's ERMF and is managed, reported and controlled across a number of sub-categories, consistent with the Basel risk classification, industry best practice and the Society's business model. The most significant operational risk sub-categories for the Society continue to relate to operational resilience, IT and change management, information security and financial crime, which are covered below.

Day to day management of operational risk is carried out as an integral part of conducting the Society's business by the relevant functional executives. The executives are responsible for identifying potential risks and ensuring that adequate controls are in place to mitigate risks in line with risk appetite, using the Society's Risk and Control Self-Assessment process.

The Operational Risk Committee, chaired by the Chief Operating Officer, provides primary oversight of all operational risk categories with further oversight provided by BRC and the Board.

Regulatory environment

The regulatory landscape continued to evolve in 2019 and it remains challenging for financial institutions to implement the necessary changes well and on a timely basis.

A key focus of the UK regulators has been maturing expectations with regard to operational resilience, with a particular focus on maintaining resilience when using third parties to provide services. The Society's existing operational resilience programme of activity aligns to the policy summary and consultation papers issued by the Supervisory Authorities in December 2019.

2019 also saw increasing focus from the regulator on the quality and accuracy of regulatory reporting across the financial services sector.

The Society notes that the implementation of the Fifth Money Laundering Directive (5MLD) is expected to take effect in 2020. This will result in a centralised bank account portal for law enforcement agencies to access and greater focus on beneficial owners of corporate accounts and Companies House registration. It will also extend the anti-money laundering regime to other types of assets, such as crypto currencies. Given the Society's simple business model, the key requirement arising from this directive will be the provision of savings account information to the centralised bank account portal.

Operational resilience

The Society considers that operational resilience is an outcome of good business management. Its risk appetite seeks to ensure that delivery of all important member services is maintained during or after any disruptive event in order to minimise customer harm.

The Society has invested in developing its approach to operational resilience in line with both existing regulatory expectations and expected future regulatory requirements. Specifically, the Society has a programme underway to deliver key activities including ratifying the firm's Impact Tolerance Statement, mapping end-to-end services and scenario testing to better understand where the Society can improve its resilience.

IT and change management

Keeping pace with technology is important to maintain the stability, security and resilience of technology systems and in doing so avoid member disruption and reputational impacts from IT outages.

The Society continues to invest in enhancing IT governance and IT operations and upgrading its IT estate. In 2019, the Society commenced using cloud services to augment its in-house IT capabilities. This change has only been made after a full assessment which showed that the risks and regulatory implications of adoption were within the Society's risk appetite. In addition, the Society has started operating from new, more resilient, third party owned data centres. Once the data centre migration is complete all of the Society's physical IT estate will be operated in an environment which is both highly resilient and very secure.

In 2019, the Society completed re-planning of the upgrade to its core technology platform and is now starting to implement key elements of this as separate modules. Whilst this approach has extended the final delivery date, it has reduced execution risks in the programme.

Inevitably change programmes such as these carry risk, as new systems and processes are introduced and integrated with existing ones. Following analysis of lessons to be learned from the re-planning activity, the Society has enhanced its change capability further by focusing on more clearly defined roles and responsibilities, enhancing dependency management and governance.

It has also strengthened risk management processes. As an example, core banking change initiatives will be subject to enhanced targeted assurance from both the first and second line, which is designed to support key milestones and decision points. Taken together, all these enhancements are designed to ensure that the Society's change programmes are delivered to expectations and without disruption to the Society's members and operations.

Information security and financial crime

2019 has witnessed a continuation of the increasing threat and pace of cyber attacks within both the financial services industry and the wider economy. Whilst the Society considers it is well protected against such threats, it continues to enhance its risk management capabilities.

Threat intelligence remains a key element of the Society's strategy to manage the risk of cybercrime, with the Society maintaining effective relations with key external stakeholders, including relevant government and law enforcement agencies, industry peers, and specialist consultancies and other organisations.

During 2019, the Society has continued to invest in other key elements of its cybercrime risk management capabilities and in the supporting control environment, building upon the enhanced security and resilience capabilities provided by the new third party data centres. Recognising that the cybercrime threat is not expected to abate, the Society plans to continue to deliver further improvements in its risk management activity and associated capability throughout 2020, ensuring that the risk to members and the Society is effectively mitigated.

Summary of risk incidents

Operational risk incidents are tracked and managed in line with the Society's ERMF and are recorded in its risk management system. The same system records strategic, model and conduct risk incidents which result in losses of over £5,000 per incident and the following analysis applies to all of these risk categories.

In 2019, the total cost of risk incidents, including PPI claims settled in the year, was £2 million and all risk incidents were within the Society's risk appetite. In 2018, the only exception to risk appetite related to the need to re-plan the core technology upgrade project, the costs of which were fully expensed in 2018.

An analysis of risk incidents by Basel risk category by both value and number of incidents is set out below excluding the 2018 exceptional incident. In 2019, as in 2018, there were no reportable risk events within the Basel risk categories for Business disruption and system failures. Damage to physical assets or employment practices and workplace safety.

	% of total volume		% of total losses	
Operational risk by Basel category[1] (Unaudited)	2019	2018	2019	2018
Execution, delivery and process management	12	50	17	12
External fraud	75	40	4	7
Clients, products and business practices[2]	13	10	79	81
Total	100	100	100	100
Value of losses (£m)			2.0	1.5

1. Losses less than £5,000 have been excluded.
2. PPI included.

Operational risk outlook

The Society expects that operational resilience and the pace of both internally driven and regulatory change will continue to be significant factors in its operational risk agenda going forward. Protecting against information security and financial crime threats will also be a major part of its risk management activity. It expects to do this through targeted change programmes and continuous improvement of day to day controls as well as maintaining its business continuity capability in line with increasing service level expectations.

Risk categories continued

These themes are consistent with the financial services industry as a whole.

- The Resolvability Assessment Framework, along with adoption of European Banking Authority guidelines on Information Communications Technology and Security Risk Management will further increase the focus on resilience and the use of third parties.
- The increased focus on regulatory reporting and new reporting requirements will continue to impact the Society.
- Open Banking and any proposals on 'Single easy access rates' are likely to require operational change as well as systems enhancement.

In addition, the Society continues to anticipate the need to adopt new regulation on an ongoing basis.

All of these factors increase both the pace and extent of change which, in turn, increases the risk that services could become less stable, or that the cost of maintaining those services could increase disproportionately. The Society's change portfolio investments are managed to levels which mitigate both business resilience risk and execution risk, while are judged to be appropriate and affordable.

Model risk

Model risk is defined as the risk that an ineffective model or incorrect interpretation of a model output leads to a loss, opportunity cost, accounting restatement, reputational damage or regulatory censure.

Model risk profile

The Society is exposed to model risk in both its credit risk models and wider financial and behavioural models. The use of models in the business is expanding due to factors such as the implementation of accounting standards that rely on forward looking assessments of behaviour, including IFRS 9 and IFRS 16.

Notwithstanding this, the Society's simple business model limits the extent of model risk to some extent.

Management of model risk

Model risk is managed by the Chief Financial Officer and oversight is provided by the Chief Risk Officer. It is governed through RCRC and ALCO.

The Society has a Board approved policy on model risk which sets out the minimum controls and standards to be applied to mitigate risk. These standards and controls are designed to conform to the regulatory expectations for model risk management practices.

Techniques to manage model risk include:

- Requirements on model development and documentation.
- Sensitivity analysis of key assumptions.
- Independent validation.
- Increasing focus on data governance.

The Society categorises its models and complex calculators dependent on their criticality and complexity and the framework operates to require increased controls on more critical and more complex models.

During 2019, the Society announced that it had made a historic error in the calculation of Risk Weighted Assets on its retail credit risk portfolio. The relevant calculator has been updated and tested and the Society is undertaking further activity to strengthen the implementation of its model risk framework as a result of this incident.

Model risk outlook

IRB models have been subject to significant regulatory reform with regulations published by UK and global bodies. The Society is in the process of concluding its update to its IRB models in response to the new regulatory requirements.

The Society anticipates that usage of models within the business will continue to increase. As a result it will continue to develop its controls over and oversight of models and complex calculators and the data that populates them.

Strategic risk

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

Managing strategic risk

The Board manages strategic risk supported by BRC and ERC. In particular, the Board's consideration and approval of the Strategic Plan includes both stress testing of the financial plan and a review of those risks that could potentially threaten the Society's business model over time.

The Society's simple and consistent business model means that the inherent risks are well understood and that the Society is experienced in managing these effectively. The main drivers of strategic risk remain as:

- Lack of diversification of the business model.
- Continued margin compression, particularly when linked with rising capital requirements.
- Regulatory change.
- Reputational risk.

In addition, as concern over climate change increases, the Society has considered how the financial risks related to climate change may impact on its strategy and business model. These are set out briefly below.

Undiversified business model

The Society's business is entirely based on low risk UK mortgages and UK savings. Potentially this generates lower capital than more diversified business models, particularly in a period of persistently low margins.

Whilst the Society's distribution of savings products is well diversified, its mortgage business is dominated by intermediated sales. Whilst this is very cost efficient and has resulted in a geographically diverse mortgage book which reduces regional concentration risk, it could create risks from lack of diversity in distribution.

The Society has no reason to believe that mortgage brokers will not remain a significant part of the UK mortgage market, due to the choice they offer customers. Further, it is confident that it can evolve its own business model to work effectively with the intermediary model as it develops.

The Society's low cost model and mutual ownership structure mean that it is able to operate effectively at low margins, maintaining capital levels, whilst investing in the business and returning superior value to its members in lieu of dividends. In addition, its size relative to that of the overall UK savings and mortgage market provides significant opportunity to grow within its low risk appetite such that it does not consider the lack of diversification to pose a significant threat to delivery of its Strategic Plan.

Market and margin compression and capital requirements change

In 2019 the mortgage market remained highly competitive in pricing terms and, as a result, margins remained compressed. Interest rates have been and are expected to remain low for a prolonged period which may keep mortgage margins suppressed in the medium term.

In addition, there remains the prospect that post-Brexit trade agreement discussions or any further slowdown in the global economy could negatively impact the UK housing market, potentially reducing the demand for mortgages and increasing competition and price pressure further.

A number of capital regime changes are expected in the short term, including wider implementation of Leverage and Leverage based MREL as well as the phase in of Basel IV risk weighted floors. These measures are largely risk agnostic and potentially increase the capital levels the Society needs to hold and the cost of doing so.

There is a risk that taken together these factors could reduce the Society's scope to grow sustainably. The Society regularly stress tests its Strategic Plan to ensure it remains robust in a number of stressed capital or margin scenarios. It considers that its low risk, low cost model and strong mortgage and savings franchise remain the best mitigants against this risk.

Regulatory change

Regulatory change, whether relating to financial or operational resilience, such as the MREL requirements, or the PRA's focus on operational resilience, as well as product related initiatives such as the FCA's focus on a 'Single easy access rate' in relation to savings products, all impact the Society.

The Society acknowledges that the regulatory changes are designed to improve either the resilience of the UK financial services sector or the outcome for customers, both of which it supports. However, there is the risk that the level of regulatory change is such that it prevents focus on member service improvements, product innovation or fails to recognise the benefits of the Society's low risk model.

The Society's Strategic Plan balances both short and longer term investment needs within the context of maintaining capital strength. It is also uplifting its change capability to allow it to safely and more efficiently deliver change initiatives. The growth of the Society in recent years has given it the scale to take on increased levels of change activity whilst maintaining a cost to mean assets ratio which is among the lowest in the sector.

Risk categories continued

Reputational risk

In 2019 and in recent years, there has continued to be a range of material risk events such as service outages and data compromises in the market. These impact the reputation of the financial services industry as a whole and potentially threaten consumer confidence in both the reliability of services and the safety of their data and savings.

The risk of more extreme service outages is potentially greatest when significant change is being delivered, especially change involving incorporating new systems alongside legacy platforms. The Society has an ambitious change programme which continues to involve an elevated level of complex change which, amongst other things, impacts how services are delivered to intermediaries and members. Unless this change is executed safely it could damage the Society's franchise with intermediaries and members.

In addition, there have been a number of regulatory reporting issues in the market which have resulted in fines and censure or the need to raise capital.

In the face of these issues, the Society manages the risk of service disruption and cybercrime carefully to protect both its members and its own reputation. Following the need to correct its risk weighted assets calculation, the Society is continuing to focus on enhancing its internal controls to prevent similar issues.

The Society has enhanced both its change capability and its risk management processes to make execution risk less likely. It continues to undertake robust analysis and supplier selection before change delivery starts. It is also increasing the use of live proving and small pilot launches of services and systems alongside thorough systems integration and end-user acceptance testing to further minimise the risks in this area.

This cautious approach continues to serve the Society well, especially within the member facing branch refurbishment project, where all elements of the design were tested before implementation and careful planning of each individual refurbishment is a continuing discipline.

Risk from climate change

As the focus on protecting our environment gathers momentum, the Society is considering how its business model is exposed to risks associated with climate change. The PRA has set out its expectation for all firms in the sector to assess the impacts of climate change in their ICAAP and stress testing and has required firms to assign a Senior Management Function (SMF) responsibility to lead this.

The CFO has responsibility for leading the Society's assessment and management of financial risks arising from climate change. These risks will be primarily overseen by ALCO, with limited oversight through RCRC and ultimate oversight through BRC and the Board.

The Society expects the financial risks from climate change to relate to **physical risks** arising from climate and weather related events and **transition risks** from regulation and other changes as the UK economy adjusts to a low carbon economy. These risks may emerge as:

- **Credit risks**, if for example properties on which the Society holds a mortgage are devalued as a result of climatic changes.
- **Market and funding risks** in the example that climate related change prompts corporate failures which disrupt the economy or the markets.
- **Operational risks**, if for example restrictions on travel seriously disrupt workforce mobility.

The Society is maturing its approach to identifying, assessing and measuring the financial risks that it could face as a result of climate change. It will then identify opportunities to effectively manage this. Existing activity to reduce its carbon footprint, eliminate waste and reduce paper usage will support this.

Consistent with the guidelines issued by the Task Force on Climate-related Financial Disclosures, the Society will enhance its disclosure in its next Annual Report & Accounts.

Strategic risk outlook

The Board continues to believe that the Society's simple business model, mutual ownership and low cost, low risk profile create significant strategic advantages. In addition, whilst there are challenges, it considers that the UK economy and the demand for good value, straightforward mortgages and savings are fundamentally robust.

As a result, it is confident that the Society will continue to be able to provide long term value savings and mortgage products and great service whilst generating sufficient capital to support its growth and invest in the Society's future.

Capital

Introduction

The Society holds sufficient capital to protect its members against future losses while maintaining its ratios and investing in the future.

Management of capital

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

The Society assesses its capital position and risks through an annual Internal Capital Adequacy Assessment Process (ICAAP) in line with the PRA requirements. The ICAAP considers the key capital risks and the amount of capital it should retain to cover these risks. These requirements are assessed against the current position and throughout the five year Strategic Plan.

Stress testing is a major part of the ICAAP and makes sure that the Society is resilient to a range of stresses. This assesses whether capital requirements would be met under severe but plausible stress scenarios specified by the regulator and considers what management actions are available to mitigate the impacts of a stress. In 2019, these stresses included both a low and a high Bank of England Base Rate scenario. In addition, the stress tests incorporate further negative trading assumptions to simulate a comprehensive stress on the Society's business model.

The ICAAP also incorporates alternative, more targeted, stress scenarios as part of the overall assessment of capital adequacy risks.

The Society carries out reverse stress testing to identify very extreme events that have the capacity to 'break' the Society, to identify risks and control mechanisms which might otherwise be missed.

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

Capital adequacy

In assessing capital adequacy the Society reviews each of the material inherent risks within its business model. It also reviews the capital needed to support planned growth in lending and operations.

The Society is currently only formally bound by its Total Capital Requirement (TCR) which is set by the PRA. The TCR was last set in 2019 and equates to 11.2% of RWAs or £590.2 million based on year end RWAs (2018: £511.2 million). The Society comfortably meets this requirement out of its CET 1 capital resources. However, in anticipation of them becoming binding, the Society monitors and seeks to maintain capital sufficient to meet both the non-risk based leverage ratio (both under CRR and UK leverage definitions) and standardised risk weighted floors that are part of the Basel IV reforms package.

During 2019, the Society tendered for the £400 million Additional Tier 1 (AT 1) security originally issued in 2014. The tender was the first of its type and was highly successful, resulting in £385.1 million of AT 1 being repurchased by the Society. Simultaneously, the Society issued £415 million of new AT 1. The remaining £14.9 million of the original AT 1 was called in November 2019.

Further information on capital management is included in the Society's 2019 Pillar 3 Disclosures (www.coventrybuildingsociety.co.uk/2019pillar3).

Risk weighted capital requirements

The Society uses the IRB basis for most of its retail credit risk and capital management, following permission from by the PRA in 2008.

These IRB models were used to calculate capital requirements for prime owner-occupier and buy to let mortgage exposures which account for around 99% of lending exposures throughout 2019 (2018: 99%). The remaining retail credit risk exposures on legacy closed products are modelled using the standardised approach.

There have been a number of changes to the regulations since the current, or incumbent, IRB models were developed. As a result, the Society has developed new IRB models to fully reflect the latest guidance. Once the Society has received permission from the PRA, they will replace the existing models. The Society expects that on adopting the new models, its RWAs will increase modestly and its CET 1 ratio will fall by between 1% and 3%. The comparatively minor adjustment arises because the Society's incumbent models already assess risks 'through the cycle' rather than solely on a 'point in time' basis.

The Society follows the standardised approach for all other lending exposures and for operational risk. The standardised approach uses capital risk weighting percentages set by CRD IV.

CRD IV requires the Society to maintain a CET 1 ratio of at least 4.5%, a Tier 1 capital ratio of at least 6% and a total minimum capital ratio of 8%. Taken together, these ratios are known as the Pillar 1 requirement.

The Pillar 2 capital requirement reflects wider risks within the Society's ICAAP assessment and any capital add-ons arising from the supervisory review of those assessments. In addition, a PRA buffer may be applied depending on the outcome of the severe but plausible stress tests.

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

Capital continued

CRD IV requires lenders to hold supplementary capital buffers. As at 31 December 2019, these were:

- A Capital Conservation Buffer (CCoB) of 2.5%.
- A Systemic Risk Buffer (SRB) at 0%[1].
- Macro-prudential Countercyclical Buffer (CCyB) at 1% (increasing to 2% from 16 December 2020).

Leverage ratio

The leverage ratio measures Tier 1 capital against total exposures, including off-balance sheet items. The leverage ratio does not reflect the degree of risk in exposures and does not differentiate unsecured and secured loans. Similarly, it does not reflect other features of the Society's low risk mortgage lending such as the low loan to value nature of the portfolio.

The capital regulations within Europe are being updated and as part of this it is highly likely that leverage will be binding on the Society in June 2021. Prior to this, the UK leverage ratio framework is applicable. This currently only applies to banks and building societies with retail deposits of £50 billion or more.

The Society's focus on low risk assets means that the leverage requirement will be more onerous than risk based requirements and will become the binding capital requirement on the Society.

The UK leverage ratio requires a minimum ratio of 3.25% calculated on the basis that exposures exclude central bank reserves. Of the UK leverage requirement, a maximum of 25% may be met using high quality AT 1 capital. Neither of these modifications exists in the CRR leverage measure where the minimum 3% requirement can be met by Tier 1 capital (CET 1 and AT 1) without restriction.

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

The CCLB is expected to increase from 16 December 2020 to 0.7%, increasing the minimum UK Leverage requirement to 3.95% from its current level of 3.65%. The Society's Strategic Plan ensures that it will continue to meet both UK and CRR leverage requirements on an ongoing basis.

Minimum Requirement for own funds and Eligible Liabilities (MREL)

MREL requirements are being introduced by regulators to ensure that taxpayers no longer absorb losses when a bank or building society fails. MREL requirements are set to reflect how complex or important to the wider economy an institution is.

The Society's resolution strategy as set by the Bank of England is 'bail-in', and as such as of 1 January 2020, the Society will need to meet an interim MREL requirement of 18% of RWAs. The indicative end-state MREL requirement for bail-in firms will be twice their binding capital requirement; currently this equates to 22.3% of RWAs[2] for the Society. This requirement will increase from 2022 due to the new Basel IV rules on RWA output floors. In addition, if leverage becomes the binding capital measure as expected, this will increase the requirement and the Society will need to issue MREL eligible debt. The Society's financial plan provides for these outcomes.

Regulatory capital analysis

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

IFRS 9 capital transitional arrangements exist but their impact on the Society's regulatory capital ratios is not material and as a result the CET 1 and leverage ratios disclosed in this report do not include the transitional reliefs.

1. A buffer of 0% applies to lenders with total assets of less than £175 million.
2. Two times Pillar 1 and Pillar 2a.

Risk weighted capital (Unaudited)

The Society's capital position on a CRD IV end-point basis is set out below based on all CRD IV requirements that were in force during 2019 excluding transitional provisions. Further information on CRD IV disclosures on a transitional basis is included in the Society's 2019 Pillar 3 Disclosures (www.coventrybuildingsociety.co.uk/2019pillar3).

At 31 December 2019, and throughout the year, the Society complied in full with the capital requirements that were in force. The CET 1 ratio has reduced to 32.0% (2018 restated: 33.9%[5]). Total risk weighted assets have increased by 11% reflecting growth in the mortgage book of 8% and a modest increase in LTV discussed in the credit risk section. During 2019, the Society announced a correction to its calculations of risk weighted assets under the IRB basis. The 2018 disclosures below have been restated accordingly.

The Individual consolidated CET 1 ratio on an end-point basis at 31 December 2019 was 0.8% (2018: 0.8%) higher than the Group ratio due to assets held by entities that sit outside of the Individual consolidation.

Capital position	End-point 31 Dec 2019 £m	End-point 31 Dec 2018 Restated[5] £m
Common Equity Tier 1 (CET 1)		
General reserve	1,773.3	1,693.5
Fair value through other comprehensive income reserve	3.7	5.6
Cash flow hedge reserve	10.8	24.4
Common Equity Tier 1 prior to regulatory adjustments	1,787.8	1,723.5
Common Equity Tier 1 regulatory adjustments		
Prudent additional valuation adjustment[1]	(1.3)	(0.9)
Intangible assets[2]	(30.4)	(33.1)
Cash flow hedge reserve[2]	(10.8)	(24.4)
Pension fund surplus adjustment[2]	(19.2)	(17.5)
Excess of expected loss over impairment[3]	(24.5)	(23.5)
Foreseeable distributions[4]	(10.6)	(9.3)
Common Equity Tier 1 capital	1,691.0	1,614.8
Additional Tier 1 (AT 1) capital		
Permanent Interest Bearing Shares (PIBS)	–	–
Additional Tier 1 – Perpetual Capital Securities	415.0	396.9
Total Additional Tier 1 capital	415.0	396.9
Total Tier 1 capital	2,106.0	2,011.7
Tier 2		
Collective provisions for impairment	–	–
Total Tier 2 capital	–	–
Total capital	2,106.0	2,011.7
Risk weighted assets		
IRB approach		
Credit risk – retail exposures[5,6]	4,213.9	3,804.6
Standardised approach		
Credit risk – retail exposures[7]	146.5	140.7
Credit risk – liquidity book	153.8	86.4
Credit risk – other	98.1	68.3
Credit valuation adjustment risk[8]	60.8	48.7
Operational risk	610.5	612.0
Total risk weighted assets	5,283.6	4,760.7
Common Equity Tier 1 ratio[5]	32.0%	33.9%

1. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
2. Items do not form part of regulatory capital, net of associated deferred tax.
3. The expected loss over accounting provisions is deducted, gross of tax.
4. Foreseeable distributions in respect of AT 1 securities are deducted, net of tax.
5. 2018 numbers for Risk Weighted Assets have been restated. 2018 reported numbers were £3,767.6 million for Credit Risk – retail exposure under IRB approach, £4,548.5 million Total Risk Weighted Assets and a CET 1 ratio of 35.5%.
6. The Society refined its calculation of this measure in 2019. Had this applied in 2018 the comparative figures would be £3,802.1 million with negligible impact on CET 1 ratio.
7. The Society refined its calculation of this measure in 2019. Had this applied in 2018 the comparative figures would be £160.4 million and the impact on CET 1 ratio would have been a reduction of 0.01%.
8. The Society refined its calculation of this measure in 2019. Had this applied in 2018 the comparative figures would be £59.6 million and the impact on CET 1 ratio would have been a reduction of 0.01%.

Capital continued

Leverage ratio analysis (Unaudited)

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

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

Both the UK and CRR leverage ratios have remained broadly static at 4.4% and 4.1% respectively (2018: 4.6% and 4.2% respectively) as the increase in eligible Tier 1 capital was matched by an increase in leverage ratio exposures, largely driven by the growth in the mortgage book. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Leverage ratio	End-point 31 Dec 2019 £m	End-point 31 Dec 2018 £m
Total Tier 1 capital – used in CRR calculation	2,106.0	2,011.7
Adjustment for AT 1 restriction	(35.2)	(47.4)
Total Tier 1 capital – used in UK calculation	2,070.8	1,964.3
Leverage ratio exposures		
Total Balance Sheet assets	49,530.8	46,070.9
Mortgage pipeline[1]	328.3	338.9
Other committed facilities (undrawn lending)[1]	17.1	20.0
Repurchase agreements[2]	1,817.5	1,711.1
Netted derivative adjustments[3]	51.6	(39.8)
Other adjustments[4]	(240.0)	(155.1)
Total leverage ratio exposures – used in CRR calculation	51,505.3	47,946.0
Adjustment to exclude central bank reserves	(4,760.3)	(4,930.2)
Total leverage ratio exposure – used in UK calculation	46,745.0	43,015.8
CRR leverage ratio	4.1%	4.2%
UK leverage ratio	4.4%	4.6%

1. Mortgage pipeline are assessed at 20% and other commitments at 50% as per the delegated regulation amending CRD IV.
2. Repurchase agreements represent the extent to which collateral provided on repurchase agreements exceeds the amount borrowed.
3. The netted derivative adjustment figure converts the accounting value of derivatives to an exposure measure.
4. Other adjustments predominantly relate to asset balances that have already been included in the capital calculation and these are therefore removed from the total Balance Sheet assets figure.

Additional capital disclosures including the European Banking Authority Templates are available in the Society's 2019 Pillar 3 Disclosures (www.coventrybuildingsociety.co.uk/2019pillar3).

Capital outlook

The upcoming changes from Basel IV risk weighted floors, MREL and leverage will impact the Society. All of these changes reduce the capital efficiency of firms, as regulations seek to enhance stability even after resolution. The impact on low risk organisations such as the Society is much more significant.

As a result of these changes the Society will see a significant reduction in reported CET 1 measures and expects the need to raise MREL debt.

Whilst this will put some pressure on margins, the Society's financial plan indicates that it will continue to have a surplus over all capital requirements, ensuring we remain safe and secure.

Welcome to our

Governance

This section outlines how the Society is managed in the interests of members and highlights the role, constitution and governance of the Board and its Committees.

Welcome to your Board of Directors

I am now in my second year as Chair and Peter Ayliffe is our Deputy Chair.

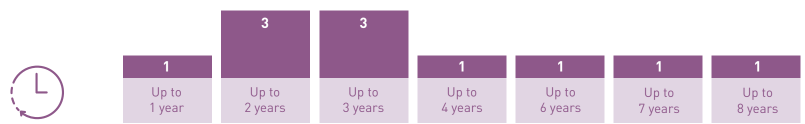
During the year, we welcomed Shamira Mohammed as a non-executive director. Additionally Roger Burnell stood down from the Board in April, after many years of valued service.

At the Coventry I am proud to have a Board who are passionate and committed about Putting Members First.

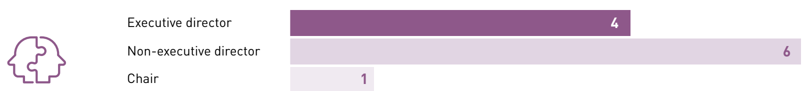
Gary Hoffman
Chair of the Board

Gender split

Longevity of Board members (years with the Society since 2012)

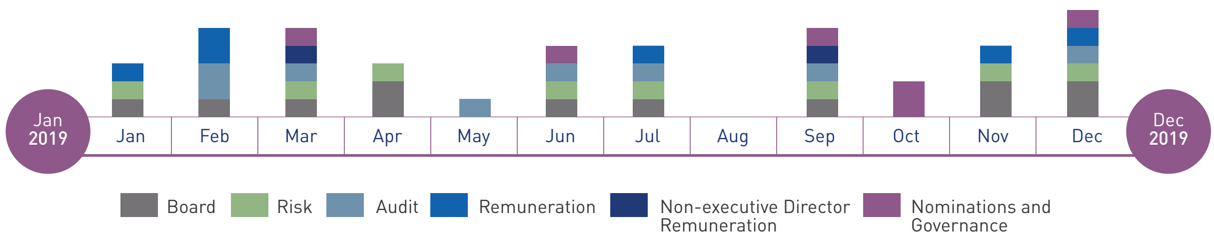


Executive and non-executive director split



The Board's calendar and commitments

The Board and its Committees have a regular cycle of meetings as set out below and will hold additional ad hoc meetings as required.



Meet the Board

Key

- Nominations & Governance Committee
- Remuneration Committee
- Non-executive Director Remuneration Committee
- Board Audit Committee
- Board Risk Committee
- C Denotes Committee Chair

Gary Hoffman
Chair of the Board

JAN 2018

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It is a real privilege to be Chair of a business that is such an important part of the community in the town where I was born and bred. I am proud to be part of the country's second biggest building society and of the great value savings and mortgages we provide to millions of customers. Because we are owned by our members, we can plan to do the right thing for them now and in the future without having to focus on profit all of the time.

My career has given me significant experience in UK financial services spanning 26 years. I started my career at Barclays where I had a number of senior roles including Group Vice Chair, Chair of UK Banking, and Chief Executive for UK Retail Banking and Group CEO of Barclaycard. Following that I have been Chief Executive of both Northern Rock and Hastings Insurance Group. I was also Chair of Visa Europe and served on the board of Visa Inc. for 17 years.

External appointments

I am also Chair of Hastings Group and have been Chair of Monzo Bank since February 2019. I was Chair of the Football Foundation until the end of December 2019.

Mark Parsons
Chief Executive and Executive Director

JUL 2014

I have been Chief Executive of the Society since 2014, and announced my plan to retire in 2019. My role as Chief Executive has been to lead the executive management team and develop the Society's strategy. During my time at the Society our mission has been a simple one – Putting Members First.

This commitment is at the heart of everything we do here, and has ensured the enduring success of the organisation. It has been my privilege to lead our colleagues in doing this for the last five years.

I have spent more than 30 years working within retail financial services in roles at Barclays and Abbey National, in addition to spending time at PwC. At Barclays I was the Chief Financial Officer for Retail and Business Banking, and also served as the Deputy Chief Executive of Barclays UK Retail Bank.

External appointments

I am a Board member of the trade association, UK Finance.

Iraj Amiri
Independent
Non-executive Director

JUN 2018

C

I joined the Society in 2018. I am Chair of the Board Audit Committee and a member of the Board Risk Committee.

My role as Chair of the Board Audit Committee is to ensure that the Society operates effective internal controls and delivers external financial reporting which is fair, balanced and understandable and in line with accounting standards.

I am delighted to be part of a Society which focuses on the needs of its members and on improving their financial well-being. I am proud of our mutual focus and privileged to be part of a team that demonstrates our CARES values on a daily basis.

Throughout my career I have gained significant expertise within Internal Audit and Risk Management, having spent 20 years within Deloitte as the lead partner for the National Internal Audit Group. I also served as Global Head of Internal Audit for Schroders Plc and I have held various non-executive roles within the financial services sector.

External appointments
I am the Chair of the Audit Committee at Development Bank of Wales plc and a member of the Regulatory Decisions Committee at the Financial Conduct Authority.

Peter Ayliffe
Deputy Chair of the Board

MAY 2013

I have been at the Society for nearly seven years. As Deputy Chair, I lead Board engagement with our employee forum, My Society, making sure that the views of colleagues are represented in the boardroom. I am delighted to hold this role as it supports our people in delivering great service to our members.

A fundamental part of our business model is returning as much value to our members as possible. To do this we must focus on growth whilst remaining low risk and spending our members' money wisely. I am proud to be part of a Society that continues to stay true to these principles.

Before joining the Society I spent over 40 years working in the retail banking and payments sector. I was President and Chief Executive Officer at Visa Europe and a main Board Director with Lloyds TSB, responsible for retail banking.

External appointments
I am a trustee of the Pennies Foundation which raises money for charity through collecting small change donations when paying by card in stores or online.

Andy Deeks
Executive Director

APR 2017

My role as Product, Marketing and Strategy Director is dedicated to finding ways to improve our products, services and communications to ensure they remain relevant for tomorrow, whilst staying true to our Members First principles.

I am extremely proud to be a director at the Society and I firmly believe that our mission and purpose feel more relevant today than ever.

I have more than ten years' experience at the Society and have previously worked as a consultant within the UK financial services sector.

External appointments
None

Catherine Doran
Independent
Non-executive Director

AUG 2016

I have served as a non-executive Director at the Society for four years. My role as a member of both the Board Risk Committee and the Remuneration Committee is to ensure that the Society responds appropriately to the risks that it faces and that our reward packages help us to motivate and retain our people.

I have been very impressed by the Society's commitment and dedication to its members and colleagues and I am excited to contribute to the Society's change agenda. Our future plans will allow us to build new capabilities and enhance our technologies in order to ensure continued success.

I have a background in technology and business transformation developed in senior roles in a number of blue chip companies including BT, NatWest Bank, Capital One and Network Rail. I most recently served as the Chief Information Officer of Royal Mail plc, and have held a number of non-executive roles.

External appointments
None

Michele Faull
Executive Director

APR 2017

I have spent nearly three years as the Society's Chief Financial Officer and my role is to ensure that we have enough capital and liquidity to remain safe and secure, and that we can return as much value to members as possible whilst investing in our services and infrastructure. I also look after our external financial reporting and manage our relationships with investors.

I am extremely proud to work at an organisation which remains true to its mutual focus and is able to take a long term member-focused approach to decision making because of this. I am delighted by the support we give to the wider community and to our home city of Coventry.

Prior to joining the Society I had 14 years' experience of working within senior finance and risk roles within the financial services sector. I have previously held the positions of Group Risk Director and Director of Financial Reporting and Tax at Nationwide Building Society and Financial Controller at Aviva Europe. At the start of my career, I worked in professional services and was a tax partner for PwC.

External appointments
I am privileged to support the community in Coventry as a member of Coventry Cathedral's Finance committee.

Peter Frost
Executive Director

NOV 2012

I have been the Society's Chief Operating Officer for the last seven years. I am responsible for managing our day to day operations including IT and business change.

It is a great privilege to work in an organisation where everyone is focused on doing the right thing, which is critical to delivering excellent service for members. Working in a member owned business my teams can focus on the things that make a difference to our members rather than being distracted by the requirements of shareholders.

Prior to this, I spent over 25 years working within the UK retail financial services sector, including serving as Operations Director of UK Retail Operations at Barclays Bank. I have also held non-executive roles at Vaultex and Intelligent Processing Solutions.

External appointments
I am a Governor and Chair of the Resources Committee of Little Heath Primary School in Coventry, supporting our local community.

Jo Kendrick
Senior independent Director
NOV 2017

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As Chair of the Remuneration Committee I am responsible for ensuring that we reward our people fairly and consistently, balancing the needs of our people and our members. I am also a member of the Nominations and Governance and Board Audit Committees. I am absolutely delighted to be part of a Society that is passionate about its purpose and providing value and service to its members, in a way that sets it apart.

I have always worked in customer facing roles and I strongly believe that an organisation that puts its customers first will be successful in the long term and that having a clear purpose beyond simply making money is vital. I started my career at Mars Confectionery before taking executive roles at Camelot Group Plc, B&Q plc and Homebase Limited. My financial services experience started when I served on the board of the Principality Building Society.

External appointments
I am currently a non-executive director of Dŵr Cymru Welsh Water, Safestore Holdings plc and Mobile Payments Service Company Limited (Pay.UK). I work with Pay.UK, the payment provider, in a range of roles including chairing the Current Account Switch Service.

Shamira Mohammed
Independent Non-executive Director
MAY 2019

I joined the Society in May 2019 and serve as a non-executive director and a member of the Board Audit Committee.

As a member of the Board Audit Committee I bring recent relevant experience to the Board, and help to ensure that we apply accounting judgements appropriately.

I believe that the key to the Society's success is our simple business model which focuses on maintaining low costs to deliver long term value to its members. I am very excited to be a part of the Society's transformation programme that will ensure it keeps pace with technological developments to benefit the members of tomorrow.

I am a chartered accountant with over 20 years experience within the financial services sector and I am currently working as Group Chief Accounting Officer of Aviva plc. At Phoenix Plc I was Finance Director for the Phoenix Life Division and Finance Acquisition Director. Throughout my career I have built experience of financial reporting, acquisitions and change management.

External appointments
I am a member of the boards of a number of Aviva Group Companies, General Accident plc, Friends Life Holdings plc and Pezula Limited.

Martin Stewart
Independent Non-executive Director
SEPT 2018

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I joined the Society in 2018 and Chair the Board Risk Committee and am a member of Board Audit Committee. In doing so, I oversee the Society's risk management and control environment, to make sure it remains financially strong and a safe home for members' savings, now and in the longer term and I am a strong advocate of our below median risk philosophy.

I am proud to be a part of an organisation that puts its communities at the heart of everything it does, not only in Coventry but across all of its branch locations in the UK. I am delighted that we are involved with Coventry's City of Culture activity and I expect that 2020 will be a very exciting year for the city as we prepare for this.

Before joining the Society, I was Director of Banks, Building Societies and Credit Unions at the Bank of England and Head of UK Banks and Mutuals at the Financial Services Authority (now Financial Conduct Authority). My career within the mutual sector began at the Yorkshire Building Society where I spent 10 years working in various senior roles.

External appointments
I am Advisory Board Member of OakNorth Bank plc and a visiting professor at the London Institute of Banking & Finance.

Directors' Report on Corporate Governance

Dear Member

I am pleased to report to you on the Society's corporate governance arrangements in my capacity as Chair of the Board. As Chair it is my responsibility to ensure that the Board works effectively to promote the long term sustainable success of the Society and maintains its high standard of corporate governance. The Board achieves this through the operation of an effective corporate governance framework.

Last year, my report talked about the introduction of the 2018 UK Corporate Governance Code (the Code). This year, I am pleased to update you on the changes that have been made to comply with this and how these have impacted the Society's operations.

The Code and recent legal changes in connection with Section 172 of the Companies Act 2006 emphasise the importance of maintaining successful relationships with key stakeholders and encourage effective engagement with them, to promote the success of the business. The Society welcomes these changes and believes they are consistent with the approach to building a sustainable business which the Society has taken over many years. During 2019, we have continued to evolve the Society's strategic planning process to take account more explicitly of all our stakeholders including members (both savers and borrowers), colleagues, intermediaries, suppliers and investors as well as the wider society.

In 2017 the Society established an employee forum known as 'My Society'. Consistent with the developments in the Code, this forum has been enhanced through 2019 to enable greater engagement between colleagues and the Board. Our Deputy Chair, Peter Ayliffe, attends the My Society forum and as a part of his role he provides the forum with the views of the Board and an insight into the Board's activities. He also represents the views of the Society's employees to the Board. I am encouraged by these developments and believe that they have been effective in shaping the Society's strategy through the year.

Notwithstanding the broader stakeholder agenda, the Society's principal focus remains on Putting Members First.

Another key principle highlighted in the Code is the need for a clear purpose and strategy and healthy business culture. At the Society, we are proud of the strong CARES values that underpin our culture and shape the way in which we conduct our business. We are supportive of the Code's initiatives on culture. We will report more on our work in this area over the course of the next year. In the meantime we remain committed to the ongoing development of the Society's culture. The Board will continue to assess and monitor progress in this area.

The composition of the Board has changed over the course of the year as outlined in my opening statement and set out below. Throughout 2019 the Board has continued to establish a pipeline of executive and non-executive talent. The Board recognises the importance of having a blend of skills, experience and knowledge. On this note I am pleased to welcome Shamira Mohammed as non-executive director and Steve Hughes as our new Chief Executive.

The Board believes diverse leadership is a recipe for balanced decision making. All Society recruitment, including Board appointments, is carried out in line with the Society's approach to diversity and inclusion. Improving gender balance is an important part of this. The Board set a target to achieve 33% female membership by the end of 2019. This target was exceeded, with 36% female membership as at the end of 2019. The Board is supportive of increasing the proportion of female directors and, in line with the Hampton-Alexander Review, has the ambition to increase female representation on the Board to 50% by 2024.

Gary Hoffman
Chair of the Board
27 February 2020

Directors' Report on Corporate Governance continued

Report on Corporate Governance

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

UK Corporate Governance Code

The Society is committed to effective corporate governance and has applied the Principles and Provisions of the Code. The exception to this are the provisions relating to major shareholder dialogue which do not apply given the Society's legal form and mutual ownership structure. The Society is committed to maintaining effective dialogue with its members and details of engagement activities are included in the Member relations section below and the Strategic Report. Details of how the Society works strategically with its wider stakeholder groups to deliver its mission and purpose are set out in the Strategic Report.

The Board

The Board defines the Society's purpose and sets a strategy to deliver it, underpinned by the values and behaviours that shape its culture and the way it conducts its business. In this way, the Board sets the overall direction of the Society and is responsible for its long term success. The directors collectively have a general duty to ensure that the Society acts in accordance with its Rules and all applicable laws and regulations.

The Board's responsibilities

- Setting the culture and values of the Society.
- Challenging and approving the Strategic Plan and monitoring performance against it.
- Setting appropriate governance arrangements and ensuring that the Society operates within its Rules, regulatory requirements and applicable laws.
- Ensuring adequate Board and executive succession planning and approving key appointments.
- Setting the Society's Remuneration Policy and approving the remuneration of directors and executives.
- Approving and overseeing delivery of significant projects and contracts.
- Agreeing the principal risks faced by the Society, and reviewing and setting the Society's risk appetite.
- Ensuring the Society has adequate capital, liquidity and funding including oversight of significant treasury transactions.
- Approving significant member communications, such as the Annual Report & Accounts, and overseeing member engagement.

Activities during 2019

Notably, the Board:

- Considered the Society's culture, member experience and service, and how this aligned with the Strategic Plan and the Society's mission of Putting Members First.
- Reviewed and agreed the Society's long term strategy.
- Monitored progress on a number of key issues such as; delivery of the People Strategy including diversity, wellbeing and employee engagement; and compliance with regulatory and legal provisions relevant to moving services to the cloud.
- Considered feedback from the My Society forum.
- Reviewed and approved a number of policies including: the Board's lending; health and safety; and treasury credit limits policies.
- Received reports on money laundering and whistleblowing.
- Reviewed and approved strategic decisions relating to IT systems development and commissioned 'lessons learned' reports.
- Monitored the progress of key change and technology projects, approving expenditure where required and providing strategic direction in this area.
- Considered the risks faced by the Society, reviewed and set its risk appetite and approved the Society's Enterprise Risk Management Framework.
- Received and constructively challenged assurance reports from the Chief Executive and other executive directors on the Society's performance, including financial performance, relevant external developments and other significant matters.
- Considered and approved the refinancing of the Society's Additional Tier 1 (AT 1) capital.
- Approved the Society's internal capital and liquidity adequacy assessments, including review of reverse stress testing scenarios which could adversely affect viability.
- Approved the Society's Recovery Plan after review by the Board Risk Committee.
- Approved the publication of the Annual Report & Accounts, Pillar 3 risk disclosures and the Interim Financial Report.
- Considered the results of an independent audit on the effectiveness of the Board and its Committees and determined the remit of the Board and its Committees.
- Approved the division of responsibilities of the roles of Chair, Chief Executive and the executives and reviewed key documentation relating to the Senior Managers Regime.
- 12 Board meetings were held during 2019; three were specifically called for the following matters:
  - A meeting held immediately after the 2019 AGM to elect the Chair and Deputy Chair of the Board.
  - A meeting held to discuss the appointment of Steve Hughes as Chief Executive of the Society.
  - A meeting to discuss market disclosure of CET 1 capital.
- In addition, the Board held two off-site strategy days to contribute to the Society's strategic planning process.

Delegation of authority

The Board delegates certain detailed matters to its Committees or to the Chief Executive to make best use of the knowledge, skills and experience on the Board.

The Board has documented this arrangement and reviews it annually.

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

The Board oversees its Committees by receiving reports from the Committee Chairs following each meeting. Each Committee carries out a review of its own effectiveness annually, including an assessment of its compliance with its terms of reference, published guidance and best practice. All Board Committees were confirmed as effective during 2019.

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

Board of Directors

Brief biographies of the directors are included in the Board of Directors section. Details of those seeking election and re-election can be found in the Notice of the 2020 AGM.

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

Changes to the Board during 2019, are as follows:

Roger Burnell	NED	Resigned April 2019
Shamira Mohammed	NED	Appointed May 2019

Independence

In January 2020, the Board reviewed the independence of its non-executive directors. In line with the Code, it considered whether there were any relationships or circumstances that were likely to affect, or could appear to affect, a director's independence.

In the opinion of the Board, Peter Ayliffe, Catherine Doran, Jo Kenrick, Iraj Amiri and Martin Stewart satisfy the requirements for independence and have demonstrated this in their character and judgement. The Board considered Shamira Mohammed was independent when appointed as non-executive director in May 2019. A letter of appointment for Shamira Mohammed is available from the General Counsel and Secretary on request. Details of the directors' external appointments are in the Annual Business Statement.

Time commitment

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

Independent advice and insurance

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

Chair of the Board and Chief Executive

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

Deputy Chair

The principal role of the Deputy Chair is to deputise for the Chair of the Board at meetings of the Board and to support the Chair of the Board in his role. In addition, the Deputy Chair has specific responsibility to represent the views and interests of the Society's employees to the Board. As a part of his Deputy Chair role, Peter Ayliffe attends quarterly meetings of the My Society forum as described above. The views of the My Society members have informed Board discussion on a number of matters, including strategy and culture.

Senior Independent Director

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

In conjunction with the other directors, the Senior Independent Director evaluates the performance of the Chair of the Board and leads succession planning for the role of the Chair of the Board. Roger Burnell carried out the role of the Senior Independent Director until the 2019 AGM when he retired from the Board. Following this, Jo Kenrick, was appointed as Senior Independent Director of the Society.

Training and development

New directors receive formal induction training on joining the Board. The training is tailored to the needs of each director given their existing knowledge and experience, and any Committees on which they will serve.
Training covers key aspects of the Society's business.

Established directors continue their professional development and maintain their knowledge of the Society's operations through branch and department visits and formal training overseen by the Nominations and Governance Committee in line with Board training policy. During 2019 training sessions included: Cyber Security; Corporate Governance; Hedge Accounting; Effective Interest Rate approach; Operational Resilience; and The Bank of England Risk Reduction Framework.

Directors' Report on Corporate Governance continued

Board and Board Committee attendance 2019

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

Name	Title	Board	Board Risk Committee	Board Audit Committee	Remuneration Committee	Non-executive Directors' Remuneration Committee	Nominations and Governance Committee
Gary Hoffman[1]	Chair of the Board	12/12			5/6	2/2	6/6
Peter Ayliffe	Deputy Chair	12/12	8/8		6/6		6/6
Iraj Amiri[2]	Non-executive Director	12/12	8/8	8/8			
Roger Burnell[3]	Non-executive Director	4/4	3/3	3/3			1/1
Andy Deeks	Product, Marketing and Strategy Director	12/12					
Catherine Doran	Non-executive Director	10/12	8/8		6/6		
Michele Faull	Chief Financial Officer	12/12				2/2	
Peter Frost	Chief Operating Officer	12/12					
Jo Kenrick[4]	Non-executive Director	12/12		8/8	6/6		6/6
Mark Parsons	Chief Executive	12/12				2/2	
Shamira Mohammed[5]	Non-executive Director	7/7		5/5			
Martin Stewart[6]	Non-executive Director	12/12	8/8	7/8			

1. Chair of the Board and Chair of Nominations and Governance Committee.
2. Chair of the Board Audit Committee.
3. Served on the Board until 24.04.2019.
4. Chair of the Remuneration Committee.
5. Non–executive Director and member of the Board Audit Committee from 01.05.2019.
6. Chair of the Board Risk Committee.

Board effectiveness

The Board reviews its performance annually, with the last internal review in December 2019. Each Board member considered the effectiveness of the Board against its terms of reference.

The Code requires boards to undertake an externally facilitated review of effectiveness every three years. The Nominations and Governance Committee chose Independent Audit Limited to undertake this work during December 2018 and the results of the external effectiveness review were reported to the Board in January 2019. The Board and its Committees were found to be operating effectively. Independent Audit Limited has no connection with the Society or individual directors of the Society. The Chair of the Board appraised the directors' performance.

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

Member relations

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

All directors attended and were available to answer questions at the Society's 2019 AGM.

All members who are eligible to vote at the 2020 AGM are encouraged to do so by one of the following means:

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

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

Culture

One of the main responsibilities of the Board is to set the culture and values for the Society. The Code is explicit in its expectation of boards to ensure an organisation's culture is aligned with its purpose and business strategy. The Board discharges this obligation through various activities, including receiving regular management information which provides insight into culture, consideration of specific agenda items with relevance to culture, and undertaking various activities outside formal Board meetings, such as branch and departmental visits, to enhance its understanding of the Society's culture.

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

Internal controls and risk management

The Risk Management Report explains each inherent risk category, and provides information on specific risks faced by the Society and what is done to mitigate each risk.

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

- Receiving reports, which are scrutinised by the Board Audit Committee, from the Internal Audit function. The reports outline the results of Internal Audit reviews. More information is included in the Board Audit Committee Report. The Chief Internal Auditor reports directly to the Board Audit Committee Chair.
- Receiving reviews of the effectiveness of the Enterprise Risk Management Framework by the Chief Risk Officer, the conclusions of which are reported to the Board Risk Committee and to the Board.
- The Chief Risk Officer presents at each meeting of the Board a risk report which covers current and emerging risks and how they are being managed.
- Reviewing lessons learned following risk or internal incidents and considering management's response to them.
- Receiving reports, which are scrutinised by the Board Risk Committee, from the Risk function on the principal risks facing the Society and the adequacy of the controls in place to mitigate such risks. The Chief Risk Officer has an independent reporting line to the Chair of the Board Risk Committee.

The Board confirms that a robust assessment of the risks facing the Society, including risks that would threaten the Society's business model, future performance, solvency or liquidity, has been carried out. In addition, the Board has considered carefully the risk incidents and associated lessons learned. The Board is satisfied that during 2019, the Society maintained adequate risk management arrangements and systems of internal control appropriate to the Society's size and scale, strategy and risk profile.

Nominations and Governance Committee Report

Dear Member

I am pleased to present to you the report of the Nominations and Governance Committee for 2019.

Current membership[1]	Member since
Gary Hoffman	2018
Jo Kenrick	2018
Peter Ayliffe	2014

1. Roger Burnell was a member of the Committee until April 2019.

UK Corporate Governance Code

The Committee is responsible for reviewing developments in corporate governance to ensure the Board maintains a high standard of compliance in this area.

The Society has fully incorporated the July 2018 changes in the Code relating to length of service, overboarding, evaluation, diversity and executive pay.

Directors' Report on Corporate Governance continued

Succession planning and policy

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

In 2019, the Committee focused on succession planning and contingency planning. There was continued emphasis on the search for non-executives to fill key Board roles.

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

In May 2019 the Committee recommended to the Board the appointment of Shamira Mohammed as non-executive director. The Committee also oversaw the rigorous recruitment process for the new Chief Executive.

Diversity

The Society values and promotes diversity and inclusion. The Committee and the Board are active sponsors of the Society's inclusion agenda.

The Society works with specialist search advisors in relation to executive and non-executive director appointments, and diversity and inclusion credentials are a key factor in selecting advisors. In 2019, the Committee used the services of advisors who were selected for their market expertise as well as their track record of making placements of diverse candidates. Active management of shortlisting by the Committee has been important to improving diversity on the Board and the following appointments were made:

Director		Search firm
Steve Hughes	Chief Executive Officer	Russell Reynolds Associates
Shamira Mohammed	Non-executive Director	Ridgeway Partners

Neither firm has any connection with the Society or individual directors of the Society.

Time commitment

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

Governance

The Committee takes an active role in reviewing the effectiveness of the Board and its Committees. In January 2019, the Committee reviewed the results of the Board Independent Audit Report and during the year it has monitored the Board's progress against the follow-up actions recommended by the Independent Auditor.

The Committee also has responsibility for reviewing the matters reserved to the Board, considering conflicts of interest and reviewing governance related policies, including those relating to the Senior Managers Regime (SMR). The Committee oversees the application of the Fit and Proper Policy and other SMR related policies to ensure compliance with this area of regulation.

Other key activities in 2019

In addition to the points already covered, the Committee:

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

Annual election/re-election

The Board has considered the provisions of the Code relating to re-election of directors, and considers that it is in the best interests of members to submit the entire Board for annual re-election. This means all directors who were re-elected at the 2019 AGM have voluntarily submitted themselves for re-election, with the exception of Mark Parsons who will retire in April 2020.

Gary Hoffman
Chair of the Nominations and Governance Committee
27 February 2020

Board Risk Committee Report

Board Risk Committee

Dear Member

I am pleased to present the Board Risk Committee (the Committee) report for the year ended 31 December 2019.

The Board Risk Committee is a sub-committee of the Board and the most senior risk committee within the Society. It has delegated authority from the Board and assists the Board in fulfilling its responsibilities for risk management across the Society. Its responsibilities include the following:

- Providing oversight and advice to the Board in relation to current and potential future risk exposures of the Society and risk strategy, including determination of risk appetite and the effectiveness of the Society's framework for managing risk.
- Promoting a risk culture that puts Members First within the Society and overseeing implementation and maintenance of the Society's Enterprise Risk Management Framework (ERMF).
- Reviewing key risk policies and frameworks, including key risk appetite statements.
- Ensuring the executive are held to account to identify, assess and manage risks in accordance with the requirements of the ERMF.
- Monitoring risks on behalf of the Board.

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

Martin Stewart
Chair of the Board Risk Committee
27 February 2020

Committee membership

The members of the Committee are detailed below:

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

1. Roger Burnell was a member of the Committee until April 2019.

At each meeting the Committee considered a consolidated risk report from the Chief Risk Officer. In addition, during 2019 the Committee:

- Reviewed the strategic and emerging risks within the Society's 2020-2024 Strategic Plan.
- Reviewed the Society's Enterprise Risk Management Framework and recommended it for approval by the Board.
- Reviewed the Society's risk appetite including risk limits and risk indicator categories for each principal risk category.
- Agreed an integrated risk assurance plan, and monitored second line risk oversight and progress in delivering a programme of thematic reviews.
- Reviewed the Conduct Risk Framework.
- Received assurance from the Chief Risk Officer that employees are risk aware and encouraged to contribute to identifying and managing risks faced by the Society.
- Reviewed risk matters relevant to the Society's IT capabilities and sought assurance as to the effectiveness of IT systems and business continuity arrangements including operational resilience.
- Reviewed assurance reports relating to the Society's strategic investment programmes.
- Scrutinised internal assessments of capital and liquidity resources, including a range of stress testing and reverse stress scenarios, prior to the Board providing its approval and reviewed and approved the Society's Recovery Plan.
- Reviewed treasury credit limits and Board policy on Treasury Risk before recommending to the Board for approval.
- Received reports on lending policy and processes in place to meet with regulatory expectations including detailed consideration of the Society's credit position.
- Undertook additional responsibilities to manage and oversee the risks of the Society's outsourcing arrangements.
- Reviewed the processes and procedures implemented by the Society in compliance with new EBA Outsourcing Guidelines.
- Reviewed the Financial Crime Policy and received a report from the Money Laundering Reporting Officer.
- Considered the impact on the Model Risk Framework from the Society's RWA correction announced to the market in December 2019.

Please refer to the Strategic Report for the principal risks facing the Society as well as a summary of the inherent risks in the Society's business model. The Risk Management Report contains information relating to how risk is managed across the Society.

Board Audit Committee Report

Board Audit Committee

Dear Member

I am pleased to present our 2019 Board Audit Committee Report. I have been Chair of the Board Audit Committee (the Committee) since September 2018. This year Shamira Mohammed joined the Committee, bringing extensive experience of finance and the financial services sector.

In 2019, the Committee continued to review and challenge the Society's financial reporting, in addition to monitoring the effectiveness of internal controls and overseeing the work of the Internal Audit function.

We have also overseen the transition of the external auditors during the year, following the appointment of PricewaterhouseCoopers LLP as auditors for the 2019 year end.

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

- Monitoring the integrity of the Society's external reporting including reviewing significant financial reporting judgements and the interim and annual financial statements, summary financial statements and Pillar 3 disclosures.
- Providing assurance to the Board that the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for members and other stakeholders to assess the Society's position and performance, business model and strategy.
- Reviewing the effectiveness of the Society's internal controls and risk management systems.
- Recommending the appointment and approving the remuneration and terms of engagement of the external auditors.
- Monitoring the external auditor's independence and objectivity, and assessing the effectiveness of the external audit process.
- Overseeing the Society's procedures and policies for maintaining probity including whistleblowing, assessing their effectiveness and reviewing a report on the effectiveness of whistleblowing procedures on an annual basis prior to submission to the Board.
- Reviewing the activities, findings and performance of Internal Audit and approving the appointment and remuneration of the Chief Internal Auditor.

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

Iraj Amiri
Chair of the Board Audit Committee
27 February 2020

Committee membership and attendees

The members of the Committee are detailed below.

Current membership[1]	Member since
Iraj Amiri	2018
Jo Kenrick	2017
Shamira Mohammed[2]	2019
Martin Stewart	2018

1. Roger Burnell was a member of the Committee until April 2019.
2. Shamira Mohammed joined the Committee in May 2019

The Committee met eight times during 2019. All Committee meetings are routinely attended by the Chief Executive, Chief Financial Officer, Chief Risk Officer, General Counsel and Secretary, Chief Internal Auditor and the external auditors. Other senior managers are invited to attend meetings as required. The Committee meet both the Chief Internal Auditor and the external auditors without management present at least twice a year to enable issues to be raised privately if necessary. The Committee Chair also meets privately with the Chief Internal Auditor and the external auditor on a regular basis.

The Board is satisfied that all committee members have recent and relevant financial services sector experience and that both Iraj Amiri and Shamira Mohammed are professionally qualified accountants.

During 2019, the Committee completed its annual review of its terms of reference and its roles and responsibilities against the Financial Reporting Council's (FRC) Guidance on Audit Committees. This exercise did not result in any significant changes to the Committee's responsibilities.

Transition to new external auditor

Following the approval of PricewaterhouseCoopers LLP (PwC) as external auditor at the 2019 AGM, the Committee and the Society's management team worked closely with EY and PwC to ensure a smooth transition of auditors. During 2019 the Committee has reviewed reports from PwC which have set out the transition progress and audit plan for the year. The overall effectiveness of the 2019 external audit process will be considered by the Committee during May 2020, with a specific focus on the process and success of the transition to PwC.

Key areas of focus during 2019

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

Preparation of Financial Statements and key areas of judgement

When assessing both the interim and full year 2019 financial statements, the Committee considered carefully areas subject to management judgement which included the following:

Revenue recognition and EIR methodology

The Society recognises income on its mortgage loans using the Effective Interest Rate (EIR) method. This applies a rate of return that reflects a constant income yield over the expected life of the mortgage loan based on expectations of future loan redemption and interest rates. The EIR calculation is most sensitive to current assumptions on loan redemption and the difference between fixed rates and Standard Variable rates in the future.

The Committee reviewed the EIR calculation methodology, in addition to the key assumptions used. The Committee concluded that the asset valuation was appropriate.

Calculation of Expected Credit Loss provisions under IFRS 9

The Committee has continued to review the appropriate adoption of IFRS 9 accounting policies during 2019.

The Committee reviewed the Expected Credit Loss (ECL) for loans and advances to customers in the financial statements and the basis of calculation. This included the method of determining a significant increase in credit risk and the application of management judgement relating to specific provisions. The Committee also reviewed the appropriateness of non-modelled overlays which have been applied to the ECL provision. The sensitivity of the provision calculation to various assumptions was considered, including the impact of alternative forward looking economic scenarios and their weighting. The Committee was satisfied with the adequacy of the provisions.

Derivatives and hedge accounting

The Committee reviewed the Society's approach to hedge accounting. Derivatives are used by the Society solely for risk management purposes, to manage either interest rate risk or foreign exchange risk and the Society uses hedge accounting to reduce income statement volatility arising from fair value accounted derivatives. The Committee has reviewed the Finance team's control activities and reports from the external auditors on the methodology, process and key assumptions applied to the Society's hedge accounting activity. In particular, the Committee has reviewed the approach for hedge accounting relating to mortgage pipeline swaps and for the Society's equity release mortgage portfolio. The Committee is satisfied that the amounts recognised in the Financial Statements are appropriately stated.

Other matters relevant to the Financial Statements

The Committee considered the accounting treatment for the repurchase of the Society's 2014 Additional Tier 1 (AT 1) instruments, and issuance of £415 million new AT 1 instruments which was completed during the year.

The Committee also considered the calculation of the Society's defined benefit pension obligations and the assumptions which are used to calculate the liability. More information on this is included in note 20 to the accounts.

Going concern and long term viability

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

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

Fair, balanced and understandable

The Committee considered whether the 2019 Annual Report & Accounts taken as a whole were fair, balanced and understandable. The Committee satisfied itself that there was a robust process of review and challenge at different levels within the Society, to ensure balance and consistency and that this is reflected in the Annual Report & Accounts, which included:

- Providing guidance on drafting;
- Making sure all messages are communicated as simply as possible and that all key messages are in the Strategic Report;
- Thorough verification of all factual content;
- Central coordination and thorough review including review by a non-specialist; and
- Comprehensive review by senior executives including the Committees' chair prior to wider Committee consideration.

The Committee also considered other information regarding the Society's performance presented to the Board during the year. After consideration of all relevant information, the Committee concluded that it could report to the Board that the 2019 Annual Report & Accounts are fair, balanced and understandable.

Board Audit Committee Report continued

New accounting standards
Regular updates and training on financial reporting developments were provided to the Committee during the year.

The Committee was updated on the impact of the adoption of IFRS 16 Leases accounting standard, which is applicable for reporting periods beginning on or after 1 January 2019. The Committee was satisfied that the new reporting standard has been implemented appropriately.

The Committee was also updated on the application of amendments to IAS 12 Income Taxes and to the Society's financial statements, in addition to changes to IAS 39, IFRS 7 and IFRS 9 as a result of IBOR transition.

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

The Society's internal control and risk management arrangements
The Committee reviewed the effectiveness of internal control and risk management arrangements through regular reporting from Internal Audit, the Risk function and the external auditor. In addition, the Committee reviewed the assurance statements received from the Chief Internal Auditor on internal control, and from the Chief Risk Officer on risk management.

In this regard the Committee has reviewed the circumstances that gave rise to a correction of the Society's prior period risk weighted assets which was announced in December 2019. It has reviewed management's proposals to enhance the internal control environment for Capital reporting and will oversee the ongoing control enhancements.

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

The Committee received regular reports during 2019 on whistleblowing and concluded that the arrangements were operating effectively and there were no material matters of concern.

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

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

During the year, the Committee oversaw an external review of the effectiveness of the Internal Audit function which considered the quality of work, the appropriateness of skills and resources within the team and compliance with the Chartered Institute of Internal Auditors' Guidance on Effective Internal Audit in the Financial Services Sector. Whilst a number of improvements were recommended, the report confirmed that the Internal Audit function was effective. The Committee is monitoring implementation of actions following the review.

External auditor
As well as discussing external audit findings, the Committee is responsible for overseeing the relationship with the external auditor and the quality of the audit process. During the year this included the following:

Audit plan
Prior to the annual audit commencing, the Committee considered PwC's audit plan including materiality levels, areas of audit focus, terms of engagement and fees payable for the audit. Following the review of the 2019 Interim Financial Report and audit of the annual financial statements, the Committee received a report setting out: the work performed in areas of significant risk and management judgment and conclusions for each area; a summary of adjustments and differences; and internal control recommendations. In recommending approval of the interim and annual financial statements the Committee considered the matters set out in these reports.

Audit quality

The Committee oversees external audit quality. Committee meetings consider factors which impact external audit quality and conclusions on external audit effectiveness are formalised as part of the year end reporting process. The factors considered included:

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

The review also considered the Financial Reporting Council's July 2019 Audit Quality Inspection Report on PwC. The Committee concluded that the external audit process was effective, and it was satisfied that there were no matters of concern with respect to the external auditor's independence or objectivity. The results of the assessment were shared with the lead audit partner so that areas for improvement could be addressed.

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

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

During 2019, the Society engaged the external audit firm to provide certain non-audit services including a review of the Society's Pillar 3 disclosures and assurance work in relation to the Society's debt issuances. All engagements complied with the Society's policy. The Committee received regular updates on the nature and cost of the engagements. Details of the fees paid to the external auditor for audit and non-audit services are set out in notes to the accounts.

The effectiveness of the Committee

The Committee carried out a review of its effectiveness during 2019, including an assessment of its work against its terms of reference, published guidance and best practice. It was concluded that the Committee had operated effectively throughout the year.

Directors' Remuneration Report

Report of the Remuneration Committee to members

Dear Member

I have been Chair of the Remuneration Committee (the Committee) since April 2018. The Committee's purpose is to assist the Board in fulfilling its responsibilities to the Society's members by ensuring that remuneration policy and practices are effective, compliant and reflect the Society's mission, values and strategy as a mutual organisation. I hope that this report will bring to life for you, our members, how we have approached this.

There are two sections to our annual report for 2019: (1) the Remuneration Policy, which confirms the principles that underpin our approach to remuneration; and (2) the Annual Remuneration Report, which confirms how the Policy was implemented in practice.

As a mutual organisation, we believe it is right to understand and be guided by the views of our members in both of these areas. As such, while it is not required by regulation, we choose to submit the Remuneration Policy to an advisory vote of members every three years (or earlier if significant changes are made to it). The annual vote on the Annual Remuneration Report is also advisory and the directors' entitlement to remuneration is not conditional on it. However, in both cases the Committee intends to take account of members' feedback.

This report has been prepared in line with legislation applicable to companies and regulation on executive pay. In particular, the Society has applied the Principles and Provisions of the Financial Reporting Council's UK Corporate Governance Code 2018 and the BSA's Guidance for Building Societies on the Code, issued last year, including those which are applicable to remuneration committees. This is a significant change to the remit of remuneration committees generally, particularly in relation to ensuring greater alignment between executive and employee remuneration and communication with the workforce. This has not been a difficult change to implement given the Society's culture and historic focus on colleagues in its decision making. The Committee's activities, and how these ensure Code compliance, are outlined in this report.

I am confident that the Committee understands and will continue to meet its responsibilities to members, to regulators and to the Society's employees.

Jo Kenrick
Chair of the Remuneration Committee
27 February 2020

Details of the Remuneration Committee

This report covers the Remuneration Policy and Annual Remuneration Report for 2019 and further information is provided below about the Committee, its role and the activities it has overseen in 2019.

Committee membership and attendees

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

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

1. Chair of the Committee since April 2018.

The Committee seeks input from the Human Resources Director, the Head of Reward and HR Services and the Chief Executive, who are invited to attend meetings. The Chief Risk Officer and the General Counsel and Secretary are invitees where appropriate. The Committee also benefits from specialist advice from its independent remuneration advisor (Deloitte LLP).

Governance and the role of the Remuneration Committee

The Committee has overall responsibility for remuneration matters delegated to it by the Board. The Committee's role is to consider the Remuneration Policy and its application to all employees, with particular scrutiny given to the remuneration of executive directors and executive managers. The Policy is considered at least annually, or more frequently in the event of any significant change. The Committee continually assesses the adequacy and effectiveness of the Policy.

All decisions about remuneration reflect the Society's mission, values and purpose. Decisions align with the approach taken for all employees and take account of the long term sustainable success of the Society.

As a mutual organisation, the Committee considers it essential that any variable pay awards are not excessive, and the maximum variable pay that can be awarded in a financial year is significantly below the cap set out in the Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV).

The requirements of the UK Corporate Governance Code in relation to determining executive director remuneration policy have been met. These include ensuring clarity and transparency of policy and arrangements and simplifying remuneration structures, which were considered as part of the Remuneration Policy update. The Committee has also considered and mitigated risk in incentivising the wrong type of behaviour. The Committee's work has involved ensuring predictability in the remuneration structure; considering proportionate awards that reward good performance (for example through approval of the executives' pay proposal for 2019); and aligning policy and practice to the Society's mission, values and strategy. The Committee considers that the Remuneration Policy has operated as intended in terms of the performance of the Society and the quantum of awards.

The Committee ensures that statutory and regulatory requirements are met and that there continues to be a clear link between corporate and individual performance and remuneration decisions.

Activities during 2019

During 2019, the Committee:

- Considered the outturn of the 2018 balanced scorecard and approved the performance measures for the 2019 scorecard.
- Approved variable pay awards under the 2018 Executive Variable Pay Plan (ExVPP), ensuring awards are in line with the Society's Remuneration Policy.
- Approved the 2018 Success Share scheme payment.
- Endorsed the Society's existing Remuneration Policy, including a restatement of the principles that ensure the same pay approach for executive directors and employees.
- Considered external benchmarking data to ensure remuneration remains competitive and appropriate.
- Approved the Society's salary review approach.
- Received a report from the Chief Risk Officer that gave assurance that the Society's remuneration framework had not encouraged excessive risk taking.
- Considered the Chief Risk Officer's annual review of any grounds to recover or withhold variable pay awards.
- Oversaw an assessment of employees whose responsibilities could impact the Society's risk profile.
- Approved the Society's Prudential Regulation Authority (PRA) Remuneration Policy Statement.
- Approved the Directors' Remuneration Report and the Society's new Remuneration Policy.

The Committee also undertook the following activities in 2019:

- Agreed the principles and provided oversight for a review of the Society's reward framework affecting all employees.
- Received updates from the Committee's advisors and from the Society's secretarial function.
- Considered the Society's gender pay ratios and CEO pay ratio and committed to future diversity and inclusion actions.
- Reviewed and applied downward discretion to the retained variable payments (see below).
- Engaged with the workforce through My Society, the Society's employee forum, to explain the work of the Committee and to take feedback from representatives.

Directors' Remuneration Report continued

Remuneration Policy

The Society's Remuneration Policy is determined by the Remuneration Committee and confirms the principles that underpin its approach to remuneration. This section of the report provides information about the Policy review that has been undertaken, the principles that underpin the Policy and the key elements of the Policy.

Approach to the Remuneration Policy review

It has been three years since the Committee last asked the Society's members to vote on the Remuneration Policy. A lot has happened in that time. There have been significant changes in the regulatory landscape with the introduction of the UK Corporate Governance Code, gender pay gap reporting and CEO pay ratio reporting. In October the Society made changes to its reward framework to increase consistency, make things simpler to understand for employees and support wellbeing. The updated Remuneration Policy reflects these changes. Variable pay opportunity and benefits are unchanged except for pension contributions, where the Committee has resolved to reduce pension contributions for all future executive director and executive manager appointments (see below).

The Committee asked its advisors, Deloitte LLP, to contribute to the review of the Remuneration Policy to ensure that the Society aligns with current best practice and regulatory requirements, and anticipate future regulatory changes. The Policy will apply for three years following the advisory vote at the 2020 AGM.

The Remuneration Policy is designed to reward all employees for their skills, knowledge, responsibilities and performance. When making any decisions about pay and benefits the Society must strike a balance between the needs of employees, the needs of members to ensure cost efficiency and the requirements of its regulators. The Society's ultimate objective is to offer a remuneration package (pay, benefits and non-financial rewards) that is competitive when compared with similar financial services organisations and that is also fair and appropriate for the size of organisation we are. The principles of the Remuneration Policy apply to all employees, including executives across the whole Society. All fixed and variable remuneration (with the exception of benefits in kind such as private medical insurance and cars, where applicable) are paid through the payroll.

In determining remuneration approach, the Society works with its employee forum, My Society, and the trade union, UNITE, to ensure that employees' views are understood and represented.

The Society follows the PRA's Code on Remuneration Practices and Disclosure Requirements and in addition aligns the Policy with the PRA's best practice guidelines and the UK Corporate Governance Code where applicable. The Remuneration Policy is consistent with the Society's risk appetite and is designed to support the overall financial stability of the Society and its strategic priorities, by promoting sound and effective risk management and not encouraging excessive risk taking.

The Remuneration Policy is based on two further principles:

- It must reflect our mission, purpose and values, and the expectations of our members.
- It must support the Society to recruit, motivate, engage and retain great people.

The main elements of executive remuneration

The main elements of remuneration in place for the executive leadership of the Society, executive directors who sit on the Board and executive managers, are set out below with an explanation of how each element links to our overall business strategy:

Base salary	
Purpose and link to strategy	Salaries of executive directors are set with reference to market rates of pay to enable the Society to recruit, retain and motivate high calibre leaders.
Operation	Executive director salaries are reviewed annually with any increases taking effect from 1 April, taking into account a number of factors, including: • The scope and size of role. • The skills, experience, and responsibility of the role holder. • The position of the role holder's salary against wider market rates of pay and their individual performance. • Equal pay principles, the Society's financial performance and the economic environment. • Increases awarded to the Society's employees. Where an executive director is to be promoted or where their role is to be expanded the Society will review the salary and decide whether an adjustment is appropriate.
Risk mitigation	Executive director salaries are benchmarked against comparable financial services organisations to ensure they are not excessive. No executive director is involved in setting their own remuneration or exercising discretion over judgements that could influence their own remuneration.
Maximum potential	Any increases will generally be in line with increases applied to the Society's employees (in percentage terms). Increases may be made either above or below that level in appropriate circumstances, taking into account the factors outlined above.
Performance metrics	Individual performance is considered when setting salaries.
Application to other employees	The Society uses the same approach when setting salaries for all its' employees.

Benefits (excluding pension)	
Purpose and link to strategy	The Society provides a competitive benefits package to all its employees to support their physical, mental and financial wellbeing.
Operation	Each executive director receives benefits that are in line with the external market. These include a company car or cash alternative, private medical insurance, health screening, permanent health insurance and life insurance.
Risk mitigation	Not applicable.
Maximum potential	Not applicable.
Performance metrics	Not applicable.
Application to other employees	All employees receive permanent health insurance and life insurance and many also receive private medical insurance. Executive directors do not receive any benefits that are unavailable to other senior managers within the Society.

Pension	
Purpose and link to strategy	The Society provides post-retirement financial security for all its employees at a cost that is sustainable for the Society over the long term.
Operation	Executive directors are eligible to participate in the defined contribution pension plan. If their contributions exceed the annual or lifetime allowance, they may be permitted to take a cash alternative in place of contributions.
Risk mitigation	No executive director is involved in exercising discretion over judgements that could influence their level of pension contribution.
Maximum potential	Executive directors receive a pension contribution or cash alternative. This is 20% of base salary for the Chief Executive and 15% for other executive directors. Future executive director appointees (including the CEO) will receive 10%, in line with all new employees.
Performance metrics	Not applicable.
Application to other employees	All employees are eligible to join the Society's defined contribution pension scheme, receiving contributions of up to 10%, (or 15% for members of the now closed defined benefit pension scheme).

Directors' Remuneration Report continued

Annual Success Share bonus	
Purpose and link to strategy	Success Share is a key part of the Society's remuneration package. It is a discretionary variable pay scheme that enables all eligible employees to share in the Society's success in delivering against its strategy. It helps the Society to be competitive in attracting and retaining high calibre employee and ensures their alignment with strategic priorities.
Operation	The scheme applies to all eligible employees (including executive directors) with the same Society performance measures used to assess payments. The scheme is reviewed each year to ensure that it is aligned to the Society's business plans and any changes in regulation.
Risk mitigation	The Society does not incentivise any employees based on individual or team sales targets. The Committee has absolute discretion to reduce any variable pay award if it decides that acceptable standards or performance levels have not been met. The Committee can also adjust, withhold or recover any vested awards using 'malus' and 'clawback' arrangements for executive directors and executive managers.
Maximum potential	The maximum award for all employees (including executive directors) is 20% of base salary for exceptional performance and 10% of base salary for on target performance.
Performance metrics	The Society measures annual performance against a number of stretching financial and non-financial targets detailed in the balanced scorecard, which is aligned to its strategic priorities (see below).
Application to other employees	All employees of the Society are included in the Success Share scheme.

Executive Variable Pay Plan (ExVPP)	
Purpose and link to strategy	The ExVPP helps to recruit and retain high calibre executive directors and rewards performance over the longer term in delivering the Society's strategy.
Operation	Awards to executive directors and executive managers are made in cash, and are subject to deferral and retention. The Remuneration Code requires that 50% of variable pay is made in shares or in the case of a non-listed business like the Society, an equivalent share-like instrument. The Society's share-like instrument does not provide for any uplift in award, however, the award can be reduced if capital strengths and profit levels are not in line with plans. The plan is reviewed each year to ensure alignment to the strategic priorities and changes in regulation.
Risk mitigation	Risk mitigation is as outlined above for the annual Success Share bonus. In addition, the plan ensures that the executive directors' remuneration package is strongly linked to the Society's long term performance and members' interests.
Maximum potential	If the Society performs in line with its plans, the ExVPP scheme provides for an award of 30% of salary for executive directors (15% for executive managers). The maximum award (60% of base salary at the date of grant for executive directors and 30% for executive managers) can only be achieved by exceeding stretching upper targets for all measures. The maximum potential is unchanged from the previous policy.
Performance metrics	The Society measures annual performance against performance targets in its balanced scorecard (see below).
Application to other employees	The plan is only available to executive directors and executive managers.

Differences between the executive directors' and wider employees' remuneration policies

Performance related variable pay makes up a higher proportion of remuneration for the executive directors and executive managers than for employees generally, reflecting the role of these individuals in managing the business to achieve the Society's strategic objectives.

Choice of performance measures for variable pay

A balanced scorecard is used to assess the performance of the Society. The performance measures in the scorecard reflect the Society's strategic priorities, and stretching performance targets are set each year for the Annual Success Share bonus and ExVPP schemes. In setting performance targets the Committee takes into account a number of different reference points which may include the Society's business plans and strategy and the market environment.

The Committee retains the discretion to adjust or set different performance measures or targets if the measures are no longer appropriate, such as in the case of a significant change in prevailing market conditions, and amendment is required so that the measures achieve their original purpose.

Malus and clawback

Malus, clawback, deferral, and retention arrangements are in place for executive directors and executive managers. The Committee ensures that an objective assessment of business risk and long term sustainability is included with any assessment of variable pay awards and it may decide to exercise its discretion and adjust Success Share or ExVPP payments. Further details about malus and clawback arrangements are set out below:

	Malus	Clawback
What is it?	The Committee can decide to reduce or cancel any variable pay award, before the payment has been made.	The Committee may decide that an individual must repay part or all of a variable pay award after the payment has been made.
Which awards does it apply to?	Malus applies to any payments under the annual Success Share bonus and ExVPP schemes, as well as any future variable pay schemes.	Clawback applies to payments under the annual Success Share bonus and ExVPP variable pay schemes, for up to seven years even if an individual leaves the Society's employment.
When would this be used?	Can be applied in circumstances including, but not limited to: • Reasonable evidence of misbehaviour or material error by the executive director; • The Society suffering a material downturn in its financial performance; or • The Society suffering a material failure of risk management.	Can be applied in circumstances including, but not limited to: • Reasonable evidence of misbehaviour or material error by the executive director; • The Society or function suffering a material failure of risk management; or • A material misstatement of the Society's financial results, such that the payment made under the variable pay arrangement was greater than it would have been.

Approach to recruitment remuneration

Ongoing remuneration

When agreeing the remuneration package for a new executive director, the Committee considers:

- Whether the overall package is sufficient to recruit a high calibre executive with the right level of experience, capability and potential required for the role, noting external benchmarks.
- The remuneration packages of other executive directors in the Society, and maximum variable pay limits.

The Committee retains discretion to include other elements of remuneration which are not included in the provisions of the Remuneration Policy set out above should business needs require. However, this discretion is subject to the following principles and limitations, and the commercial rationale for taking such action will be disclosed in the following Annual Report on Remuneration.

The maximum level of variable remuneration which may be granted to a new executive director on appointment (excluding any award to take account of remuneration relinquished when leaving the former employer) will be 60% of salary in line with the Policy table set out above.

Buyout awards

When hiring an external candidate the Committee may decide to compensate them for any variable pay awards from their previous employer that they will forfeit as a result of joining the Society, known as 'buyout'. In determining any buyout, the Remuneration Committee will conduct rigorous due diligence and consider all relevant factors, including the likelihood of the awards vesting, the form in which they were awarded and the time over which they would have vested. Any buyout will be made in line with the Remuneration Policy wherever possible. The Society will always comply with regulatory requirements in effect at the time of making any awards of this nature.

Internal appointments

For an internal executive director appointment, any variable pay element awarded in respect of the prior role will be paid according to its terms.

Directors' Remuneration Report continued

Approach to payment for loss of office

If an individual ceases to be an executive director, the Society will take a different approach to paying them for the loss of office depending on the circumstance of their leaving.

In all circumstances, termination payments will include any base salary or other contractual benefits due for the notice period, although these may be reduced if the executive director finds alternative employment during the notice period.

If an individual ceases to be an executive director due to retirement, redundancy, death, ill-health, injury/disability or certain reasons as determined by the Committee, they are considered to be a 'good leaver'. Under good leaver circumstances, the scheme rules state that any annual Success Share bonus or ExVPP award will be paid on a pro rata basis, depending on the time served during the performance period. Any deferred and retained awards will be subject to any necessary performance or malus adjustments and paid at the same time as awards for executive directors remaining in employment. Clawback rules will continue to apply.

If an individual ceases to be an executive director under any circumstance not covered by the good leaver provisions, no annual Success Share bonus or ExVPP payments will be made, and any unvested awards will be forfeited.

The Committee reserves the right to make any other payments in connection with an executive director's cessation of office or employment where the payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation) or by way of settlement of any claim arising in connection with the cessation of a director's office or employment. Any such payments may include but are not limited to paying any fees for outplacement assistance and/or the director's legal and/or professional advice fees in connection with their cessation of office or employment.

Other considerations when setting executive director remuneration

When approving executive director pay, the Committee will take decisions aligned to the Society's Remuneration Policy. The Committee's decisions take into account wider market benchmarking across financial services and remuneration paid to other employees across the Society.

Application of the Remuneration Policy

The following table shows the maximum variable pay for executive directors, as a percentage of base salary:

	As a percentage of base salary		
2019 performance scenarios	Success Share %	ExVPP %	Total variable pay %
Minimum	0	0	0
On target	10	30	40
Maximum	20	60	80

The graph below illustrates what executive directors could earn, based on the Remuneration Policy 2019, in three potential performance scenarios – minimum, on target and maximum variable payments.

In applying these performance scenarios, the following assumptions apply:

Fixed remuneration is the current base salary, pension as a percentage of base salary, and benefits paid over the course of the calendar year. Benefits figures are the same as those disclosed in the single figure table below:

During the year, there were no changes in executive directors and accordingly no payments were made for loss of office, nor compensation for variable pay awards from any previous employer.

Service contracts

Executive directors' terms and conditions of employment are detailed in their individual service contracts available at the Principal Office. An executive director's contract can be terminated by the director giving six or twelve months' notice (dependent on role), or by the Society giving one year's notice.

The dates that current executive directors were appointed are shown in the table below:

Executive director	Date of appointment as a director of the Society
Chief Executive – Mark Parsons	1.7.2014
Product, Marketing and Strategy Director – Andy Deeks	27.4.2017
Chief Financial Officer – Michele Faull	27.4.2017
Chief Operating Officer – Peter Frost	1.11.2012

All of the Society's executive directors must voluntarily stand for re-election by its members each year.

Non-executive directors

The Committee oversee remuneration for all employees, including executive directors and executive managers. Non-executive director matters are dealt with separately as outlined below.

Details of the Non-executive Directors' Remuneration (NEDR) Committee

The members of the NEDR Committee are:

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

1. Chair of the Committee.

The NEDR Committee is responsible for reviewing and recommending to the Board for approval the remuneration of the non-executive directors to the Board other than for the Chair of the Board. The Committee met once during the year to conduct the annual remuneration review.

Approach for non-executive directors' fees

The approach for non-executive directors is in line with the objectives of the Remuneration Policy for the whole Society and is to offer fees that are competitive when compared with similar financial services organisations and, as such allows the Society to recruit, retain and motivate high calibre non-executive directors to the Society.

The NEDR Committee recommends the remuneration of the non-executive directors, other than the Chair of the Board, to the Board for approval. Recommendations for the remuneration of the Chair of the Board are made by the Remuneration Committee and approved by the full Board without the participation of the Chair. No director takes part in the discussion of their own remuneration.

Directors' Remuneration Report continued

Non-executive director fees

Base salary	
Purpose and link to strategy	Non-executive director fees are set at a level that reflects market conditions and is sufficient to attract individuals with appropriate knowledge and experience.
Operation	Fees are usually reviewed annually and amended to reflect market positioning and any change in responsibilities. Non-executive directors may be eligible to receive appropriate benefits such as the use of secretarial support and expenses for travel and accommodation costs.
Risk mitigation	Benchmarking non-executive director salaries against comparable financial services organisations ensures they are not excessive. Fees paid to non-executive directors are recommended by the NEDR Committee and approved by the Board as a whole. Non-executive directors do not participate in the Annual Success Share bonus and ExVPP.
Maximum potential	Fees are based on the level of fees paid to non-executive directors serving on Boards of similar-sized UK-listed companies and the time commitment and contribution expected for the role. Non-executive directors receive a basic fee and an additional fee for further duties (for example chair of a Committee or Senior Independent Director responsibilities).
Performance metrics	Not applicable.

Non-executive directors' letters of appointment

Non-executive directors are appointed for an initial term of three years which can be terminated by the director, or at the discretion of the Board with a notice period. Non-executive directors must voluntarily stand for re-election each year.

Conclusion

This concludes the Remuneration Policy section of the Committee's annual report; the following pages outline how the policy was implemented in the annual remuneration report.

Annual Remuneration Report

This report set outs remuneration awarded to executive and non-executive directors for 2019. All remuneration decisions are taken in accordance with the Remuneration Policy approved by an advisory vote at the AGM in 2017.

The total pay package that was earned by each executive director for 2018 and 2019 is shown below:

Total remuneration earned by each executive director

	Fixed remuneration				Variable remuneration			
Audited information	Base salary[1] £000	Taxable benefit £000	Pension allowance[2] £000	Total fixed £000	Success Share £000	ExVPP £000	Total variable £000	Total remuneration £000
2019								
Mark Parsons	536	18	107	661	54	146	200	**861**
Andy Deeks	228	10	34	272	23	62	85	**357**
Michele Faull	357	10	54	421	36	97	133	**554**
Peter Frost	292	29	44	365	29	79	108	**473**
Total	1,413	67	239	1,719	142	384	526	**2,245**

	Fixed remuneration				Variable remuneration			
Audited information	Base salary[1] £000	Taxable benefit £000	Pension allowance[2] £000	Total fixed £000	Success Share £000	ExVPP £000	Total variable £000	Total remuneration £000
2018								
Mark Parsons	524	18	105	647	58	158	216	863
Andy Deeks	221	10	33	264	25	68	93	357
Michele Faull	350	10	53	413	39	106	145	558
Peter Frost	285	28	43	356	32	86	118	474
Total	1,380	66	234	1,680	154	418	572	2,252

1. Base salary is the actual salary earned in the year and will differ from the current salary effective from 1 April.
2. Pension allowance includes both contributions to the Group's defined contributory pension scheme and cash payments in lieu of contributions.

Further information on individual remuneration elements: executive directors

Base salary 2019

The annual review of salaries in April 2019 saw a 2% basic increase for all employees and an additional 1.5% discretionary pot made available to progress salaries towards market levels where appropriate. Executive directors received the basic increase awarded to all employees as set out below:

Executive director	Effective 1 April 2019 £	Effective 1 April 2018 £	% increase
Mark Parsons	538,560	528,000	2.0
Andy Deeks	229,500	225,000	2.0
Michele Faull	358,938	351,900	2.0
Peter Frost	293,321	287,570	2.0

Benefits and pension 2019

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

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

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

Variable pay 2019

The Society made good progress against its balanced scorecard targets, given challenging market conditions in 2019. The Society outperformed against four of the twelve performance targets which determine variable pay, performed in line with six measures and performed below target in two measures.

Further information on the Society's performance can be found in the Strategic Report. Performance against the balanced scorecard measures, which are equally weighted, is summarised below:

Performance measure	Performance target range	Performance result	Performance relative to target range
Financial:			
Mortgage balance growth	7.5% – 8.5%	7.6%	On target
Savings balance growth	7.7% – 8.7%	8.9%	Ahead of target
Cost to mean assets ratio	0.48% – 0.50%	0.48%	On target
Capital ratios:			
Leverage ratio	4.35% – 4.45%	4.4%	On target
Common Equity Tier 1 ratio	34% – 36%	32.0%	Behind target
Risks and projects:			
Mortgage balances in arrears (%)	<0.13%	0.06%	Ahead of target
Liquidity Coverage Ratio	>150%	214%	Ahead of target
Investment programme delivery	Qualitative assessment	Qualitative assessment	Behind target
Members:			
Experience Net Promoter Score[1]	+70 – +74	+74	On target
Relationship Net Promoter Score[1]	Top 3 (+/- 1)	3rd	On target
People:			
Employee engagement[2]	718 – 738 / 2star	720 / 2star	On target
Community involvement	77% – 80%	82%	Ahead of target

1. NPS is a measure of customer advocacy that ranges between -100 and +100 which represents how likely a customer is to recommend our products and services.
2. The Best Companies employees engagement score reflects the assessment as a mid sized company. Two star denotes 'Outstanding' employee engagement. Until 2018, Best Companies classified the Society as "mid sized". From 2019 this changed to a "big company" classification, which impacts the assessment of engagement. 2019 performance assumes the Society remained at "mid sized" to give a like for like comparison. The score based on the "big company" assessment is 747.3 and engagement is rated as 3 star.

Directors' Remuneration Report continued

Given the performance outlined above, the Committee considered the appropriate level of variable awards and determined:

- An annual Success Share bonus for all eligible employees, including executive directors, equivalent to 10% of base salary from a potential maximum of 20%.
- An ExVPP award to executive directors equivalent to 27% of base salary from a potential maximum of 60% and to executive managers of 13.5% of base salary from a potential maximum of 30%. In determining this award the Committee applied a degree of downward discretion.
- This assessment reflects the Common Equity Tier 1 (CET 1) ratio and Investment Programme delivery measures being behind target. In addition, the Committee also applied downward discretion to outstanding deferred variable payments, for the CEO and another Material Risk Taker, to reflect the RWA correction announced in December 2019.

For executive directors and executive managers these awards will be deferred as described below.

The impact of deferral

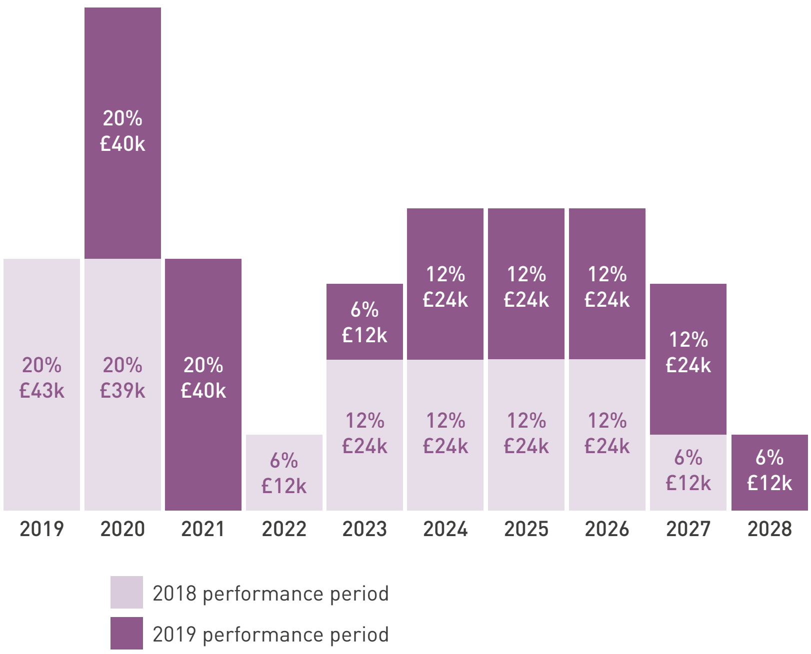
Variable remuneration is subject to regulatory deferral arrangements as described below. For executive directors whose total remuneration is above the regulatory deferral threshold of £500,000, their total variable pay (annual Success Share bonus and ExVPP) is paid over nine years following the performance period, with 60% of this being paid in the last six years of the 'extended deferral period'. The percentage which is paid in each year is set out in the table below. For each annual payment, half is made in cash with the other half retained in an equivalent share-like instrument for a further 12 months. All payments are subject to malus and clawback reductions.

Impact of deferral in relation to the 2018 and 2019 performance periods

In 2019, Mark Parsons and Michele Faull are above the regulatory deferral threshold and therefore their variable remuneration will be paid in instalments as set out below. The table shows the percentage of variable remuneration which will be paid in each year.

Variable pay received		2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
2019 performance period	%	–	20	20	–	6	12	12	12	12	6
2018 performance period	%	20	20	–	6	12	12	12	12	6	–

The impact of deferral is illustrated by reference to Mark Parsons' variable pay in the diagram below which takes into account the downward discretion applied by the Committee to deferred variable payments.



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

In 2019, Peter Frost and Andy Deeks are below the regulatory deferral threshold and therefore will be paid 100% of the annual Success Share bonus in 2020 and 60% of the ExVPP amount. The remaining 40% of ExVPP will be paid in 2022.

Remuneration elements in 2020

Base salary 2020

Base salaries for executive directors will be reviewed in April 2020, in line with the approach outlined in the Remuneration Policy.

Benefits including pension 2020

No changes to the Society's approach to benefits are anticipated in 2020.

Variable pay 2020

The 2020 annual Success Share bonus scheme and ExVPP will be reviewed in line with the Society's strategic priorities and any changes to regulation. The Committee does not anticipate that there will be any significant changes to variable pay arrangements for 2020. Details of the performance metrics for both variable pay plans will be provided in the 2020 Directors' Remuneration Report.

Forward looking statement

Mark Parsons announced his decision to retire as CEO in October 2019 and this will come into effect on 17 April 2020. He will be treated as a good leaver and all deferred variable pay will be released in line with the scheme rules.

Steve Hughes will join the Society as CEO in the coming months, subject to regulatory approval, and his remuneration will be in line with the Society's remuneration policy.

Relative importance of spend on pay

The following table sets out the changes in profit after tax in 2019 and 2018 and compares these with the overall spend on remuneration over the two years. As a mutual organisation, the Society only seeks to retain sufficient profit to maintain capital ratios and allow for investment in the business, returning any surplus above this to members through superior pricing. A better measure of the Society's activity is the level of growth in mortgages and savings balances and so the percentage change in total assets has been included to give an appropriate indication of this.

	2019 £m	2018[1] £m	Percentage change %
Total assets	49,530.8	46,070.9	7.5
Employee remuneration costs	101.6	95.6	6.3
Profit after tax[1]	121.7	163.0	(25.3)

1. 2018 restated as a result of amendments to IAS 12, see note 1 to the accounts for more information.

The increase in employee remuneration costs reflects the increase in salaries following the annual salary review and a 4.7% increase from additional full time equivalent headcount to support the growth of the business and investment in our technology and infrastructure.

Change in remuneration of Chief Executive

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

	2019 %	2018 %	2017 %	2016 %	2015 %	2014 %	2013 %	2012 %	2011 %	2010 %
Current Chief Executive										
Annual Success Share bonus as a percentage of maximum	50	55	60	70	60	60	–	–	–	–
LTIP as a percentage of maximum	n/a	n/a	63	63	–	–	–	–	–	–
ExVPP as a percentage of maximum	45	50	60	65	n/a	n/a	n/a	n/a	n/a	n/a
Former Chief Executive										
Annual Success Share bonus as a percentage of maximum	–	–	–	–	–	60	70	60	65	55
LTIP as a percentage of maximum	–	–	–	–	–	100	100	97	38	38

Directors' Remuneration Report continued

CEO pay ratio

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

The Society has elected to publish its CEO pay ratios using the Government's preferred methodology (Option A) which is based on actual full time equivalent pay and benefit values for all employees for the financial year. It is calculated by identifying the median total remuneration as well as the total remuneration at the 25th percentile and 75th percentile points. For 31 December 2019, these were as set out in the table below. In calculating these figures, leavers were excluded but all other employees who started partway through the year or who were on extended leave for some or all of the year have been included on the basis of a full year's salary.

Remuneration element	25th percentile £	Median £	75th percentile £
Total pay and benefits	24,415	31,627	45,291
Salary	20,967	26,964	39,897

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

Year	Method	25th percentile	Median	75th percentile
2019	Option A	35:1	27:1	19:1
2018	Option A	36:1	27:1	19:1

The median pay ratio remains stable from 2018 and the Society believes it is consistent with the principles of its Remuneration Policy.

Details of the non-executive directors' remuneration

Audited information	Base Fees 2019 £000	Committee Chair and other Fees 2019 £000	Expense payments 2019 £000	Total Fees and Expense payments 2019 £000	Base Fees 2018 £000	Committee Chair and other Fees 2018 £000	Expense payments 2018 £000	Total Fees and Expense payments 2018 £000
Non-executive director:								
Gary Hoffman Chair of the Board from 26.04.18	178	–	–	**178**	119	–	–	**119**
Peter Ayliffe Deputy Chair of the Board from 27.04.18 Chair of the Board until 26.04.18	52	7	3	**62**	83	4	3	**90**
Iraj Amiri From 28.06.18 Chair of the Board Audit Committee from 18.09.18	52	14	7	**73**	26	5	5	**36**
Roger Burnell Senior Independent Director until 24.04.19 Chair of the Board Risk Committee until 25.09.18 Chair of the Board Audit Committee until 18.09.18 Resigned from the Board 24.04.19	17	3	–	**20**	50	25	–	**75**
Catherine Doran	52	–	3	**55**	50	–	4	**54**
Ian Geden Chair of the Remuneration Committee until 25.04.18 Deputy Chair of the Board until 26.04.18	–	–	–	**–**	24	6	–	**30**
Jo Kenrick Senior Independent Director from 24.04.19 Chair of the Remuneration Committee from 26.04.18	52	16	3	**71**	50	8	3	**61**
Shamira Mohammed from 01.05.19	35	–	1	**36**	–	–	–	**–**
Martin Stewart from 01.09.18 Chair of the Board Risk Committee from 25.09.18	52	14	14	**80**	17	5	6	**28**
Total	490	54	31	**575**	419	53	21	**493**

Fees for non-executive directors were increased from April 2019 and the increases were in line with increases applied to all employees. The table below sets out fees for non-executive director compared with the previous year. Non-executive director fees are made up of a base fee, plus a Committee Chair fee as appropriate. The Chair of the Board does not receive additional fees for roles carried out other than that of Chair. Any changes to the fees for non-executive directors will next be applied from April 2020, in line with employee pay reviews.

Non-executive director fees	2019 £000	2018 £000
Chair of the Board	178	175
Base fee	52	51
Deputy Chair of the Board	7	7
Senior Independent Director (if different from Deputy Chair of the Board)	7	7
Chair of the Remuneration Committee	12	11
Chair of the Board Audit Committee	14	14
Chair of the Board Risk Committee	14	14

Expense and other payments

Expense payments reimburse travel and accommodation costs in relation to attending meetings. Non-executive directors do not receive performance related pay or bonus, pension arrangements or other benefits.

Remuneration Committee advisor and fees

Deloitte LLP (Deloitte) was appointed by the Committee and is retained to provide independent advice to the Committee as required. Deloitte is a founding member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The Committee is satisfied that the advice received is objective and independent and services provided by Deloitte are reviewed annually to ensure this continues to be the case. Fees for providing advice to the Committee amounted to £19,200 (2018: £23,400), including VAT, for the year ended 31 December 2019.

Consideration of member views

The Society welcomes feedback on executive and non-executive directors' remuneration. Member approval of the Directors' Remuneration Report is voted on at each AGM and every three years the Committee ask members for a non binding vote on the Remuneration Policy.

Statement of member vote at AGM

At the 2019 AGM, an ordinary resolution (advisory vote) was proposed to members to approve the Annual Remuneration Report for the year ended 31 December 2018 for which the following votes were received:

Annual Remuneration Report	Number of votes	% votes cast
Votes cast for	111,466	92.5%
Votes cast against	9,048	7.5%
Total votes cast	120,514	100.0%
Votes withheld	2,354	–

Material Risk Takers

The disclosures required under the Capital Requirements Regulation (CRR) Part Eight Article 450 in respect of the Society's Material Risk Takers for the performance year ended 31 December 2019 are included in this report. The Society's remuneration policies, practice and governance comply with the Remuneration Part of the PRA Rulebook and the FCA Remuneration Code for dual-regulated firms (SYSC 19D 'the Remuneration Code'). Material Risk Takers fall into two categories: individuals whose actions have a material impact on the risk profile of the Society (based on criteria set by the European Banking Authority) and individuals outside of these criteria, who the Society has determined have a material impact on the risk profile of the Society.

During the year there were a total of 40 Material Risk Takers. Of these, 19 fall within the senior management category (being the executive and non-executive directors of the Board and executive managers).

The following table shows the remuneration of the Society's Material Risk Takers for the performance year ended 31 December 2019:

Analysis of remuneration by fixed and variable elements	Senior management	Other Material Risk Takers	Total
Number of Material Risk Takers	**19**	**21**	**40**
Fixed pay (£000)[1]	3,976	2,807	6,783
Variable pay (£000)[2]	828	233	1,061
Total (£000)	4,804	3,040	7,844

1. Fixed pay includes base salary, benefits, pension and severance pay and fees for non-executive directors.
2. Variable pay includes the 2019 annual Success Share bonus and 2019 ExVPP awards.

Directors' Report

The directors have pleasure in presenting their Annual Report & Accounts for 2019.

Business objectives, future developments and key performance indicators

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

Profit and capital

Profit before tax for the year ended 31 December 2019 was £147 million (2018: £202 million). The profit after tax transferred to the general reserve was £122 million (2018: £163 million[1]).

Total Group reserves and equity at 31 December 2019 were £2,203 million (2018: £2,120 million). Further details on the movements on reserves and equity are given in the Group Statement of Changes in Members' Interests and Equity.

Gross capital at 31 December 2019 was £2,270 million (2018: £2,188 million), including £26 million (2018: £26 million) of subordinated debt, £42 million (2018: £42 million) of subscribed capital and £415 million (2018: £397 million) of Perpetual Capital Securities. The ratio of gross capital as a percentage of savings and borrowings at 31 December 2019 was 4.84% (2018: 5.02%) and the free capital ratio was 4.60% (2018: 4.82%). The Annual Business Statement gives an explanation of these ratios.

Mortgage arrears

At 31 December 2019, there were 69 mortgage accounts more than 12 months in arrears (including those in possession) (2018: 72). The balance on these accounts totalled £9.8 million (2018: £11.7 million) and the value of these arrears was £0.6 million (2018: £0.8 million) or 0.002% (2018: 0.002%) of total mortgage balances. Mortgage arrears disclosures are based on the UK Finance definition, which calculates months in arrears by dividing the arrears balance outstanding by the latest contractual payment.

Charitable and political donations

The Board approved donations of £1.3 million (2018: £1.5 million) to charitable organisations during the year. This included an amount of £1.2 million (2018: £1.4 million) to The Royal British Legion's Poppy Appeal and £70,000 (2018: £70,000) to the Coventry Building Society Charitable Foundation.

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

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

Creditor payment policy

The Society's policy is to agree the terms of payment at the start of trading with suppliers and to pay in accordance with its contractual and other legal obligations. The Society's creditor days were eight days as at 31 December 2019 (2018: nine days).

Country-by-country reporting

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

Risk management

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

Colleagues

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

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

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

The following statement, which should be read in conjunction with the Statement of the auditors' responsibilities on page 116, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the

1. Taxation and profit for the 2018 financial year have been restated following amendments to IAS 12. See note 1 to the Financial Statements for more information.

Directors' Remuneration Report, the Annual Business Statement and this Directors' Report.

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

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

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

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

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

Directors' responsibilities in respect of accounting records and internal control

The directors are responsible for ensuring that the Group:

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

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

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

Directors' statement pursuant to the Disclosure and Transparency Rules

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

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

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

Directors' statement of compliance with the UK Corporate Governance Code

As required by the UK Corporate Governance Code, the directors confirm their opinion that the 2019 Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for members to assess the performance, strategy and business model of the Society.

Directors' responsibilities in respect of going concern and long term viability

The UK Corporate Governance Code (the Code) requires that the directors state whether they consider it appropriate to adopt the going concern basis of accounting, and identify any material uncertainties to the Society's ability to continue as a going concern for a period for at least 12 months from the reporting date.

In addition, Provision 31 of the Code requires that the directors explain how the prospects of the company have been assessed and whether there is a reasonable expectation that the Society will continue in operation and meet its liabilities as they fall due over the period of assessment. Details of this assessment are set out below.

Directors' Report continued

Assessment of going concern

In preparing the financial statements the directors are required to satisfy themselves that it is appropriate to adopt the going concern basis of accounting in accordance with guidance from the Financial Reporting Council and IAS 1 Presentation of Financial Statements.

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

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

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

Long term viability

In accordance with the UK Corporate Governance Code the directors are required to explain how, taking account of the Society's current position and principal risks, they have assessed the prospects of the Society, over what period they have done so and why they consider the period to be appropriate. The Code also requires the directors to confirm that they believe the Society will be able to continue in operation and meet its liabilities as they fall due over a specified period determined by the directors. In order to make this assessment, the directors have considered separately the prospects of the Society and its long term viability.

Assessment of prospects

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

The directors considered the Society's strategy and the key threats to its delivery including continued uncertainty in relation to the Brexit process. The most significant impact of this is considered to be the potential impact on wholesale funding markets. Mitigating plans are in place and therefore the directors are comfortable this will not have a material impact on the prospects of the Society.

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

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

Viability assessment

The directors have assessed the viability of the Society over the three year period to December 2022. The directors consider a three year period appropriate as it is within the period covered by the strategic plan and the stress testing activities undertaken by the Society. In addition, using a period of three years eliminates the inherent uncertainties in the assumptions underpinning the outer years of the Society's strategic plan and is in line with market practice.

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

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

Based upon the assessment set out above, the directors have a reasonable expectation that the Society will continue in operation and meet its liabilities as they fall due over the period to December 2022.

Directors

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

The auditors

A resolution to reappoint PricewaterhouseCoopers LLP auditors of the Society will be proposed at the 2020 AGM.

Approved by the Board of directors and signed on its behalf by

Gary Hoffman
Chair of the Board
27 February 2020

Welcome to our

Financial Statements

In this section you will find our primary statements and related notes.

Independent Auditors' Report to the Members of Coventry Building Society

Report on the audit of the financial statements

Opinion

In our opinion, Coventry Building Society's Group financial statements and Society financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and Society's affairs as at 31st December 2019 and of the Group's and the Society's income and expenditure and the Group's and the Society's cash flows for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise: the Group and Society balance sheets as at 31 December 2019; the Group and Society income statements and the statements of comprehensive income, the Group and Society statement of cash flows, and the Group and Society statements of changes in members' interests and equity for the year then ended; the accounting policies; and the notes to the financial statements.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

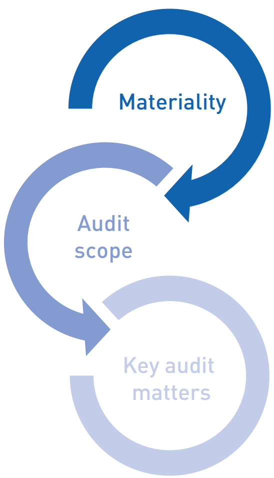
We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

Other than those disclosed in note 9 to the financial statements, we have provided no non-audit services to the Group or the Society in the period from 1st January 2019 to 31st December 2019.

Our audit approach

Overview



- Overall Group materiality: £7.3 million, based on 5% of Group profit before tax.
- Overall Society materiality: £3.2 million, based on 5% of Society profit before tax.

- We conducted our audit from Coventry; and
- We performed audit procedures over all material account balances and financial information of the Society and Group;

The following areas were identified as key audit matters for the Group and Society:

- The appropriateness of key estimates used in the accounting for the effective interest rate of mortgage products;
- The application of key judgements and estimates in relation to applying expected credit loss provisioning on loans and advances to customers;
- The application of hedge accounting in accordance with IFRS;
- Privileged access to IT systems; and
- The appropriateness of actuarial assumptions relating to the defined benefit pension obligations.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations include, but not limited to, the Financial Conduct Authority's regulations, the Prudential Regulation Authority's regulations, Pensions legislation and the UK tax legislation. We considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Building Societies Act 1986. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to the posting of inappropriate manual journal entries to manipulate financial performance and management bias in significant accounting estimates. Our audit procedures included:

- Discussions with management and those charged with governance including consideration of known or suspected instances of non-compliance with laws and regulations and fraud;
- Review of internal audit and compliance monitoring findings throughout the year;
- Reading key correspondence with the Financial Conduct Authority and Prudential Regulation Authority;
- Incorporation of an element of unpredictability in our testing through altering the nature, timing and/or extent of work performed;
- Challenging assumptions and judgements made by management in their significant accounting estimates;
- Identifying and testing journal entries, in particular any journal entries posted by senior management, posted with descriptions indicating a higher level of risk, posted to unusual account combinations based on our understanding of usual business operations, and material late adjustments.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Independent Auditors' Report to the Members of Coventry Building Society continued

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
The appropriateness of key estimates used in the accounting for the effective interest rate of mortgage products	
Accounting standards require interest receivable and similar income to be recognised on an effective interest rate ('EIR') accounting basis. The EIR approach has the effect of recognising interest at a single constant rate that averages out the effect of fixed and variable rates of interest and fees across the expected life of the mortgage. The loans and advances to customers line item includes effective interest rate accounting adjustments of £75.8 million at the balance sheet date (2018: £84.2 million). This adjustment is released to the income statement in accordance with the forecast behavioural life of the Group's mortgage book which is a key estimate. In addition, the reversionary interest rate after the fixed mortgage initial term is inherently uncertain. Management calculates these estimates by considering past repayment behaviour on the loan book and by considering the prevailing interest rate environment. We focussed our audit work on these two key estimates. The Group's disclosures are given in note 3. Management's associated accounting policies are detailed on page 125. Management's significant estimates are set out on page 132. The Audit Committees' consideration of the matter is described on page 89.	We performed a walkthrough of the EIR model logic, methodology and associated calculations and tested the accuracy and validity of the calculations used. We tested that all fees and charges included within the EIR accounting calculation are in line with accounting standards. We tested the completeness and accuracy of the redemption data used in the generation of the behavioural life profiles, and challenged management as to whether the current loan book will perform consistently with historical experience. We performed a sensitivity analysis to determine whether the overall adjustment is reasonable, focussing on the estimation uncertainty in determining the lifetime of the mortgage and future interest rates. We performed substantive testing over the completeness and accuracy of the transfer of critical data from the mortgage book source system to the EIR model and supporting evidence. We tested the reconciliation of the accounting model outputs to the general ledger to ensure appropriate recording in the financial statements. We reviewed the disclosures made by management to ensure compliance with accounting standards and agreed the disclosures and sensitivity analysis to supporting evidence. From the evidence we obtained we found that the mortgage lifetimes and the reversionary interest rates used within the EIR accounting models are reasonable estimates.

Key audit matter	How our audit addressed the key audit matter
The application of key judgements and estimates in relation to applying expected credit loss provisioning on loans and advances to customers	
The Group held £12.0 million of expected credit loss ('ECL') provisions against residential mortgages in accordance with IFRS 9 (2018: £11.6 million) against total loans and advances to customers of £42,234.7 million (2018: £39,264.6 million). The determination of ECL is highly subjective and judgemental. The introduction of IFRS 9 in the prior year has meant that significant changes have been incorporated into the measurement of loan loss provisioning, including the development of new models where losses are recognised on an expected, forward-looking basis, reflecting the Group's view of potential future economic events. We focussed our audit work on the areas of the methodology that we identified as most judgemental. These were: • The appropriateness of the 'staging' thresholds selected by management to determine whether a significant increase in credit risk had arisen, and hence whether a 12 month or lifetime loss provision is recorded. • The application of forward-looking economic assumptions used in the models and the weightings assigned to scenarios (specifically the base and the downside scenarios as these are most material to ECL); and • The completeness of post model adjustments, to take account of latent risks and known model limitations. The Group's disclosures are given in note 13. Management's associated accounting policies are detailed on pages 127 to 129. Management's judgements in application of accounting policy and critical estimates is disclosed on page 140 and the considerations of the effect of the future economic environment are given on page 141. The Audit Committees' consideration of the matter is described on page 89.	We understood and critically assessed the methodology applied in the impairment models, using modelling specialists in the more judgemental areas, including the results of empirical testing on key model components, primarily the Probability of Default ('PD') model, to check that the implemented methodology was compliant with IFRS 9. We tested key estimates and judgements used in the calculation of provisions and tested the accuracy of critical data inputs used by the impairment models on a sample basis to supporting documentation. We validated management's 'staging' thresholds by re-performing key back testing procedures performed by management. We examined subsequent account performance to confirm that the criteria selected by management were reasonable and that the models are sufficiently predictive of defaults. We assessed the reasonableness and likelihood of the forward looking economic assumptions and weightings assigned to the scenarios using our economic experts. For the base and downside economic scenarios, their reasonableness was assessed against known or likely economic, political and other relevant events, including potential risks from the UK's withdrawal from the European Union. The severity and magnitude of the scenarios were compared to external forecasts and data from historical economic downturns, and the sensitivities of the scenarios on the ECL were considered. We tested management's monitoring controls performed throughout the year and re-performed a number of monitoring tests independently to ensure that changes to customer behaviour are reflected in the ECL calculation. We considered the completeness of post model adjustments to take account of known model limitations or latent risks using our industry expertise. We reviewed the ECL disclosures made by management to ensure compliance with accounting standards and agreed the disclosures to supporting evidence without material exceptions. From the evidence we obtained we found that the judgements and estimates applied in relation to forward looking economics and the appropriateness of staging and post model adjustments as they relate to the ECL provision to be reasonable.

Independent Auditors' Report to the Members of Coventry Building Society continued

Key audit matter	How our audit addressed the key audit matter
The application of hedge accounting in accordance with IFRS	
Operations of the Group expose the Group to significant interest rate risk as a result of a mismatch between fixed and floating interest rate cash flows. Management have sought to mitigate the risk of future movements in market interest rates affecting profitability through the use of derivative financial instruments in the form of interest rate and cross currency swap contracts. Management designate these under hedge accounting arrangements to reduce the effect of future movements in interest rates on amounts recorded in the financial statements. Where a designated hedge accounting relationship is formed, accounting rules allow the Group's fixed rate mortgage book to be carried at fair value. We focussed on this area as hedge accounting rules are complex. Given the size of both the fixed interest mortgages and interest rate swaps held on balance sheet, this gives rise to an increase in the risk of error in application. This risk of error is compounded as the Group has a manual process in hedging and therefore there is an increased risk of operational errors. The Group's disclosures are given in note 24. Management's associated accounting policies are detailed on pages 129 to 130. Management's significant assumptions and estimates are set out on page 153. The Audit Committees' consideration of the matter is described on page 89.	We performed a walkthrough of management's end to end process for performing hedge accounting in relation to fair value and cash flow hedges. We obtained and read the hedge accounting documentation to evaluate whether it was compliant with the accounting requirements of International Accounting Standard (IAS) 39 'Financial Instruments'. This included testing of a sample of hedge designations and inspection of a sample of hedge documentation. We independently re-performed a sample of hedge effectiveness tests performed by management, considering both prospective and retrospective testing. We also re-performed the valuation of a sample of derivatives and underlying hedged items, tested a sample of manual calculations for mathematical accuracy, and performed logic and calculation checks to ensure manual hedging calculations are valid. We tested the reconciliation between the hedging models and the amounts recorded in the general ledger. From the evidence we obtained, we found that the hedge accounting methodology was compliant with IAS 39.
Privileged access to IT systems	
The Society is highly dependent on technology due to the significant number of transactions that are processed daily. Controls over privileged access rights are important as they ensure that changes to applications and data are authorised and made in an appropriate manner. Ensuring that staff only have appropriate access, and that the access is monitored, is key to mitigate the potential for misuse or error as a result of a change to an application or underlying data. Improvements are required to privileged access controls. We therefore did not rely on IT general controls applying to relevant systems, but instead performed additional substantive testing to mitigate risks of material misstatement in the Group financial statements by fraud or error.	In response to the weaknesses identified, we performed an assessment of the risks of fraud or error in the financial statements. Additional substantive testing was performed on those areas where we identified a higher risk of fraud or error in relation to privileged access, including the following: • A higher extent of testing on loans and advances to customers, including sending a sample of external confirmations to the Group's members; • Increased extent of sample testing of administrative expenses; • Additional risk based manual journal testing; • Additional payroll testing to mitigate the risk of inappropriate amendments to standing data. In performing the procedures noted above, no inappropriate changes to system data were identified.
The appropriateness of actuarial assumptions relating to the defined benefit pension obligations	
The valuation of the defined benefit obligations of the Group Pension Scheme (the 'Fund') is dependent on a number of actuarial assumptions, including the discount rate, inflation rates and mortality rates. Changes in these assumptions will have an impact on the valuation. The Funds pension surplus is £24.3 million at the balance sheet date (2018: £22.9 million). Management performs a review of the valuation methodology and assumptions each year. The assumptions were updated to reflect changing market practice and management's future outlook. The valuation of the defined benefit obligations is relatively complex and judgemental and therefore represents a key audit matter. We focussed our work on the key assumptions used in the valuation. The Group's disclosures are given in note 20. Management's associated accounting policies are detailed on pages 130 to 131. The Audit Committees' consideration of the matter is described on page 89.	We understood the process for determining the actuarial assumptions used in calculating the valuation of pension obligations. We engaged our actuarial specialists to understand the estimates made by management in determining the key financial assumptions used in the calculation of the liability. We assessed the reasonableness of the assumptions using PwC developed benchmarks and external market data and performed sensitivity analysis. Based on the evidence obtained, we found the assumptions and methodologies used in the valuation of the Fund's defined benefit obligations to be within a reasonable range. We read and assessed the disclosures made in the financial statements, including the disclosures of the assumptions, and found them to be appropriate.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Society, the accounting processes and controls, and the industry in which they operate.

All of the Group's activities are administered in the United Kingdom. The principal activity of the Group is the provision of savings products and mortgage finance to members. The Group's mortgage book is predominantly secured on UK residential property.

The Group is formed of the Society and several other subsidiary companies. Based on Group materiality, we performed audit procedures over all material account balances and financial information of the Society and its subsidiaries. Our audit procedures on the Society and its subsidiaries provided us with sufficient audit evidence as a basis for our opinion on the Group financial statements as a whole.

The accounting records and functions for all entities within the Group are located at the Society's offices in Coventry, with the consolidation being performed in Coventry. We performed all of the work to support the Group and Society audit opinion.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the annual accounts as a whole as follows:

	Group financial statements	Society financial statements
Overall materiality	£7.3 million	£3.2 million
How we determined it	5% of profit before tax	5% of profit before tax
Rationale for benchmark applied	Profit before tax is one of the principal considerations when assessing the Group's and Society's performance, and is a generally accepted auditing benchmark.	

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £368,000 (Group audit) and £161,000 (Society audit), as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report to you as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the Group's and Society's ability to continue as a going concern over a period of at least 12 months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Society's ability to continue as a going concern. For example, the terms of the United Kingdom's withdrawal from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Group's business, customers, suppliers and the wider economy.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Annual Business Statement and Directors' Report we also considered whether the disclosures required by the Building Societies Act 1986 have been included.

Independent Auditors' Report to the Members of Coventry Building Society continued

Based on the responsibilities described above and our work undertaken in the course of the audit, the Building Societies Act 1986 and ISAs (UK) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Building Society Act 1986 – Opinion on Annual Business Statement and Directors' Report

In our opinion, based on our work undertaken in the course of the audit:

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the year ended 31 December 2019 is consistent with the accounting records and the financial statements; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

The director's assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group.

As a result of the directors' reporting on how they have applied the UK Corporate Governance Code (the"Code"), we are required to report to you if we have anything material to add or draw attention to regarding:

- The directors' confirmation on page 107 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on page 108 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to necessary qualifications or assumptions.

We have nothing to report in respect of this responsibility.

Other Code Provisions

As a result of the directors' reporting on how they have applied the Code, we are required to report to you if, in our opinion:

- The statement given by the directors, on page 107, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Society's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Society obtained in the course of performing our audit.
- The section of the Annual Report on page 89 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of this responsibility.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Directors' responsibilities in respect of the preparation of the Annual Report and Accounts set out on page 107, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group and Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report
This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Building Societies Act 1986 exception reporting
Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Society; or
- the Society annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have no exceptions to report arising from this responsibility.

Appointment
Following the recommendation of the Audit Committee, we were appointed by the members on 24 April 2019 to audit the financial statements for the year ended 31 December 2019 and subsequent financial periods. This is therefore our first year of uninterrupted engagement.

Other voluntary reporting

Going concern
The directors have requested that we review the statement on page 108 in relation to going concern as if the Society were a premium listed company. We have nothing to report having performed our review.

The directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group
The directors have requested that we perform a review of the directors' statements on page 108 that they have carried out a robust assessment of the principal risks facing the Group and in relation to the longer-term viability of the Group, as if the Society were a premium listed company. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the Code; and considering whether the statements are consistent with the knowledge and understanding of the Group and Society and their environment obtained in the course of the audit. We have nothing to report having performed this review.

Other Code provisions
The directors have prepared a corporate governance statement and requested that we review it as though the Society were a premium listed company. We have nothing to report in respect of the requirement for the auditors of premium listed companies to report when the directors' statement relating to the Society's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' remuneration
The Society voluntarily prepares a Directors' Remuneration in accordance with the provisions of the Companies Act 2006. The directors requested that we audit the part of the Directors' Remuneration Report specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Carl Sizer (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Birmingham
27 February 2020

Income Statements

For the year ended 31 December 2019

	Notes	Group 2019 £m	Group 2018 Restated[1] £m	Society 2019 £m	Society 2018 Restated[1] £m
Interest receivable and similar income calculated using the Effective Interest Rate method	3	1,010.5	976.3	875.1	893.1
Interest payable and similar charges	4	(613.8)	(550.5)	(601.5)	(557.9)
Net interest income		396.7	425.8	273.6	335.2
Fees and commissions receivable	5	7.8	8.1	6.0	6.3
Fees and commissions payable	6	(10.2)	(10.4)	(7.6)	(7.6)
Other operating income	7	2.5	1.1	2.5	1.1
Net (losses)/gains from derivatives and hedge accounting	8	(17.2)	(0.3)	(18.5)	3.1
Total income		379.6	424.3	256.0	338.1
Administrative expenses	9	(201.4)	(200.2)	(162.1)	(189.6)
Amortisation of intangible assets	18	(13.5)	(13.7)	(13.5)	(13.7)
Depreciation of property, plant and equipment	19	(14.2)	(7.8)	(14.2)	(7.8)
Impairment (charge)/credit on loans and advances to customers	13	(2.1)	0.4	(0.5)	(0.8)
Provisions for liabilities and charges	25	–	–	–	(0.1)
Charitable donation to Poppy Appeal		(1.2)	(1.4)	(1.2)	(1.4)
Profit before tax		147.2	201.6	64.5	124.7
Taxation	14	(25.5)	(38.6)	(9.8)	(24.0)
Profit for the financial year		121.7	163.0	54.7	100.7

1. Taxation and Profit for the financial year have been restated in the comparative periods following amendments to IAS 12. See note 1 for more information.

Profit for the financial year arises from continuing operations and is attributable to the members of the Society.

Statements of Comprehensive Income

For the year ended 31 December 2019

	Notes	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Profit for the financial year (restated)[1]		121.7	163.0	54.7	100.7
Other comprehensive (expense)/income					
Items that will not be transferred to the Income Statement:					
Remeasurement of defined benefit pension plan	20	(6.2)	2.5	(6.2)	2.5
Taxation	14	1.6	(0.6)	1.6	(0.6)
Effect of change in corporation tax rate	14	(0.1)	0.1	(0.1)	0.1
Items that may be transferred to the Income Statement:					
Fair value through other comprehensive income investments:					
Fair value movements taken to reserves		3.7	(12.4)	3.7	(12.4)
Amount transferred to the Income Statement		(6.2)	13.4	(6.2)	13.4
Taxation	14	0.6	(0.2)	0.6	(0.2)
Effect of change in corporation tax rate	14	–	–	–	–
Cash flow hedges:					
Fair value movements taken to reserves	24	(124.2)	24.4	(39.5)	0.9
Amount transferred to the Income Statement	24	106.0	(18.9)	33.9	(8.0)
Taxation	14	4.9	(1.5)	1.5	1.8
Effect of change in corporation tax rate	14	(0.3)	0.1	(0.1)	–
Other comprehensive (expense)/income for the year, net of tax		(20.2)	6.9	(10.8)	(2.5)
Total comprehensive income for the year, net of tax (restated)[1]		101.5	169.9	43.9	98.2

1. Taxation and Profit for the financial year have been restated in the comparative periods following amendments to IAS 12. See note 1 for more information.

The notes on pages 122 to 165 form part of these accounts.

Balance Sheets

As at 31 December 2019

	Notes	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Assets					
Cash and balances with the Bank of England		5,226.0	5,219.4	4,896.3	5,048.6
Loans and advances to financial institutions		336.1	231.3	425.0	231.3
Debt securities	15	1,292.6	951.2	1,292.6	951.2
Loans and advances to customers	16	42,234.7	39,264.6	26,659.4	24,660.2
Hedge accounting adjustment		149.7	6.5	149.7	6.5
Derivative financial instruments	24	137.9	268.9	103.4	186.4
Investment in equity shares		4.1	3.1	4.1	3.1
Investment in Group undertakings	17	–	–	15,090.8	14,232.6
Intangible assets	18	33.2	37.2	33.2	37.2
Property, plant and equipment	19	77.8	48.8	77.8	48.8
Pension benefit surplus	20	24.3	22.9	24.3	22.9
Prepayments and accrued income		14.4	17.0	14.4	17.0
Total assets		49,530.8	46,070.9	48,771.0	45,445.8
Liabilities					
Shares		36,238.1	33,281.6	36,238.1	33,281.6
Deposits from banks	22	5,318.6	5,453.8	5,276.4	5,380.7
Other deposits		8.5	9.5	8.5	9.5
Amounts owed to other customers		462.7	496.5	462.7	588.9
Debt securities in issue	23	4,815.6	4,353.9	4,675.7	4,191.5
Hedge accounting adjustment		44.0	36.5	44.0	36.5
Derivative financial instruments	24	281.8	167.4	240.6	167.4
Current tax liabilities		14.2	15.4	6.4	8.1
Deferred tax liabilities	21	5.0	17.2	4.0	13.0
Accruals and deferred income		36.0	38.1	31.1	32.5
Other liabilities	30	35.7	10.5	35.4	10.5
Provisions for liabilities and charges	25	0.7	3.0	0.7	3.0
Subordinated liabilities	26	25.5	25.5	25.5	25.5
Subscribed capital	27	41.6	41.6	41.6	41.6
Total liabilities		47,328.0	43,950.5	47,090.7	43,790.3
Members' interests and equity					
General reserve		1,773.3	1,693.5	1,253.8	1,241.0
Other equity instruments	28	415.0	396.9	415.0	396.9
Fair value through other comprehensive income reserve		3.7	5.6	3.7	5.6
Cash flow hedge reserve		10.8	24.4	7.8	12.0
Total members' interests and equity		2,202.8	2,120.4	1,680.3	1,655.5
Total members' interests, liabilities and equity		49,530.8	46,070.9	48,771.0	45,445.8

The notes on pages 122 to 165 form part of these accounts.

Approved by the Board of directors on 27 February 2020 and signed on its behalf by

Gary Hoffman
Chair of the Board

Mark Parsons
Chief Executive

Michele Faull
Chief Financial Officer

Statements of Changes in Members' Interests and Equity

For the year ended 31 December 2019

Group	General reserve £m	Other equity instruments £m	Fair value through other comprehensive income reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2019	1,693.5	396.9	5.6	24.4	2,120.4
Changes on initial application of IFRS 16[1]	(0.8)	–	–	–	(0.8)
Restated position at 1 January 2019	1,692.7	396.9	5.6	24.4	2,119.6
Profit for the financial year	121.7	–	–	–	121.7
Net remeasurement of defined benefit plan	(4.7)	–	–	–	(4.7)
Net movement in fair value through other comprehensive income reserve	–	–	(1.9)	–	(1.9)
Net movement in cash flow hedge reserve	–	–	–	(13.6)	(13.6)
Additional Tier 1 Capital repurchased (net of tax)	(9.3)	(396.9)	–	–	(406.2)
Additional Tier 1 Capital issued (net of tax)	(2.5)	415.0	–	–	412.5
Total comprehensive income	105.2	18.1	(1.9)	(13.6)	107.8
Distribution to Additional Tier 1 capital holders	(24.6)	–	–	–	(24.6)
As at 31 December 2019	1,773.3	415.0	3.7	10.8	2,202.8
As at 1 January 2018	1,553.1	396.9	5.7	20.3	1,976.0
Changes on initial application of IFRS 9	1.0	–	(0.9)	–	0.1
Restated position at 1 January 2018	1,554.1	396.9	4.8	20.3	1,976.1
Profit for the financial year (restated)[2]	163.0	–	–	–	163.0
Net remeasurement of defined benefit plan	2.0	–	–	–	2.0
Net movement in fair value through other comprehensive income reserve	–	–	0.8	–	0.8
Net movement in cash flow hedge reserve	–	–	–	4.1	4.1
Total comprehensive income (restated)[2]	165.0	–	0.8	4.1	169.9
Distribution to Additional Tier 1 capital holders (restated)[2]	(25.6)	–	–	–	(25.6)
As at 31 December 2018	1,693.5	396.9	5.6	24.4	2,120.4

1. More information on IFRS 16 transition is provided in note 1 to the accounts.
2. Profit for the year, Total comprehensive income and Distributions to Additional Tier 1 capital holders have been restated in the comparative periods following amendments to IAS 12. See note 1 to the accounts for more information.

Society	General reserve £m	Other equity instruments £m	Fair value through other comprehensive income reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2019	1,241.0	396.9	5.6	12.0	1,655.5
Changes on initial application of IFRS 16[1]	(0.8)	–	–	–	(0.8)
Restated balance at 1 January 2019	1,240.2	396.9	5.6	12.0	1,654.7
Profit for the financial year	54.7	–	–	–	54.7
Net remeasurement of defined benefit plan	(4.7)	–	–	–	(4.7)
Net movement in fair value through other comprehensive income reserve	–	–	(1.9)	–	(1.9)
Net movement in cash flow hedge reserve	–	–	–	(4.2)	(4.2)
Additional Tier 1 Capital repurchased (net of tax)	(9.3)	(396.9)	–	–	(406.2)
Additional Tier 1 Capital issued (net of tax)	(2.5)	415.0	–	–	412.5
Total comprehensive income	38.2	18.1	(1.9)	(4.2)	50.2
Distribution to Additional Tier 1 capital holders	(24.6)	–	–	–	(24.6)
As at 31 December 2019	1,253.8	415.0	3.7	7.8	1,680.3
As at 1 January 2018	1,163.1	396.9	5.7	17.3	1,583.0
Changes on initial application of IFRS 9	0.8	–	(0.9)	–	(0.1)
Restated position at 1 January 2018	1,163.9	396.9	4.8	17.3	1,582.9
Profit for the financial year (restated)[2]	100.7	–	–	–	100.7
Net remeasurement of defined benefit plan	2.0	–	–	–	2.0
Net movement in fair value through other comprehensive income reserve	–	–	0.8	–	0.8
Net movement in cash flow hedge reserve	–	–	–	(5.3)	(5.3)
Total comprehensive income (restated)[2]	102.7	–	0.8	(5.3)	98.2
Distribution to Additional Tier 1 capital holders (restated)[2]	(25.6)	–	–	–	(25.6)
As at 31 December 2018	1,241.0	396.9	5.6	12.0	1,655.5

1. More information on IFRS 16 transition is provided in note 1 to the accounts.
2. Profit for the year, Total Comprehensive Income and Distributions to Additional Tier 1 capital holders have been restated in the comparative periods following amendments to IAS 12. See note 1 to the accounts for more information.

Statements of Cash Flows

For the year ended 31 December 2019

	Notes	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Cash flows from operating activities					
Profit before tax		147.2	201.6	64.5	124.7
Adjustments for:					
Expected credit loss provisions and other provisions	13, 25	2.4	(0.4)	0.6	0.9
Depreciation and amortisation		27.7	21.5	27.7	21.5
Interest on subordinated liabilities and subscribed capital		6.6	6.7	6.6	6.7
Changes to fair value adjustment of hedged risk		85.3	(19.4)	8.7	(35.3)
Other non-cash movements[1]		13.9	17.1	13.9	17.0
Non-cash items included in profit before tax		135.9	25.5	57.5	10.8
Loans and advances to credit institutions		(119.3)	(69.8)	(208.2)	(69.8)
Loans and advances to customers		(2,972.5)	(3,333.2)	(1,999.8)	(1,596.7)
Prepayments, accrued income and other assets		(4.2)	(8.5)	(4.2)	(8.6)
Changes in operating assets		(3,096.0)	(3,411.5)	(2,212.2)	(1,675.1)
Shares		2,963.5	2,238.4	2,963.5	2,238.4
Deposits and other borrowings		(170.3)	1,713.7	(231.8)	1,791.7
Debt securities in issue		(57.6)	(229.0)	(57.7)	(229.2)
Accruals and deferred income and other liabilities[1]		(5.8)	9.2	8.3	22.3
Changes in operating liabilities		2,729.8	3,732.3	2,682.3	3,823.2
Interest paid on subordinated liabilities and subscribed capital		(6.6)	(6.7)	(6.6)	(6.7)
Interest paid on lease liabilities[1]		(0.7)	–	(0.7)	–
Taxation		(29.0)	(41.6)	(27.5)	(41.6)
Net cash flows from operating activities		(119.4)	499.6	557.3	2,235.3
Cash flows from investing activities					
Purchase of investment securities		(1,095.1)	(454.2)	(1,095.1)	(454.2)
Sale and maturity of investment securities and equities		739.2	477.1	739.2	447.1
Purchase of property, plant and equipment and intangible assets		(28.7)	(31.5)	(28.7)	(31.5)
Net cash flows from investing activities		(384.6)	(8.6)	(384.6)	(38.6)
Cash flows from financing activities					
Loans to connected undertakings		–	–	(858.2)	(1,675.1)
Distribution paid to Additional Tier 1 capital holders		(24.6)	(25.6)	(24.6)	(25.6)
Repurchase of Additional Tier 1 capital		(400.0)	–	(400.0)	–
Repurchase of Additional Tier 1 transaction costs		(8.5)	–	(8.5)	–
Issue of Additional Tier 1 capital		415.0	–	415.0	–
Additional Tier 1 issuance costs		(3.4)	–	(3.4)	–
Repurchase and repayment of debt securities		(22.6)	(780.7)	–	(750.0)
Principal elements of lease payments[1]		(4.5)	–	(4.5)	–
Issue of debt securities		544.6	499.0	544.6	499.0
Net cash flows from financing activities		496.0	(307.3)	(339.6)	(1,951.7)
Net increase in cash		(8.0)	183.7	(166.9)	245.0
Cash and cash equivalents at start of year		5,122.3	4,938.6	4,951.5	4,706.5
Cash and cash equivalents at end of year		5,114.3	5,122.3	4,784.6	4,951.5
Cash and cash equivalents:					
Cash and balances with central banks[2]		5,114.3	5,122.3	4,784.6	4,951.5

1. Relates to the first adoption of IFRS 16 from 1 January 2019; see note 1 to the accounts for further information.
2. This does not include the mandatory reserve with the Bank of England of £111.7 million (2018: £97.1 million).

The notes on pages 122 to 165 form part of these accounts.

Notes to the accounts

1. Accounting policies

Basis of preparation
These accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union; interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC); and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to organisations reporting under IFRS.

The accounts comprise the standalone financial statements of the Society and the consolidated financial statements of the Group. They have been prepared on an historical cost basis, as modified by the revaluation of fair value through other comprehensive income (FVOCI) debt securities and certain financial instruments which are measured at fair value. As stated in the Directors' Report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts. A summary of the Group's accounting policies is set out within this note.

Basis of consolidation
The assets, liabilities and results of the Society and its consolidated subsidiaries and structured entities are included in the financial statements of the Group.

The Group consolidates an entity from the date on which it: (a) has power over the entity; (b) is exposed to, or has the right to, variable returns from its involvement with the entity; and (c) has the ability to affect those returns through the exercise of its powers. Upon consolidation, intra-group transactions, balances and unrealised gains and losses are eliminated. The Group reassesses whether it controls an entity if facts and circumstances indicate that there are changes in one or more of these three elements. The Group deconsolidates entities from the date that control ceases.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control. In making this judgement, the Group considers factors such as the purpose and design of the entity, size and exposure to variability of returns and the nature of the relationship, including power over the structured entity.

The Society's investment in shares in its subsidiaries is recognised on the Balance Sheet at cost less any provision for impairment in value.

Changes in accounting standards
The Group adopted IFRS 16 Leases and amendments to IAS 12 Income Taxes from 1 January 2019. The Society has also early adopted the amendments to IFRS 9, IAS 39 and IFRS 7 which were issued in 2019. Further information, including IFRS 16 transitional disclosures, is set out below.

IFRS 16 Leases
The adoption of IFRS 16 Leases has resulted in changes to amounts recognised in the financial statements for leases classified as 'operating leases' under the previous accounting standard, IAS 17 Leases. The Group has implemented IFRS 16 using the modified retrospective approach and has recognised the impact of transition in the general reserve on 1 January 2019. The Group has elected not to restate comparative financial information, as permitted by the transitional provisions of IFRS 16. Comparative information is presented in accordance with IAS 17 and the accounting policy as set out on page 115 of the 2018 Annual Report & Accounts.

The Group's new accounting policy under IFRS 16 is set out below.

Leases
The majority of the Group's leases relate to property including branches, head office buildings and data centres. The Group also has other leases which relate to cars and office equipment.

Where the Group enters into a lease or contract which meets the criteria for lease classification under IFRS 16, the Group recognises an asset representing its right to use the leased item and a corresponding liability on the Balance Sheet. The lease liability is measured at the present value of the lease payments including any incentives, additional lease components and lease extension or termination options where they are reasonably certain to be exercised. These payments are discounted using the Group's incremental borrowing rate since no interest rates are specified in the Group's leases. The right-of-use asset is measured at cost including the lease liability, any initial direct costs and committed restoration costs.

The right-of-use asset is depreciated over the shorter of its useful life or the lease term on a straight line basis through the Income Statement, and the interest charge on the lease liability is recognised within Interest payable. The interest paid on lease liabilities and the principal element of the lease payments are shown on separate lines within the Cash Flow Statement.

Expenses relating to leases which are for less than 12 months, of low value or relate to intangibles such as software are recognised in the Income Statement as charged.

On an ongoing basis the Group reviews the right-of-use asset and lease liability for any modifications that would require remeasurement and makes an assessment for impairment as required.

Impact of transition to IFRS 16

On adoption of IFRS 16, the Group has applied the recognition criteria to all leases previously treated as 'finance' or 'operating' leases under IAS 17. In measuring the present value of the lease obligations the Group has used an incremental borrowing rate at the point of transition and throughout the period of 2.1% to discount lease cash flows. The transition impact has been recognised on a modified retrospective basis with the difference between the lease liabilities and right-of-use assets recognised in reserves on 1 January 2019.

For leases previously classified as finance leases the Group has recognised the carrying amount of the lease asset and liability at an amount equal to that of the carrying amount at 31 December 2018.

The adjustments to the Group's Balance Sheet on transition to IFRS 16 are set out in the tables below:

1 January 2019	£m
Right-of-use assets[1]	29.6
Deferred tax	0.3
Accruals[2]	2.1
Lease liability presented in Other liabilities[3]	(32.8)
General reserves	(0.8)

1. Presented within Property, plant and equipment and includes £2.1 million previously recognised as finance leases reclassified as right-of-use assets.
2. Release of rental accruals which are now included within the lease liability.
3. Included within Other liabilities is £2.1 million relating to finance leases which were previously recognised in Other liabilities.

The recognised right-of-use assets above relate to the following types of assets:

1 January 2019	£m
Property	27.5
Cars	1.8
Equipment	0.3
Total	29.6

A reconciliation of the operating lease commitments which were disclosed in the 2018 Annual Report & Accounts to the opening lease liabilities recognised under IFRS 16 as at 1 January 2019 is shown below:

IFRS 16 reconciliation	£m
Operating lease commitment disclosed as at 31 December 2018	20.0
Impact of discounting using the Society's incremental borrowing rate at 1 January 2019	(2.1)
Add: Finance lease liabilities recognised at 31 December 2018	2.1
Add: Adjustments as a result of extension options and additional lease components	6.8
Add: Contracts reassessed as leases under IFRS 16	6.3
Less: Short-term leases recognised as an expense on a straight line basis	(0.3)
Lease liability recognised as at 1 January 2019	32.8

In applying IFRS 16 for the first time the Group has used the following permitted practical expedients:

- The use of a single incremental borrowing rate to a portfolio of leases with reasonably similar characteristics.
- Accounting for operating leases with a remaining term of less than 12 months as at 1 January 2019 as short-term leases.
- Exclusion of initial direct costs from the measurement of the right-of-use asset.
- The use of hindsight in determining the lease liability.

Notes to the accounts continued

1. Accounting policies continued

IAS 12 amendments

The amendments to IAS 12 clarify the recognition of income tax on dividends, which for the Society relates to Additional Tier 1 (AT 1) distributions. As a result of these changes, income tax relief on the distributions to holders of the Group's AT 1 instruments which was previously recognised within the Statement of Changes in Members' Interest and Equity is now recognised within the Income Statement. The Group has applied this change retrospectively and the impact of restatement on the comparative period is a reduction in the tax charge by £6.9 million from £45.5 million to £38.6 million within the Income Statement, increasing Profit for the financial year to £163.0 million. This has been offset by an increase in the distributions to AT 1 capital holders in Members interest and equity to £25.6 million from £18.7 million. There is no impact to the Group's General reserve overall as a result of this change in the current or comparative periods and the changes do not have a significant impact on the Group's financial statements.

Classification	Primary statement impacted	31 Dec 2018 £m
Taxation	Income Statement	(6.9)
Distribution to Additional Tier 1 capital holders	Statement of Changes in Members' Interests and Equity	6.9
General reserve	**Balance Sheet**	–

IFRS 9, IAS 39 and IFRS 7 amendments – interest rate benchmark reform

In September 2019 the International Accounting Standards Board (IASB) issued amendments to IFRS 9, IAS 39 and IFRS 7 that provide temporary relief from applying certain hedge accounting requirements to hedge relationships which are impacted by Interbank Offered Rate (IBOR) reform. These amendments apply to a number of the Group's hedge relationships which are linked to London Interbank Offered Rate (LIBOR) or the Euro Interbank Offered Rate ('EURIBOR'), which is expected to be replaced by Sterling Overnight Index Average (SONIA) in 2021. These reliefs serve to facilitate hedge accounting by ensuring that the hedge accounting is not terminated solely as a result of failing to meet the testing criteria set out in IAS 39 as a result of IBOR transition.

The amendments are applicable from 1 January 2020, and the Society has chosen to early adopt these amendments as at 31 December 2019, as permitted. The impact of the amendments on the Group's hedge accounting is set out below. There have been no changes to the Group's reported results in 2019 as a result of adopting these amendments.

Fair value hedge accounting

Where the Group has fixed rate mortgages, savings and wholesale issuances which are held in hedge relationships subject to changes in LIBOR, the reliefs permit hedge accounting to continue on the basis that the benchmark interest rate component (LIBOR) was separately identifiable at the time of initial designation, even if the benchmark rate may no longer be separately identifiable.

Cash flow hedge accounting

Where the Group uses cash flow hedge accounting of forecast future transactions, hedge accounting will be able to continue on the basis that the interest rate on which the hedged cash flows are based (EURIBOR or LIBOR) does not change.

The Group retains the cumulative gain or loss in the cash flow hedge reserve for designated cash flow hedges that are subject to benchmark interest rate reforms even though there is some uncertainty with respect to the timing and amount of the cash flows of the hedged items. Should the hedged future cash flows no longer be considered highly probable due to reasons other than interest rate benchmark reforms, the cumulative gain or loss will be reclassified to the Income Statement.

Hedge effectiveness

The Group does not discontinue hedge accounting should the retrospective assessment of hedge effectiveness fall outside the 80–125% range and the hedging relationship is subject to interest rate benchmark reforms, providing that all other hedge accounting criteria is met. Ineffectiveness is recognised in the Income Statement which includes any differences arising due to IBOR reform.

When testing prospective effectiveness, it is assumed that the cash flows of the hedged item and hedging instrument do not change as a result of the reform.

The reliefs will continue to apply until either the hedging relationship to which the relief is applied is discontinued, or there is no longer uncertainty arising from IBOR reform over the timing or amount of IBOR based cash flows.

More information on the impact of IBOR reform is included in note 24. More information on the Group's IBOR transition project is included in the Risk Management Report.

Derecognition of financial assets and liabilities

The Group derecognises financial assets where the right to receive cash flows has expired, or where the assets are transferred with substantially all the risks and rewards of ownership. Where the transfer does not result in the transfer of cash flows, but the Group assumes an obligation to pay the cash flows to the transferee, the financial assets are also derecognised.

The Group derecognises financial liabilities when the obligation is discharged, cancelled or has expired.

Securitisation and covered bond transactions

The Group has securitised certain mortgage loans by transferring the loans to structured entities controlled by the Group. The securitisations enable issuance of debt to investors, who take security in the underlying assets as collateral. The structured entities are fully consolidated into the Group accounts.

Transfers of mortgage loans to the structured entities are not treated as sales and the loans are not derecognised but remain on the transferor's own Balance Sheet as it retains substantially all the risks and rewards of the mortgage loans. In the accounts of the transferor, the proceeds received from the transfer of mortgage loans to structured entities are accounted for as a deemed loan from the structured entity and are disclosed within Other liabilities on the Balance Sheet.

For covered bonds, the Society itself and not the structured entity issues the covered bonds and then lends the proceeds to the structured entity on back to back terms. The structured entity then uses these proceeds as consideration for the loans transferred from the Society. In the accounts of the Society, neither the loan to the structured entity nor the consideration for the transfer of mortgage loans is recognised separately as an additional asset and liability.

The Group has also issued debt to be used as collateral for central government schemes or for use in sale and repurchase agreements (repos) and similar transactions. Some or all of the debt issuances may be retained by the Society. Investments in such self-issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Society's financial statements.

To manage interest rate risk, the Society enters into derivative transactions with its structured entities, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IFRS 9, these internal derivatives are treated as part of the deemed loan and not separately measured at fair value because the relevant mortgage loans are not derecognised. All other derivatives relating to securitisations and covered bonds are explained in the derivatives and hedge accounting policy below.

Sale and repurchase agreements (repos)

Securities sold subject to a commitment to repurchase them are retained on the Balance Sheet when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately on the Balance Sheet, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the Effective Interest Rate (EIR) method.

Interest receivable and interest payable

For instruments measured at amortised cost, the EIR method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The EIR is the rate that discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset. Interest income on FVOCI debt is also included on an EIR basis.

In calculating the EIR, the Group estimates cash flows considering all contractual terms of the financial instrument. For assets which are in default and assessed as stage 3 under IFRS 9, interest is calculated by applying the EIR to the expected recoverable amount. The EIR calculation includes all fees received and paid and costs borne and all other premiums above or below market rates.

Fees and commissions

Fees and commissions receivable and payable that are not spread across expected asset lives under the EIR method are taken to income on an accruals basis as the related obligations are satisfied.

Notes to the accounts continued

1. Accounting policies continued

Taxation including deferred tax
Corporation tax on the profits for the year comprises current and deferred taxation.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the Balance Sheet date.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which they can be utilised.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled. Deferred tax assets and liabilities are offset when there is both a legally enforceable right and an intention to settle on a net basis.

Corporation tax is charged or credited directly to the Statement of Comprehensive Income if it relates to items that are credited or charged to the Statement of Comprehensive Income. Otherwise corporation tax is recognised in the Income Statement.

Research and development expenditure credits
Research and development expenditure credits are recognised in the Balance Sheet when receipt is virtually certain. They are released in the Income Statement within Administrative expenses in line with the recognition of the underlying cost to which the credit relates.

Segmental reporting
The Group operates solely within the retail financial services sector within the United Kingdom. As such, no segmental analysis is required.

Financial assets
Financial assets comprise cash and balances with the Bank of England, loans and advances to financial institutions, debt securities, loans and advances to customers, derivative financial instruments and investment in equity shares.

At initial recognition, the Group measures financial assets at their fair value. Subsequently, financial assets are classified in one of the following measurement categories:

- Amortised cost.
- Fair value through other comprehensive income (FVOCI).
- Fair value through profit and loss (FVTPL).

Financial assets are classified based on an assessment of the Group's business model for managing the assets and their contractual cash flow characteristics.

Amortised cost
Financial assets held to collect contractual cash flows and where contractual terms comprise solely payment of principal and interest are classified as amortised cost. This category of financial asset includes cash and balances with the Bank of England, loans and advances to financial institutions, loans and advances to customers and a small portfolio of debt securities.

Financial assets within this category are recognised on either the receipt of cash or deposit of funds into one of the Group's bank accounts or when the funds are advanced to borrowers. After initial recognition, the assets are measured at amortised cost using the EIR method, less provision for expected credit losses.

Assets acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the opening amortised cost for acquired assets. Fair value adjustments are made to reflect both credit risk and interest yield associated with the acquired loan assets. Any discount between the amount due and the fair value is subsequently recognised in interest receivable and similar income using the EIR method.

Significant judgements – classification and measurement of equity release loans
The Group has a £223.9 million (2018: £248.4 million) portfolio of equity release mortgages where the borrower is guaranteed that the amount recoverable at the end of the mortgage will not exceed the value of the property. The Society has not offered new mortgages on this basis since September 2009. The average loan to value of the portfolio is 40% (2018: 38%). The Group has assessed the cash flow characteristics at recognition of each loan within the portfolio to confirm that the IFRS 9 criteria for amortised cost classification are met. The Group has concluded that this is the case as the low loan to value of the portfolio means that the guarantee is a de minimise feature of the product for substantially all of the loans.

Fair value through other comprehensive income (FVOCI)

Financial assets held with the intent of collecting contractual cash flows or selling, where contractual terms comprise solely payment of principal and interest, are classified and measured at FVOCI. This category of financial asset includes most of the Group's debt securities which are held to manage liquidity.

Assets are measured at fair value based on quoted market prices or prices obtained from market intermediaries where available. In cases where quoted market prices are not available, discounted cash flow valuations are used.

Interest on FVOCI assets is recognised in interest receivable and similar income in the Income Statement, using the EIR method.

Unrealised gains and losses arising from changes in fair value are recognised directly in Other comprehensive income, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income Statement. Gains and losses arising on the sale of FVOCI assets, including any cumulative gains or losses previously recognised in Other comprehensive income, are recognised in the Income Statement.

Fair value through profit and loss (FVTPL)

FVTPL is the default category for financial assets which do not meet the criteria for amortised cost or FVOCI assets. Assets which are classified as FVTPL include derivative financial instruments and investments in equity shares.

These assets are carried at fair value and are initially recognised at the trade date.

Interest income and changes in the fair value of derivatives other than the effective portion of those in cash flow hedge accounting relationships are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy.

Dividends and changes in the fair value of equity instruments are recognised in the Income Statement.

Impairment of financial assets

The Group assesses, on a forward looking basis, the expected credit loss (ECL) associated with its financial assets carried at amortised cost and FVOCI and its mortgage pipeline commitments. Financial assets held at FVTPL are not subject to impairment under IFRS 9.

IFRS 9 requires the Society to categorise its financial assets into one of three stages at the Balance Sheet date. Assets that are performing are shown in stage 1; assets where there has been a significant increase in credit risk since initial recognition are in stage 2; and assets which are credit impaired or in default are in stage 3. The Society is required to recognise a 12 month ECL allowance on all stage 1 assets and a lifetime ECL allowance on all stage 2 and 3 assets. The Society does not have any purchased or originated credit-impaired financial assets.

Loans and advances to customers

Significant judgement – determining criteria for significant increase in credit risk

The Group considers a loan to have experienced a significant increase in credit risk when one or more of the following qualitative, quantitative or backstop criteria have been met.

Qualitative criteria

The qualitative measures used to allocate a loan to stage 2 are aligned to the Group's underwriting and forbearance practices. In some cases, the qualitative measures will be evident before the borrower's credit score is impacted and they are therefore lead indicators of a deteriorating credit risk. The most significant qualitative criteria include bankruptcy, cancelled direct debits or poor external credit bureau data which exceeds the Society's underwriting policy at the reporting date, even if the loan is currently performing. Qualitative criteria are monitored and reviewed periodically for appropriateness.

Quantitative criteria

The Group uses internal credit risk gradings that reflect its assessment of the probability of default (PD) of individual borrowers and counterparties. Given the Society's very low risk loan book, a three grade decrease in rating may still result in a very low PD and the application of the current decline limit ensures that loans below this threshold are regarded as still being of sufficiently high quality that they are allocated to stage 1. The loan will be assessed as stage 2 where there has been a three risk grade decrease and the remaining lifetime PD has doubled since origination.

Notes to the accounts continued

1. Accounting policies continued

Backstop criteria

In addition, a loan is considered to have experienced a significant increase in credit risk if its total arrears are equal to one current monthly repayment. Loans subject to this backstop measure will continue to be classified as stage 2 for a period of 12 months (cure period) from the date that the arrears fall below one current monthly repayment. A cure period is not applied to the qualitative and quantitative criteria as the borrower's credit score will be adversely affected for some time after the trigger event and to add a further cure period beyond this would overstate the impact on the credit risk of the account.

Default

The Society considers a loan to be in default when the loan is three months or more in arrears i.e. current arrears balances are equal to three or more current monthly repayments. Alternatively, a loan is considered to be in default if any of the following unlikeliness to pay indicators are present:

- A payment concession has been agreed with the borrower whereby a sum less than the contractual monthly payment is made for a limited period of time.
- Litigation proceedings against the borrower have begun.
- The customer is bankrupt and the account is in arrears.
- The loan is interest only and has gone three months past the scheduled term date, or 12 months for equity release loans.
- The property has been taken into possession by the Group.
- A specific provision has been raised indicating a potential issue that may give rise to a loss (e.g. title or boundary issues).

A loan is considered to be no longer in default (i.e. to have been cured) when a consecutive period of 12 months has passed since it met any of the above qualitative and quantitative criteria (cure period).

Inputs, assumptions and estimation techniques

The measurement of expected credit loss reflects:

- An unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes.
- The time value of money.
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Expected credit losses (ECL), being forward looking, are discounted back to the reporting date and are calculated by multiplying the probability of default (PD), exposure at default (EAD) and loss given default (LGD) where:

- The PD represents the likelihood of a borrower defaulting over either the next 12 months or over the remaining lifetime of the mortgage (being the contractual lifetime).
- EAD is the amount the Society expects to be owed at the time of default. The Society does not have any significant revolving commitments where guaranteed further amounts can be drawn down by the borrower.
- LGD represents the Society's expectation of the extent of loss on a default and takes account of available collateral, likely sales cost and potential discount needed to secure a sale.

The Society has based its IFRS 9 ECL calculations on the models used to calculate regulatory expected losses, with the following amendments:

- The IFRS 9 PD is based on a point in time calculation adjusted to take into account estimates of future economic conditions. The regulatory PD is long run and is averaged throughout a full economic cycle.
- The IFRS 9 EAD has been modelled based on expected payments over the term up to the point of default. The regulatory EAD cannot be lower than the current balance.
- The IFRS 9 LGD includes the impact of future economic conditions such as changes in value of collateral and does not include any floors. Only costs associated with obtaining/selling the collateral are included and the discounting of the expected cash flows is performed using the Effective Interest Rate of the loan. The regulatory LGD is based on downturn conditions and includes all collection costs, is subject to regulatory floors and is discounted using a stressed measure of the cost of capital.
- IFRS 9 also requires the use of multiple economic scenarios to calculate a probability weighted forward looking ECL. More information on the forward looking information incorporated in the ECL calculations is included in note 13.

Key assumptions and judgements within the ECL calculations, such as whether the forward looking views remain appropriate or whether staging criteria require adjustment, are monitored and reviewed on a regular basis, at least quarterly. These modelled ECL provisions may be adjusted by the Society if it considers that there are potentially additional risks that have not been identified or that cannot be adequately modelled. Examples of these post model adjustments are in respect of small loan portfolios where there is insufficient data on which to build statistically robust models and the risk of buy to let interest only customers not repaying the capital at maturity. The assumptions applied as part of IFRS 9 are regularly reviewed and further information can be found in note 13.

ECLs for loans and advances to customers reduce the carrying amount of these assets in the Balance Sheet and the movement in ECLs is included in impairment losses in the Income Statement. For mortgage pipeline exposures and undrawn mortgage loan facilities, the provision is included in the ECL provision in the Balance Sheet.

Calculation of expected credit loss under IFRS 9 – treasury credit risk and investment in Group undertakings

Treasury assets comprise cash and balances with the Bank of England, loans and advances to financial institutions and debt securities.

Credit losses on treasury assets are rare for the Group. In accordance with IFRS 9, impairment for treasury credit exposures is calculated taking the exposure value and applying an externally published PD for the credit rating applicable to the exposure. Exposures are monitored to review whether any change in the counterparty credit profile reflects a significant increase in credit risk.

ECLs for treasury assets held at amortised cost reduce the carrying amount of these assets in the Balance Sheet and the movement in ECLs is included in impairment losses in the Income Statement. ECLs for debt securities measured at FVOCI do not reduce the carrying amount of these assets which remain at fair value in the Balance Sheet. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in other comprehensive income as an accumulated impairment amount with a corresponding charge to impairment losses in the Income Statement. The accumulated loss recognised in other comprehensive income is then recycled to the Income Statement upon derecognition of the assets.

The Society's Investment in Group undertakings comprises shares and intercompany loans which are valued at cost less any provision for impairment. These investments are reviewed annually for evidence of potential impairment, significant increase in credit risk with any impairment recognised in the Income Statement. No impairment on Investments in Group undertakings has been identified.

Write off policy

The Group writes off financial assets when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery.

Derivative financial instruments

The Group holds derivative financial instruments only to manage the risks associated with its non-variable rate assets and liabilities and its foreign currency transactions and not for speculative or trading purposes.

All external derivative financial instruments are carried at fair value. Derivatives are principally valued by discounting cash flows using yield curves that are based on observable market data. In measuring fair value, separate adjustments are made for credit risk to the extent not already included in the valuation.

Hedge accounting

Although the Group adopted IFRS 9 from 1 January 2018, it elected to continue to apply the hedge accounting requirements of IAS 39.

Where the documentation, eligibility and testing criteria for hedge accounting set out in IAS 39 (including amendments issued in the year) are met, the Group uses hedge accounting and designates the hedging derivative as either hedging fair value or cash flow risks. The Group undertakes this both on an individual and a portfolio accounting basis.

Fair value hedges

Changes in the fair value of derivatives that qualify as fair value hedges are recorded in the Income Statement under Net gains/losses from derivatives and hedge accounting in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that is attributable to the hedged risk (interest rate risk). This also applies if the hedged item is classified as an FVOCI financial asset.

Notes to the accounts continued

1. Accounting policies continued

Cash flow hedges

Gains and losses on derivative financial instruments hedging the variability in cash flows of a designated asset or liability are recognised directly through the Statement of Comprehensive Income in the cash flow hedge reserve. The relevant portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately to the extent that the hedge is deemed ineffective under IAS 39. Any amounts deferred to the cash flow hedge reserve are subsequently recycled to the Income Statement when the underlying asset or liability being hedged impacts the Income Statement, for example when foreign exchange movements occur.

Intangible assets

Intangible assets are stated at cost less accumulated amortisation and any impairment. Maintenance costs associated with the operation of these intangibles are charged to the Income Statement as incurred. Amortisation is charged to the Income Statement on a straight line basis over the useful life of the asset commencing from the date the asset is ready for use. The useful life of computer software is reviewed by management at each financial year end and is currently between three and eight years for assets which are currently in use.

Software development costs, both internal and external, and purchased software that is not an integral part of a related hardware purchase are recognised as an intangible asset if it is probable that: (a) the asset is controlled by the Group; (b) it is separately identifiable; and (c) it will generate future economic benefits. For each significant project undertaken by the Group, an assessment of capitalisation criteria including future economic benefit is performed by the relevant business area and reviewed in accordance with agreed governance processes.

Intangible assets, including assets in the course of construction, are reviewed for impairment at each reporting date or whenever events or changes in circumstances indicate that the carrying amount may exceed the recoverable amount. Where impairment is identified the asset is written down immediately to the estimated recoverable amount and the impairment amount is charged to the Income Statement.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment. The carrying values of property, plant and equipment are reviewed at each reporting date for impairment or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Where this is the case the asset is written down immediately to the estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying value of the asset and are included within the Income Statement.

Depreciation commences when the asset is ready for use and is provided on a straight line basis over the anticipated useful life of the asset which is currently as follows:

Freehold and long leasehold buildings	Over a period of 50 years
Leasehold adaptations	Shorter of remaining term of the lease and useful life
Equipment, fixtures and fittings	Three to eight years

Employee benefits

Pensions

The Group operates a defined benefit pension scheme and a defined contribution scheme for employees.

Contributions to the defined contribution pension scheme are recognised as an expense in the Income Statement as incurred, on an accruals basis.

The Group's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds. This calculation allows the net obligation of the scheme to be expressed as either a surplus or a deficit, which is recognised as either an asset or a liability respectively in the Group's accounts at the Balance Sheet date.

Gains or losses arising from the remeasurement of the defined benefit plan are recognised in full, in the year they occur, in the Statement of Comprehensive Income.

Other long term employee benefits

The cost of bonuses payable 12 months or more after the end of the financial years in which they are earned is recognised in the year in which the employees render the related service.

Short-term employee benefits
The cost of short-term employee benefits, including wages and salaries, social security costs, bonuses payable within 12 months and healthcare, is recognised in the year of service.

Financial liabilities
Financial liabilities include shares, bank and other deposits, amounts owed to other customers, debt securities in issue, derivative financial instruments, subordinated liabilities and subscribed capital. The Group classifies its financial liabilities into the following categories:

Amortised cost
Financial liabilities, other than derivatives, are measured on an amortised cost basis reflecting their face value adjusted for any unamortised premiums, discounts and transaction costs directly attributable to the acquisition or issue. Amortisation is recognised in Interest payable and similar charges at the Effective Interest Rate of the liability.

Fair value through profit or loss
All derivatives are carried at fair value.

Changes in the fair value of derivatives other than those in cash flow hedge accounting relationships are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy above.

For changes in the fair value of derivatives in cash flow hedge accounting relationships, see the hedge accounting policy for cash flow hedges.

Provisions and contingent liabilities
A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably. For the Financial Services Compensation Scheme (FSCS) levy, a provision is recognised when the levy is legally enforceable, in accordance with IFRIC 21 Levies.

Contingent liabilities are potential obligations from past events which will only be confirmed by future events. Contingent liabilities are not recognised within the Balance Sheet.

Equity instruments
Financial instruments are classified as equity instruments where the contractual arrangements with the holder do not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity net of the costs directly attributable to the issuance.

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted from the general reserve.

Foreign currency translation
The consolidated financial statements are presented in pounds sterling, which is the functional currency of the Group.

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the Balance Sheet date. Foreign exchange gains and losses resulting from retranslation and settlement are recognised in the Income Statement.

Cash and cash equivalents
Cash and cash equivalents in the Statement of Cash Flows comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks and loans and advances to credit institutions.

IFRS disclosure
For ease of reference, certain audited IFRS disclosures related to credit, market and liquidity and funding risks are included within the Risk Management Report.

A maturity analysis for all assets and liabilities is presented in the Liquidity and Funding section of the Risk Management Report.

Audited information is also included within the Directors' Remuneration Report. These disclosures, where marked as 'audited', are covered by the Independent Auditor's Report.

Notes to the accounts continued

2. Judgement in applying accounting policies and significant accounting estimates

There are judgements relating to the application of the Group's accounting policies which have had a significant effect on the amounts recognised in the financial statements. The Group has also made significant judgements relating to assumptions and estimates that could affect the reported amount of assets and liabilities both in the accounts and in the following financial years. The most significant judgements and assumptions and estimates are disclosed in the following notes:

Significant accounting policy judgements	Notes
Classification and measurement of equity release loans and associated hedge accounting	1
Determining a significant increase in credit risk under IFRS 9	1
Significant assumptions and estimates	
Mortgage EIR	3
Expected credit loss provision on loans and advances to customers	13

3. Interest receivable and similar income

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
On financial assets measured at amortised cost:				
On loans and advances to customers	**997.7**	967.2	**563.9**	561.3
Connected undertakings	**–**	–	**299.4**	323.2
Foreign currency gain[1]	**–**	0.2	**–**	11.0
Interest on other liquid assets	**39.1**	30.6	**38.1**	29.8
Interest and other income on debt securities	**0.5**	0.2	**0.5**	0.2
Interest and other income on debt securities measured at FVOCI	**21.2**	23.2	**21.2**	23.2
On financial instruments in a qualifying hedging relationship	**(48.0)**	(60.0)	**(48.0)**	(60.0)
Total interest receivable and similar income calculated using the EIR method	**1,010.5**	961.4	**875.1**	888.7
Gain on derecognition of financial assets	**–**	14.9	**–**	4.4
Total interest receivable and similar income	**1,010.5**	976.3	**875.1**	893.1

1. Foreign currency gains and losses have been presented on a net basis within Interest payable and similar charges in 2019.

The £14.9 million gain on derecognition of financial assets in the year ended 31 December 2018 relates to the derecognition of a £350.9 million mortgage portfolio and associated derivative financial instruments. For more information see note 11.

Significant assumptions and estimates – Effective Interest Rate (EIR)

The Group recognises interest on loans and advances to customers on the basis of their EIR. This is a single constant rate that averages out the effect of fixed and variable rates of interest and fees across the expected life of the loan account. Critical assumptions in the EIR calculation are the expected life and the assumed reversion rate at the end of the fixed rate period, as these determine the assumed period over which customers may be paying differentiated interest rates and the amount of those rates. The calculation of the EIR uses assumptions on expected life that are based on the experience of similar products.

These assumptions are monitored to ensure their ongoing appropriateness. Changes in the amortised cost arising from actual product experience, differing from the assumptions, are periodically calculated and an adjustment made to loans and advances to customers, with a corresponding adjustment to the Income Statement. This adjustment reflects changes to income which has been previously been recognised, in addition to changes in expectations of future interest and therefore can introduce significant volatility.

As at 31 December 2019, the EIR method resulted in an asset of £75.8 million (2018: £84.2 million), gross of fees, within loans and advances to customers. This adjustment represented 0.2% (2018: 0.2%) of the Balance Sheet carrying value of mortgages. The movement in the year of £8.4 million was recognised in the Income Statement.

A significant proportion of the Society's mortgage portfolio includes balances on fixed rate deals. The level of repayment immediately post maturity of the fixed rate deal is a key estimate within the EIR assumptions. Modelling is undertaken to analyse customer behaviour at the end of their fixed rate period and support the assumptions used. If the proportion of customers who redeem their mortgage at the end of their fixed rate deal differs to the estimate, it can have a material impact on the revised future cash flows. To illustrate this, the Society has undertaken sensitivity analysis on post-maturity behaviour. An increase in redemption rates of loans after the initial fixed rate incentive period of 5% for 12 months would result in a decrease in the Balance Sheet value of mortgages of £10.5 million, with a corresponding reduction in the Income Statement. The other key estimate within the EIR assumptions is the rate to which mortgages will revert following the initial fixed rate period, usually the Standard Variable Rate (SVR). The EIR calculation is based on the SVR applicable at the date of the origination of the mortgage. If the actual SVR differs from the estimate, it can also have a material impact on the revised future cash flows. If all of the fixed rate mortgage balances were subject to a fall in SVR of 25 basis points, a reduction to the Balance Sheet value of mortgages of £10.2 million would result, with a corresponding reduction in the Income Statement.

4. Interest payable and similar charges

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Subordinated liabilities	1.8	1.8	1.8	1.8
Other	45.5	33.0	45.7	33.2
Debt securities in issue	96.7	102.1	93.3	98.5
Other borrowed funds				
On shares held by individuals	482.2	444.2	482.2	444.1
On subscribed capital	4.8	4.9	4.8	4.9
Net income on financial instruments hedging liabilities	(18.1)	(35.5)	(27.3)	(35.5)
Foreign currency losses[1]	0.2	–	0.3	10.9
Other interest payable	0.7	–	0.7	–
Total	613.8	550.5	601.5	557.9

1. Foreign currency losses have been presented on a net basis within Interest payable and similar charges in 2019.

5. Fees and commissions receivable

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Mortgage related administration fees	4.7	4.9	2.9	3.1
General insurance commissions	0.8	1.1	0.8	1.1
Other fees and commissions	2.3	2.1	2.3	2.1
Total	7.8	8.1	6.0	6.3

6. Fees and commissions payable

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Banking fees	2.6	2.8	2.6	2.8
Other fees and commissions	7.6	7.6	5.0	4.8
Total	10.2	10.4	7.6	7.6

7. Other operating income

Operating income of £2.5 million includes £1.4 million relating to receipt of deferred contingent consideration following the sale of the Society's equity investment in VocaLink Holdings Limited in 2017 as well as the gain of £1.0 million on the remaining investments in equity shares of Visa Inc. and VocaLink, measured at fair value through profit and loss.

Notes to the accounts continued

8. Net (losses)/gains from derivatives and hedge accounting

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Derivatives designated as fair value hedges				
(Losses)/gains on derivatives designated as fair value hedges	(120.2)	10.6	(120.2)	16.2
Movement in fair value of hedged items attributable to hedged risk	123.0	(10.8)	123.0	(16.3)
Ineffectiveness on fair value hedges	2.8	(0.2)	2.8	(0.1)
Derivatives designated as cash flow hedges[1]				
Foreign exchange	–	–	–	–
Foreign exchange and interest rate	0.6	(1.0)	(0.1)	–
Interest rate	(0.6)	0.9	(0.6)	0.9
Ineffectiveness on cash flow hedges	–	(0.1)	(0.7)	0.9
(Losses)/gains on other derivatives	(20.0)	–	(20.6)	2.3
Total	(17.2)	(0.3)	(18.5)	3.1

1. Represents ineffectiveness on cash flow hedge relationships which will mature over a period of nine years (2018: six).

Further information on the Society's risk management strategy and how it hedges interest and foreign exchange risk is in note 24.

Losses on other derivatives of £20.0 million have been recognised in the Income Statement reflecting fair value movements on derivatives where hedge accounting relief has not been fully obtained. The loss has been driven by considerable market volatility which has impacted swap valuations. The losses represent timing differences and are expected to reverse over the remaining life of the derivatives although further volatility may also be experienced.

Foreign exchange gains of £105.2 million (2018: £18.0 million loss) have been recognised in the Income Statement relating to the principal amount of financial instruments held at amortised cost. This is offset by foreign exchange losses of £105.4 million (2018: £18.0 million gain) on derivative financial instruments held at fair value.

9. Administrative expenses

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Employee costs				
Wages and salaries	87.4	82.0	87.4	82.0
Social security costs	9.2	8.7	9.2	8.7
Pension costs				
Defined benefit plan (note 20)	(0.8)	(0.5)	(0.8)	(0.5)
Defined contribution plan	5.8	5.4	5.8	5.4
	101.6	95.6	101.6	95.6
Other expenses				
Loss on disposal of property, plant and equipment and intangibles	0.9	0.9	0.9	0.9
Premises and facilities	8.2	13.4	8.2	13.4
Project costs	36.3	49.2	36.3	49.2
Information systems	15.4	12.2	15.4	12.2
Other operating expenses	39.0	28.9	38.3	28.6
Intercompany management charge	–	–	(38.6)	(10.3)
Total	201.4	200.2	162.1	189.6

The costs above relate to both ongoing business as usual activity and delivering change as shown below. Costs of delivering change include both third party and employee costs which relate to change activity. The Intercompany management charge reflects a contribution to operational costs by Godiva Mortgages Limited and ITL Mortgages Limited in respect of management and servicing of their mortgage portfolios.

Group and Society	2019 £m	2018 £m
Business as usual run costs	149.1	145.8
Costs of delivering change	52.3	54.4
Total	201.4	200.2

The remuneration of the auditor, PricewaterhouseCoopers LLP (2018: Ernst & Young LLP) is set out below:

Group and Society	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Audit of the Group and Society annual accounts	0.6	0.3	0.6	0.3
Audit of Group subsidiaries	0.1	0.1	–	–
Audit related assurance services	0.1	0.1	0.1	0.1
Other non-audit services	–	–	–	–
Total	0.8	0.5	0.7	0.4

The Group's policy in relation to its auditor providing non-audit engagements sets out the services generally precluded from performing. Further details are included in the Board Audit Committee Report in the Governance section. All non-audit engagements provided by the Group's auditors are subject to pre-approval by either the Board Audit Committee or the Chief Financial Officer (under delegation from the Board Audit Committee), depending upon the nature of the non-audit engagement.

10. Employee numbers

Group and Society	2019 Full time	2019 Part time	2019 Total	2018 Full time	2018 Part time	2018 Total
The average number of persons employed during the year (including executive directors) was:						
Head office and administrative centres	1,574	447	2,021	1,482	435	1,917
Branches	316	298	614	311	304	615
Total	1,890	745	2,635	1,793	739	2,532

The average number of employees on a full time equivalent basis was 2,345 (2018: 2,240) and all of these are employed within the United Kingdom.

11. Interest in unconsolidated structured entity

The Group completed a whole loan sale of its beneficial interests in £350.9 million of buy to let mortgages originated by its subsidiary Godiva Mortgages Limited (Godiva) to a third party in June 2018 and continues to service this book. The gain on derecognition of the mortgages and associated derivative financial instruments is included in Interest receivable and similar income calculated using the Effective Interest Rate method in the Income Statement for the year ended 31 December 2018.

It was concluded that it was appropriate to derecognise these assets under IFRS 9 and that there was no requirement to consolidate the results of the third party who purchased the loan under IFRS 10 Consolidated Financial Statements. Further information is included in the 2018 Annual Report & Accounts note 11 on page 122.

Under the arrangements, the Group continues to service the loans and is paid a service fee which is set on an arm's-length basis and on market terms. The fees from servicing arrangements totalling £1.2 million (2018: £1.0 million) are included in Fees and commissions receivable in the Income Statement.

Notes to the accounts continued

12. Classification and measurement of financial instruments

The following table summarises the classification of carrying amounts of the Group's financial assets and liabilities at the reporting date. A separate Society table is not presented as there are no differences in classification to that of the Group.

Group	31 December 2019 Amortised cost £m	Fair value through other comprehensive income £m	Fair value through profit and loss £m	Total £m
Financial assets				
Cash and balances with the Bank of England	5,226.0	–	–	5,226.0
Loans and advances to financial institutions	336.1	–	–	336.1
Debt securities	16.0	1,276.6	–	1,292.6
Loans and advances to customers	42,234.7	–	–	42,234.7
Hedge accounting adjustment	149.7	–	–	149.7
Derivative financial instruments	–	–	137.9	137.9
Investment in equity shares	–	–	4.1	4.1
Total financial assets	47,962.5	1,276.6	142.0	49,381.1
Other non-financial assets	149.7	–	–	149.7
Total assets	48,112.2	1,276.6	142.0	49,530.8
Financial liabilities				
Shares	36,238.1	–	–	36,238.1
Deposits from banks	5,318.6	–	–	5,318.6
Other deposits	8.5	–	–	8.5
Amounts owed to other customers	462.7	–	–	462.7
Debt securities in issue	4,815.6	–	–	4,815.6
Hedge accounting adjustment	44.0	–	–	44.0
Derivative financial instruments	–	–	281.8	281.8
Subordinated liabilities	25.5	–	–	25.5
Subscribed capital	41.6	–	–	41.6
Total financial liabilities	46,954.6	–	281.8	47,236.4
Other non-financial liabilities	91.6	–	–	91.6
Total liabilities	47,046.2	–	281.8	47,328.0

Group	Amortised cost £m	Fair value through other comprehensive income £m	Fair value through profit and loss £m	Total £m
	31 December 2018			
Financial assets				
Cash and balances with the Bank of England	5,219.4	–	–	5,219.4
Loans and advances to financial institutions	231.3	–	–	231.3
Debt securities	16.3	934.9	–	951.2
Loans and advances to customers	39,264.6	–	–	39,264.6
Hedge accounting adjustment	6.5	–	–	6.5
Derivative financial instruments	–	–	268.9	268.9
Investment in equity shares	–	–	3.1	3.1
Total financial assets	44,738.1	934.9	272.0	45,945.0
Other non-financial assets	125.9	–	–	125.9
Total assets	44,864.0	934.9	272.0	46,070.9
Financial liabilities				
Shares	33,281.6	–	–	33,281.6
Deposits from banks	5,453.8	–	–	5,453.8
Other deposits	9.5	–	–	9.5
Amounts owed to other customers	496.5	–	–	496.5
Debt securities in issue	4,353.9	–	–	4,353.9
Hedge accounting adjustment	36.5	–	–	36.5
Derivative financial instruments	–	–	167.4	167.4
Subordinated liabilities	25.5	–	–	25.5
Subscribed capital	41.6	–	–	41.6
Total financial liabilities	43,698.9	–	167.4	43,866.3
Other non-financial liabilities	84.2	–	–	84.2
Total liabilities	43,783.1	–	167.4	43,950.5

Notes to the accounts continued

13. Impairment on loans and advances to customers

Under IFRS 9, impairment provisions are required to be calculated on amortised cost, fair value through other comprehensive income assets and mortgage pipeline commitments.

For the Group substantially all impairment relates to loans and advances to customers and the tables below provide additional information. Further information on the credit quality of these loans, including by IFRS 9 stage, is included in the Risk Management Report.

Given the low risk nature of the Society's treasury assets all have been assessed as performing throughout the period and therefore the resulting ECL is immaterial.

The impairment charge in the year was £2.1 million (2018: credit £0.4 million). A reconciliation of the movement on impairment provision split by IFRS 9 stage from 1 January 2019 to 31 December 2019 is set out below:

Group Loans and advances to customers	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Total £m
Loss allowance at 1 January 2019	1.4	3.9	6.3	11.6
Movements with Income Statement impact				
Transfers:				
Transfers from stage 1 to stage 2	(0.1)	1.1	–	1.0
Transfers from stage 1 to stage 3	–	–	1.1	1.1
Transfers from stage 2 to stage 1	0.1	(0.5)	–	(0.4)
Transfers from stage 3 to stage 1	–	–	(0.1)	(0.1)
New mortgages originated	0.6	–	–	0.6
Remeasurement of ECL due to changes in risk parameters	(0.1)	(0.3)	0.6	0.2
(Decrease)/increase in post model adjustments	–	(0.3)	3.1	2.8
Remeasurement of ECL due to model refinements	(0.4)	(0.6)	(0.1)	(1.1)
Financial assets derecognised during the period	(0.4)	(0.3)	(0.7)	(1.4)
Other items impacting Income Statement	–	–	(0.3)	(0.3)
Net write off to Income Statement	0.1	–	(0.4)	(0.3)
Total net Income Statement (credit)/charge in the period	(0.2)	(0.9)	3.2	2.1
Other movements with no Income Statement impact				
Transfers:				
Transfers from stage 2 to stage 3	–	(0.3)	0.3	–
Transfers from stage 3 to stage 2	–	0.5	(0.5)	–
Net write offs and other ECL movements	(0.2)	–	(1.5)	(1.7)
Loss allowance at 31 December 2019	1.0	3.2	7.8	12.0

A number of refinements to the Society's ECL models have been made during 2019. These include an update to the calculation of the probability of default and an enhancement to the regional House Price Index modelling capability. In the year these refinements decreased ECLs by £1.1 million at Group level and £0.3 million within the Society.

The impact of post model adjustments on the impairment provision has increased by £2.8 million to £4.0 million during 2019.

Society Loans and advances to customers	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Total £m
Loss allowance at 1 January 2019	0.9	1.4	3.0	5.3
Movements with Income Statement impact				
Transfers:				
Transfers from stage 1 to stage 2	–	0.4	–	0.4
Transfers from stage 1 to stage 3	–	–	0.6	0.6
Transfers from stage 2 to stage 1	–	(0.2)	–	(0.2)
Transfers from stage 3 to stage 1	–	–	–	–
New mortgages originated	0.4	–	–	0.4
Remeasurement of ECL due to changes in risk parameters	(0.1)	(0.4)	0.4	(0.1)
Increase in post model adjustments	–	0.1	0.9	1.0
Remeasurement of ECL due to model refinements	(0.1)	(0.1)	(0.1)	(0.3)
Financial assets derecognised during the period	(0.3)	(0.1)	(0.4)	(0.8)
Other items impacting Income Statement	–	–	(0.1)	(0.1)
Net write off to Income Statement	–	–	(0.4)	(0.4)
Total net Income Statement (credit)/charge in the period	(0.1)	(0.3)	0.9	0.5
Other movements with no Income Statement impact				
Transfers:				
Transfers from stage 2 to stage 3	–	(0.1)	0.1	–
Transfers from stage 3 to stage 2	–	0.3	(0.3)	–
Net write offs and other ECL movements	(0.1)	–	(0.6)	(0.7)
Loss allowance at 31 December 2019	0.7	1.3	3.1	5.1

Group Loans and advances to customers	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Total £m
Loss allowance at 1 January 2018	1.3	3.9	8.3	13.5
Movements with Income Statement impact				
Transfers:				
Transfers from stage 1 to stage 2	(0.1)	1.1	–	1.0
Transfers from stage 1 to stage 3	–	–	0.8	0.8
Transfers from stage 2 to stage 1	0.1	(0.5)	–	(0.4)
Transfers from stage 3 to stage 1	–	–	(0.1)	(0.1)
New mortgages originated	0.6	–	–	0.6
Remeasurement of ECL due to changes in risk parameters	(0.1)	(0.3)	0.4	–
Decrease in post model adjustments	–	(0.4)	–	(0.4)
Financial assets derecognised during the period	(0.4)	(0.2)	(1.0)	(1.6)
Other items impacting Income Statement	–	–	–	–
Net write off to Income Statement	0.1	–	(0.4)	(0.3)
Total net Income Statement charge/(credit) in the period	0.2	(0.3)	(0.3)	(0.4)
Other movements with no Income Statement impact				
Transfers:				
Transfers from stage 2 to stage 3	–	(0.2)	0.2	–
Transfers from stage 3 to stage 2	–	0.5	(0.5)	–
Net write offs and other ECL movements	(0.1)	–	(1.4)	(1.5)
Loss allowance at 31 December 2018	1.4	3.9	6.3	11.6

Notes to the accounts continued

13. Impairment on loans and advances to customers continued

Society Loans and advances to customers	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Total £m
Loss allowance at 1 January 2018	0.8	1.3	3.1	5.2
Movements with Income Statement impact				
Transfers:				
Transfers from stage 1 to stage 2	–	0.5	–	0.5
Transfers from stage 1 to stage 3	–	–	0.2	0.2
Transfers from stage 2 to stage 1	0.1	(0.3)	–	(0.2)
Transfers from stage 3 to stage 1	–	–	(0.1)	(0.1)
New mortgages originated	0.5	–	–	0.5
Remeasurement of ECL due to changes in risk parameters	(0.1)	(0.2)	1.3	1.0
Decrease in post model adjustments	–	(0.2)	–	(0.2)
Financial assets derecognised during the period	(0.3)	–	(0.3)	(0.6)
Other items impacting Income Statement	–	–	–	–
Net write off to Income Statement	–	–	(0.3)	(0.3)
Total net Income Statement charge/(credit) in the period	0.2	(0.2)	0.8	0.8
Other movements with no Income Statement impact				
Transfers:				
Transfers from stage 2 to stage 3	–	(0.1)	0.1	–
Transfers from stage 3 to stage 2	–	0.4	(0.4)	–
Net write offs and other ECL movements	(0.1)	–	(0.6)	(0.7)
Loss allowance at 31 December 2018	0.9	1.4	3.0	5.3

Significant assumptions and estimates – forward looking information incorporated in the ECL models

The assessment of a significant increase in credit risk and the calculation of ECL both incorporate forward looking information and therefore require significant management judgement. The Group has used four economic scenarios to assess ECLs for its core owner-occupier and buy to let portfolios which represent over 99% of total loans and advances to customers. An explanation of each scenario and its relative weighting in calculating ECL is as follows:

Scenario	2019	2018
Base – a central scenario based on the Group's Strategic Plan, updated for the latest forecasts	60%	60%
Upside – based on an improved credit environment given the current benign conditions the improvement on base case is minor	2%	1%
Downside – a scenario that represents a significant downside (but less sharp fall than the severe downside) equivalent to a significant economic downturn in the UK	26%	29%
Severe downside – based on the Internal Capital Adequacy Assessment Process (ICAAP) high rates stress (being the worst case scenario from a credit loss perspective used in capital stress testing) is viewed as being severe enough to reflect a negative outcome from Brexit trade negotiations	12%	10%

The changes which have been made to the weightings in the year reflect a continued uncertain economic outlook. The most significant assumptions used in these scenarios are set out below:

Scenario 2019		Base %	Severe downside %	Downside %	Upside %
Bank of England base rate	Five year average	0.6	3.4	0.4	1.3
Unemployment	Five year average	4.2	7.9	5.9	3.7
House Price Index	Peak to trough	3.5	(38.3)	(7.8)	19.9
	Range	(1.0) – 2.5	(38.3) – 0.0	(7.8) – 0.0	0.0 – 19.9
UK GDP	Peak to trough	7.0	(4.7)	(3.6)	14.4
	Range	0.0 – 7.0	(4.7) – 0.0	(1.0) – 2.6	0.0 – 14.4

Scenario 2018		Base %	Severe downside %	Downside %	Upside %
Bank of England base rate	Five year average	1.1	3.3	1.9	0.5
Unemployment	Five year average	4.5	8.1	6.1	4.1
House Price Index	Peak to trough	9.8	(37.8)	(13.0)	20.3
	Range	0.1 – 9.9	(37.8) – 0.0	(12.6) – 0.4	0.2 – 20.5
UK GDP	Peak to trough	7.5	(4.7)	8.0	15.5
	Range	0.1 – 7.6	(4.5) – 0.2	(0.6) – 7.4	0.2 – 15.7

The ECL calculation is particularly sensitive to changes in:

- House Price Index (HPI), given the significant impact it has on mortgage collateral valuations.
- Unemployment rate, given its impact on borrowers' ability to meet their loan repayments.

There is a significant degree of estimation relating to the relative weightings of the scenarios, incorporating different views of the HPI and unemployment as indicated above. In order to demonstrate this sensitivity, the impact of applying 100% of a particular scenario on the reported IFRS 9 impairment provision is shown below; for example, if the provision was wholly calculated on the base case scenario it would be a decrease by £1.6 million, or 13.3% (2018: £2.0 million, 17.2%) compared with the reported provision. If a 100% weighting was attributed to the severe downside, ECLs would increase by £10.7 million, or 89.2% (2018: £14 million, 120.7%).

	2019		2018	
Scenario	IFRS 9 provision £m	Increase/ (decrease) %	IFRS 9 provision £m	Increase/ (decrease) %
IFRS 9 weighted average	12.0	–	11.6	–
Base	10.4	(13.3)	9.6	(17.2)
Severe downside	22.7	89.2	25.6	120.7
Downside	11.1	(7.5)	11.9	2.6
Upside	9.5	(20.8)	8.7	(25.0)

To demonstrate the sensitivity on the Base scenario to HPI falls and unemployment increases, if average regional house prices indices were to fall by 10% alongside a 10% increase in the unemployment rate, the estimated impact on the impairment provision to the base scenario would be an increase of £3.2 million (2018: £3.3 million), with a corresponding charge in the Income Statement.

The impact of applying 100% weighting to the downside and severe downside has reduced compared with 2018. This is a result of the changes which have been made to the scenarios during the year. In particular, the base scenario has reduced HPI growth assumptions compared with 2018. This has driven the base calculations and the IFRS 9 weighted average closer to the downturn ECLs.

Notes to the accounts continued

14. Taxation

	Group 2019 £m	Group 2018 Restated £m	Society 2019 £m	Society 2018 Restated £m
Current tax				
UK corporation tax	31.1	39.8	15.4	25.2
UK corporation tax – adjustment in respect of prior years	0.4	(5.6)	0.4	(5.6)
Total current tax	31.5	34.2	15.8	19.6
Deferred tax				
Current year	(5.6)	(0.8)	(5.6)	(0.8)
Adjustment in respect of prior years	(0.4)	5.2	(0.4)	5.2
Total deferred tax	(6.0)	4.4	(6.0)	4.4
Total	25.5	38.6	9.8	24.0

In the 2018 Annual Report & Accounts, the tax charge was recorded as £45.5 million for the Group and £30.9 million for the Society. In 2019, the 2018 charge has been restated and the decrease of £6.9 million (Group and Society) relates to the reclassification of tax in relation to distributions to holders of the Group's AT 1 instrument following amendments to IAS 12. More information is included in note 1.

A reconciliation between the actual tax expense and tax that would be due if the UK standard corporation tax rate of 19.0% (2018: 19.0%) was applied to the profit before tax without adjustment is as follows:

	Group 2019 £m	Group 2018 Restated £m	Society 2019 £m	Society 2018 Restated £m
Profit before tax (PBT)	147.2	201.6	64.5	124.7
Tax at UK standard rate of corporation tax on PBT of 19.0% (2018: 19.0%)	28.0	38.3	12.3	23.7
Recurring items				
Surcharge on banking profits	3.2	8.1	3.2	8.1
Tax credit on Additional Tier 1 capital distribution	(6.6)	(6.9)	(6.6)	(6.9)
Expenses not deductible for tax purposes – compensation payments	–	0.2	–	0.2
Effect of tax rate change	1.0	(0.5)	1.0	(0.5)
Non-recurring items				
Adjustments in respect of prior years	–	(0.4)	–	(0.4)
Other	(0.1)	(0.2)	(0.1)	(0.2)
Total	25.5	38.6	9.8	24.0

The Society, but not other Group companies, is subject to a surcharge of 8% on taxable profits in excess of £25 million in line with other banking companies, including building societies.

The effective tax rate for the year is 17.3% (2018: 19.1%) for the Group and 15.2% (2018: 19.2%) for the Society. The effective tax rates for 2019 are below the UK standard corporation tax rate, because the £6.6 million (2018: £6.9 million) tax credit in relation to distributions to holders of the Group's AT 1 instrument outweighs the £3.2 million (2018: £8.1 million) surcharge on banking profits.

The Society publishes its tax strategy on the website, at www.coventrybuildingsociety.co.uk/consumer/our-performance/corporate-governance/tax-strategy.html.

Tax on items reported through the Statements of Comprehensive Income is as follows:

Statements of Comprehensive Income	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Tax (credit)/charge on remeasurement of defined benefit pension plan	(1.6)	0.6	(1.6)	0.6
Tax (credit)/charge on fair value through other comprehensive income movements	(0.6)	0.2	(0.6)	0.2
Tax (credit)/charge on cash flow hedges	(4.9)	1.5	(1.5)	(1.8)
Effect of change in corporation tax rate	0.4	(0.2)	0.2	(0.1)
Total	(6.7)	2.1	(3.5)	(1.1)

15. Debt securities

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Fair value through other comprehensive income:				
UK Government investment securities	**864.8**	859.8	**864.8**	859.8
Other listed transferable debt securities	**411.8**	75.1	**411.8**	75.1
Amortised cost				
Other listed transferable debt securities	**16.0**	16.3	**16.0**	16.3
Total	**1,292.6**	951.2	**1,292.6**	951.2
Movements during the year are analysed below:				
At 1 January	**951.2**	1,011.3	**951.2**	981.3
Additions	**1,095.1**	454.2	**1,095.1**	454.2
Maturities and disposals	**(739.2)**	(477.1)	**(739.2)**	(447.1)
Changes in fair value	**(14.5)**	(37.2)	**(14.5)**	(37.2)
At 31 December	**1,292.6**	951.2	**1,292.6**	951.2

A maturity analysis of the Group debt securities is included in the Liquidity and Funding section of the Risk Management Report.

At the year end no debt securities had been sold under sale and repurchase agreements (2018: £629.4 million). As such, no cash received or accrued interest in relation to these agreements (2018: £623.8 million) was included within deposits from banks (see note 22).

16. Loans and advances to customers

	Notes	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Residential					
Owner-occupier mortgages		**25,198.9**	23,177.0	**24,806.1**	22,723.3
Buy to let mortgages		**16,732.6**	15,738.3	**1,679.7**	1,733.4
Near-prime mortgages		**59.2**	66.3	**3.6**	4.1
Self-certification mortgages		**156.3**	184.2	**78.6**	94.2
Other					
Commercial mortgages		**2.0**	2.2	**0.5**	0.5
Unsecured personal loans		**20.0**	23.8	**13.3**	16.0
Total Gross loans and advances to customers (contractual amounts)		**42,169.0**	39,191.8	**26,581.8**	24,571.5
Impairment	13	**(12.0)**	(11.6)	**(5.1)**	(5.3)
Total Net loans and advances to customers (contractual amounts)		**42,157.0**	39,180.2	**26,576.7**	24,566.2
EIR, fair value and other adjustments		**77.7**	84.4	**82.7**	94.0
Total		**42,234.7**	39,264.6	**26,659.4**	24,660.2

More detailed analysis at the Balance Sheet date together with a reconciliation of opening and closing balances by IFRS 9 stage is included in the Risk Management Report.

Maturity analysis

The remaining contractual maturity of loans and advances to customers at the Balance Sheet date is as follows:

	Notes	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Repayable in less than one year		**3,040.9**	2,853.7	**1,814.9**	1,715.0
Repayable in more than one year		**39,205.8**	36,422.5	**24,849.6**	22,950.5
		42,246.7	39,276.2	**26,664.5**	24,665.5
Impairment provision	13	**(12.0)**	(11.6)	**(5.1)**	(5.3)
Total		**42,234.7**	39,264.6	**26,659.4**	24,660.2

Actual redemption levels experienced by the Group or Society may differ from the contractual analysis.

Notes to the accounts continued

16. Loans and advances to customers continued

Pledged assets – loans and advances to customers

Certain loans and advances to customers have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools with the Bank of England to enable the Group to obtain secured funding.

Loans and advances to customers pledged to support secured funding and the notes in issue are as follows:

		Notes in issue[1]			
2019	Mortgages pledged £m	Held by third parties £m	Held by the Group drawn £m	Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bond programme	6,552.3	2,517.3	695.0	705.0	3,917.3
Securitisation programme – Mercia No.1 plc	1,110.4	–	150.0	823.6	973.6
Securitisation programme – Offa No.1 plc	250.2	139.9	–	77.6	217.5
Whole mortgage loan pools[2]	6,932.1	–	6,355.5	576.7	6,932.2
Total	**14,845.0**	**2,657.2**	**7,200.5**	**2,182.9**	**12,040.6**

1. Notes in issue exclude Class Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.
2. The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under TFS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

		Notes in issue[1]			
2018	Mortgages pledged £m	Held by third parties £m	Held by the Group drawn £m	Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bond programme	4,960.3	2,047.3	927.4	472.6	3,447.3
Securitisation programme – Mercia No.1 plc	1,094.7	–	–	973.6	973.6
Securitisation programme – Offa No.1 plc	285.0	162.4	–	90.3	252.7
Whole mortgage loan pools[2]	7,235.0	–	5,470.1	1,764.9	7,235.0
Total	13,575.0	2,209.7	6,397.5	3,301.4	11,908.6

1. Notes in issue exclude Class Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.
2. The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under TFS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

Mortgages pledged are not derecognised from the Group or Society Balance Sheets as the Group has retained substantially all the risks and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue and held by third parties are included within debt securities in issue (note 23).

Notes in issue, held by the Group and drawn, include debt securities issued by the covered bond programme to the Society, notes issued by the Mercia securitisation programme and whole mortgage loan pools all pledged as collateral.

Notes in issue, held by the Group and undrawn, are other debt securities issued by the programmes to the Society, and mortgage loan pools that have been pre-positioned at the Bank of England but not utilised. These are held to provide collateral for potential future use in sale and repurchase agreements or central bank operations.

Notes in issue, and held by the Group, are not recognised on the Group or Society Balance Sheets, thus preventing inappropriate 'grossing up' of the Group and Society Balance Sheets.

During the year, the Group increased the amount of whole mortgage loan pools pre-positioned at the Bank of England and used this as part of its liquidity risk management strategy.

Covered bonds

Coventry Building Society Covered Bonds LLP (the LLP) provides security for issues of self-issued covered bonds and for external issuances. As at 31 December 2019, the Society had £2,650 million (2018: £2,550 million) and €1,500 million (2018: €1,000 million) of covered bonds in issue, of which £1,400 million (2018: £1,400 million) was retained by the Group. At the reporting date, the Society has overcollateralised the LLP as set out in the table above to secure the ratings of the covered bonds and to provide operational flexibility. The Society maintains the overcollaterisation by adding loans to the loan portfolio throughout the period. From time to time, the obligation of the Society to provide collateral may increase due to the formal requirements of the covered bonds programme and the value of the collateral would depend upon conditions at that time. The Society may also voluntarily contribute collateral to support the covered bond ratings; no such contributions were made during 2019 or 2018.

During the period, the Society voluntarily repurchased £93.5 million (2018: £80.5 million) of mortgages from the LLP to maintain the quality of the pool and minimise the overcollateralisation requirement.

Securitisation – Mercia No.1 plc

Mercia No.1 plc (Mercia) was incorporated in October 2012 and in December 2012 Mercia issued £1,436.4 million of listed debt securities, all of which were retained by the Group. The Society's obligations in respect of the Mercia securitisation vehicle are limited to transferring cash flows from the underlying assets.

In March 2016, Godiva Mortgages Limited repurchased £462.8 million of the mortgages from Mercia and Mercia used the proceeds to reduce notes in issue by this same amount.

Securitisation – Offa No.1 plc

Offa No.1 plc (Offa) was incorporated in February 2016 and in March 2016 Offa issued £427.5 million of listed debt securities secured against certain loans of Godiva Mortgages Limited, of which £152.5 million was held by the Group. The Society's obligations in respect of the Offa securitisation vehicle are limited to transferring cash flows from the underlying assets.

Under the terms of the securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme.

The fair values of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset are presented in the table below:

	Fair value assets pledged 2019 £m	Fair value liabilities 2019 £m	Fair value net position 2019 £m	Fair value assets pledged 2018 £m	Fair value liabilities 2018 £m	Fair value net position 2018 £m
Securitisation programme – Offa No.1 plc	250.2	140.6	109.6	285.0	164.2	120.8

The above table excludes the Mercia securitisation programme as all the notes issued were retained by the Society.

17. Investments in Group undertakings

Society	Shares £m	Loans £m	Total £m
At 1 January 2019	8.0	14,224.6	14,232.6
Additions	–	858.2	858.2
At 31 December 2019	8.0	15,082.8	15,090.8

The Society has the following consolidated subsidiary undertakings, all of which operate in the United Kingdom and are wholly owned by Coventry Building Society:

Subsidiary undertakings	Principal activity
Godiva Mortgages Limited	Mortgage lending
ITL Mortgages Limited	Mortgage lending and mortgage acquisition vehicle
Coventry Financial Services Limited	Non-trading
Coventry Property Services Limited	Non-trading
Godiva Financial Services Limited	Non-trading
Godiva Housing Developments Limited	Non-trading
Godiva Savings Limited	Non-trading
Godiva Securities and Investments Limited	Non-trading

During 2018, Five Valleys Property Company Limited, which was a former investment properties holding company and a subsidiary of the Society, entered winding up proceedings which have completed during 2019.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control in accordance with the accounting policy set out in note 1. The following structured entities are consolidated:

Consolidated structured entities	Principal activity
Coventry Building Society Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds
Mercia No.1 plc	Funding vehicle
Offa No.1 plc	Funding vehicle

The nature and risks associated with the Society's investments in these entities (including obligations of financial support) are disclosed in note 16.

The registered office for Mercia No.1 plc and Offa No.1 plc is 35 Great St. Helens, London EC3A 6AP, for Godiva Mortgages Limited is Oakfield House, Binley Business Park, Binley, Coventry CV3 2TQ and for all of the others is Oakfield House, PO Box 600, Binley Business Park, Coventry CV3 9YR.

Notes to the accounts continued

18. Intangible assets

Group and Society	Externally acquired 2019 £m	Internally developed 2019 £m	Total 2019 £m	Externally acquired 2018 £m	Internally developed 2018 £m	Total 2018 £m
Cost						
At 1 January	17.1	66.2	83.3	15.0	59.0	74.0
Additions	1.3	8.2	9.5	2.1	8.0	10.1
Retirements	(2.1)	(1.3)	(3.4)	–	(0.8)	(0.8)
At 31 December	16.3	73.1	89.4	17.1	66.2	83.3
Amortisation						
At 1 January	12.0	34.1	46.1	9.0	24.2	33.2
Charge for the year	2.8	10.7	13.5	3.0	10.7	13.7
Retirements	(2.1)	(1.3)	(3.4)	–	(0.8)	(0.8)
At 31 December	12.7	43.5	56.2	12.0	34.1	46.1
Net book value at 31 December	3.6	29.6	33.2	5.1	32.1	37.2

Intangible assets primarily consist of externally acquired and internally developed software that is not an integral part of a related hardware purchase.

Internally developed assets at 31 December 2019 include £6.4 million (2018: £5.3 million) of assets in course of construction. These assets relate mainly to the Society's investment in new system platforms to meet the future needs of the business. To the extent that these new system platforms are not yet ready for use by the business, no amortisation has been charged against these assets.

19. Property, plant and equipment

Group and Society	Land and buildings £m	Equipment, fixtures and fittings £m	Right-of-use assets £m	Total £m
Cost				
At 31 December 2018	18.5	65.5	–	84.0
Transfer of right-of-use assets	–	(3.4)	3.4	–
Recognition of leases upon implementation of IFRS 16[1]	–	–	27.5	27.5
At 1 January 2019	18.5	62.1	30.9	111.5
Additions	–	15.3	3.9	19.2
Disposals	(1.9)	(6.9)	(3.5)	(12.3)
At 31 December 2019	16.6	70.5	31.3	118.4
Depreciation				
At 31 December 2018	5.9	29.3	–	35.2
Transfer of right-of-use assets	–	(1.3)	1.3	–
At 1 January 2019	5.9	28.0	1.3	35.2
Charge for the year	0.5	8.9	4.8	14.2
Depreciation on disposals	(1.8)	(6.5)	(0.5)	(8.8)
At 31 December 2019	4.6	30.4	5.6	40.6
Net book value at 31 December 2019	12.0	40.1	25.7	77.8

1. More information on IFRS 16 transition is provided in note 1 to the accounts.

Included within right-of-use assets additions is £1.3 million associated with lease modifications which relate to changes in lease agreements during the period which do not constitute a new agreement but adaptations or amendments to an existing contract.

The net book value of right-of-use assets above relates to the following types of assets:

Right-of-use asset:	2019 Total £m
Property	20.7
Enhanced data infrastructure	4.0
Cars and leased equipment	1.0
Total	25.7

The Society has not restated comparative information on transition to IFRS 16 and disclosures that were presented in the previous period under IAS 17 are presented below:

Group and Society	Land and buildings £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost			
At 1 January 2018	18.6	49.0	67.6
Additions	–	21.4	21.4
Disposals	(0.1)	(4.9)	(5.0)
At 31 December 2018	18.5	65.5	84.0
Depreciation			
At 1 January 2018	5.5	25.9	31.4
Charge for the year	0.4	7.4	7.8
Depreciation on disposals	–	(4.0)	(4.0)
At 31 December 2018	5.9	29.3	35.2
Net book value at 31 December 2018	12.6	36.2	48.8

Disposals relate to assets that were retired during the year.

The net book value of land and buildings occupied by the Group for its own activities is as follows:

Group and Society	2019[1] £m	2018 £m
At 31 December	12.0	12.6

1. Relates to land and buildings owned by the Society and does not include right-of-use assets.

20. Pension scheme

The Society operates both a funded defined benefit and a defined contribution pension scheme.

The Coventry Building Society defined benefit pension scheme (the Fund) is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are require to act in the best interest of the Fund members. The appointment of the trustees is determined by the Fund's trust documentation.

The 31 December 2014 actuarial valuation showed a deficit of £11.5 million. The Society agreed with the trustees that it would aim to eliminate the deficit by 30 September 2019 by the payment of annual contributions of £1.4 million in respect of the deficit. A full actuarial valuation carried out by a qualified independent actuary as at 31 December 2017 was finalised in 2019 and at that date there were 1,758 members comprising current employees, former employees and former executive directors. Since the Fund is closed to future service accrual no contributions were made in respect of members' pensionable salaries during 2019 (2018: £nil); the Society continued to contribute on the basis of the existing deficit recovery plan until June 2019 when the Society commenced the process of transferring its defined benefit pension scheme to a new scheme administered by TPT Retirement Solutions; this process is ongoing at the year end. As part of this transfer a deficit contribution of £6.0 million was made to the scheme, taking total contributions to £6.6 million for the year. There are no further planned deficit contributions ahead of the next actuarial valuation dated 30 September 2019, with the Society meeting and continuing to meet the Fund's expenses through contributions, including levies to the Pension Protection Fund.

Notes to the accounts continued

20. Pension scheme continued

The Fund is subject to the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, set out the framework for funding defined benefit occupational pension plans in the UK.

The Fund typically exposes the Society to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the Balance Sheet and may give rise to increased charges in future periods. This effect would be partially offset by an increase in the value of the plan's bond and liability matching holdings. Caps on inflationary increases are in place to protect the plan against extreme inflation.

The pension scheme assets include investments in Liability Driven Investment (LDI funds). These are leveraged pooled funds that are used to help manage interest rate and inflation risk. The investment policy of the LDI funds can be summarised as follows:

- Each fund holds a portfolio of assets whose cash flows are designed to broadly replicate the liability cash flows of a typical scheme, and funds may have exposure to both nominal and real rates.
- The particular funds chosen are selected so that, when combined, they provide a suitable match for the scheme's liability profile.
- The funds will principally hold a combination of gilt repos, interest rate swaps, inflation swaps, gilt total return swaps and physical gilts.
- The leverage of each fund will vary with changes in interest rates and inflation. The fund manager will follow a recapitalisation process if the leverage in any individual fund reaches a heightened level and follow a re-leveraging process if the leverage in any individual fund decreases to a depressed level.
- The fund manager aims to limit the exposure to each counterparty to 30% of each LDI fund's overall exposure.
- The LDI funds will make distributions based on the coupon payments received from the underlying instruments.

For the purposes of IAS 19 Employee Benefits (Revised) the preliminary results of the full actuarial valuation in progress as at 31 December 2017, which was carried out by a qualified independent actuary, have been updated on an approximate basis to 31 December 2019. There have been no changes in the valuation methodology adopted for this period's disclosures compared with the previous period's disclosures.

The cost of the Fund was assessed in accordance with the advice of a qualified actuary on the basis of valuations using the projected unit credit method. The main assumptions used in the valuations were:

- An investment return pre-retirement of 0.2% (2018: 0.8%) per annum in excess of projected pre-retirement benefit increase.
- An investment return post-retirement of -0.6% (2018: -0.1%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 0.15% (2018: 0.85%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is deducted from the fair value of plan assets and the net surplus is presented on the Balance Sheet as shown below:

Group and Society	2019 £m	2018 £m
Present value of funded obligation	(221.5)	(196.0)
Fair value of plan assets	245.8	218.9
Funded status/pension benefit surplus	24.3	22.9

	2019			2018		
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Present value of obligation £m	Fair value of plan assets £m	Total £m
As at 1 January	(196.0)	218.9	22.9	(203.2)	221.7	18.5
Included within administrative expenses:						
Interest (expense)/income	(5.7)	6.5	0.8	(5.2)	5.7	0.5
Included within other comprehensive income:						
Remeasurements:						
Return on plan assets (excluding amounts in the Income Statement)	–	19.7	19.7	–	(3.7)	(3.7)
(Losses)/gains from changes in financial assumptions	(25.9)	–	(25.9)	6.2	–	6.2
	(25.9)	19.7	(6.2)	6.2	(3.7)	2.5
Other contributions and payments:						
Employer contributions[1]	–	6.8	6.8	–	1.4	1.4
Benefit payments and expenses	6.1	(6.1)	–	6.2	(6.2)	–
	6.1	0.7	6.8	6.2	(4.8)	1.4
As at 31 December	(221.5)	245.8	24.3	(196.0)	218.9	22.9

1. Employer contributions include a £0.2 million contribution paid by the Society for the scheme expenses of operating the Fund over the agreed deficit recovery contributions.

The surplus reflects the Society's ability to recover a surplus either through reduced contributions in the future or through refunds from the Fund after the last benefit has been paid in line with IAS 19.

The major categories of plan assets are:

	Plan assets at 31.12.2019 £m	Plan assets at 31.12.2018 £m
Quoted		
Corporate bonds and liability matching	136.6	111.8
Diversified growth funds	9.1	14.3
Direct lending	16.0	15.8
Cash	7.2	2.6
Unquoted		
Corporate bonds and liability matching	54.9	48.4
Property	22.0	26.0
Total	245.8	218.9

Notes to the accounts continued

20. Pension scheme continued

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligation at	31.12.2019 %	31.12.2018 %
Discount rate	2.10	2.95
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	2.90	3.15
Rates of inflation (Consumer Prices Index)	1.90	2.15

Weighted average assumptions used to determine net pension cost for the year ended	31.12.2019 %	31.12.2018 %
Discount rate	2.95	2.60
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	3.15	3.10
Rates of inflation (Consumer Prices Index)	2.15	2.10

	31.12.2019		31.12.2018	
Weighted average life expectancy for mortality tables used to determine benefit obligation at	Male	Female	Male	Female
Member age 60 (current life expectancy)	26.2	28.2	26.3	28.3
Member age 45 (life expectancy at age 60)	27.0	28.7	26.7	28.9

The assumptions on mortality are 106% for non-pensioners and 100% for pensioners determined by the actuarial table known as the S2PXA table with CMI 2018 projections with a 1.00% p.a long term improvement rate (2018: S2PXA with CMI 2017 projections with a 1.00% p.a long term improvement rate).

The Group has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension fund surplus and changes in these assumptions could affect the reported surplus. The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is indicated below for isolated changes in assumptions; in reality it is likely that assumptions will be related to each other and impact simultaneously:

Impact on present value of obligation:	Change in assumption	Increase in assumption %	Increase in assumption £m	Decrease in assumption %	Decrease in assumption £m
Discount rate	0.25%	(4.5)	(9.9)	4.8	10.5
Rates of inflation (Retail Prices Index and Consumer Prices Index)	0.25%	2.9	6.5	(2.2)	(5.0)
Life expectancy	1 year	3.5	7.7	(3.4)	(7.6)

The average duration of the defined benefit obligation at the period ended 31 December 2019 is 22 years.

21. Deferred tax

Deferred tax assets and liabilities are attributable to the following items:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Deferred tax (assets)/liabilities				
Cash flow hedges	4.0	8.7	3.0	4.5
Other derivatives	(4.6)	–	(4.6)	–
Defined benefit pension plan surplus	6.1	5.4	6.1	5.4
Transfer of engagements – fair value adjustments	0.1	0.1	0.1	0.1
Investment in equity shares	1.0	0.8	1.0	0.8
Fair value through other comprehensive income	1.3	1.8	1.3	1.8
Excess of capital allowances over depreciation	(1.2)	0.9	(1.2)	0.9
Provisions	(0.4)	(0.5)	(0.4)	(0.5)
IFRS 16 transitional adjustments	(0.3)	–	(0.3)	–
Pension fund special contribution	(1.0)	–	(1.0)	–
Total	5.0	17.2	4.0	13.0

Deferred tax assets are recognised where they have arisen on the basis that sufficient future taxable trading profits will be available to utilise the deferred tax assets.

The deferred tax balances at 31 December 2019 reflect enacted future reductions in the standard rate of corporation tax, as introduced by the Finance (No. 2) Act 2015 and the Finance Act 2016, to 17% from 1 April 2020.

22. Deposits from banks

A maturity analysis for the Group's deposits from banks is included in the Risk Management Report Liquidity and Funding section.

For the Group and Society, deposits from banks includes £4,250.0 million (2018: £4,250.0 million) drawn down against the Bank of England Term Funding Scheme (TFS).

Deposits from banks also includes £532.4 million (2018: £623.8 million) in respect of sale and repurchase agreements (repos) of on-balance sheet notes in issue relating to the covered bond programme (see note 16) at 31 December 2019 and debt securities (see note 15) at 31 December 2018.

Notes to the accounts continued

23. Debt securities in issue

The change in debt securities issued by the Group is as follows:

2019 Group	Opening £m	Cash flows £m	Non-cash flows: Foreign exchange movements £m	Non-cash flows: Change in accrued interest £m	Amortisation £m	Closing £m
Medium-term notes	2,144.2	48.8	(33.7)	(2.6)	1.7	2,158.4
Covered bonds	2,047.3	539.6	(71.5)	0.5	1.4	2,517.3
Residential Mortgage Backed Securities	162.4	(22.6)	–	–	0.1	139.9
Total	4,353.9	565.8	(105.2)	(2.1)	3.2	4,815.6

2018 Group	Opening £m	Cash flows £m	Non-cash flows: Foreign exchange movements £m	Non-cash flows: Change in accrued interest £m	Amortisation £m	Closing £m
Certificates of deposit	251.3	(250.5)[1]	–	(0.8)	–	–
Medium-term notes	2,135.2	–	7.2	–	1.8	2,144.2
Covered bonds	2,309.4	(251.0)	11.0	(23.5)	1.4	2,047.3
Residential Mortgage Backed Securities	192.9	(30.6)	–	–	0.1	162.4
Total	4,888.8	(532.1)	18.2	(24.3)	3.3	4,353.9

1. Cash flows relating to certificates of deposit are included within changes in operating liabilities in the Statements of Cash Flows.

The position for the Society is the same as that for the Group other than the Society had no Residential Mortgage Backed Securities at the reporting date for the current and prior year.

In the year, £100.0 million of covered bonds were issued in February 2019 and €500.0 million in May 2019. The Society's change in liabilities from financing activities is the same as the Group, other than they exclude Residential Mortgage Backed Securities (issued by Offa No.1 plc, a consolidated structured entity).

Debt securities in issue are repayable in the ordinary course of business as follows:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Accrued interest	15.7	18.4	15.6	18.3
Other debt securities in issue with residual maturity repayable:				
In not more than one year	1,550.2	349.7	1,550.2	349.7
In more than one year	3,249.7	3,985.8	3,109.9	3,823.5
Total	4,815.6	4,353.9	4,675.7	4,191.5

24. Derivative financial instruments

The Group elected to continue to apply the hedge accounting requirements of IAS 39 as permitted under IFRS 9.

In September 2019 the IASB issued amendments to IFRS 9, IAS 39 and IFRS 7 that provides temporary reliefs from the effects of IBOR reform for hedge accounting relationships directly impacted. The Society has elected to early adopt these amendments and additional disclosure has been included below for the current period only. Additional disclosure is provided for the notional amount of the hedge accounting relationships impacted by IBOR reform.

Risk management strategy

Derivative financial instruments, predominantly interest rate and cross currency swaps, are held solely for purposes of mitigating interest rate risk, foreign exchange risk or interest rate and foreign exchange risk together, as explained in the Risk Management Report. Where appropriate, they are designated as hedging instruments within either fair value or cash flow hedge relationships under the terms of IAS 39. Derivatives can hedge specific assets or liabilities such as liquidity or wholesale instruments (sometimes referred to as 'micro' hedges) or portions of a portfolio of fixed rate mortgages or savings products (sometimes referred to as 'macro' hedges).

For micro hedges, the Group establishes the hedging ratio by matching the notional amount of the derivatives with the principal of the instruments being hedged. For macro hedges, the Group establishes the hedging ratio by matching the notional amount of the derivatives with the principal of that portion of the portfolio being hedged and manages this on a monthly basis by entering into interest rate swaps.

Where interest rate risk is hedged, only the interest rate risk element of the underlying position is designated as the hedged item and therefore other risks, such as credit risk, which are managed but not hedged by the Group, are excluded. The interest rate risk element is determined with regard to the fixed rate that represents the benchmark rate of interest being hedged. Where foreign exchange risk is hedged, the foreign currency risk component is determined as the change in cash flows of the foreign currency debt arising solely from changes in the relevant forward exchange rates.

For fair value hedges, the effectiveness of the hedge relationship is assessed by comparing changes in the fair value of the hedged item attributable to changes in the benchmark rate of interest with changes in the fair value of the derivative. For cash flow hedges, effectiveness is assessed by comparing the changes in the fair value of the derivative with changes in the fair value of the hedged item attributable to the hedged risk, using the hypothetical derivative method. Possible sources of ineffectiveness are as follows:

- Differences in the benchmark rates of interest used to value the hedged item and the hedging instrument, such as when cash collateralised interest rate swaps are discounted using SONIA but this is not the benchmark rate of interest for the hedged item.
- Differences in timing of cash flows between the derivative and the hedged item.
- Differences between the expected and actual volume of prepayments where a portfolio is being hedged, as the hedging ratio is calculated with regard to expected repayment dates, taking account of expected prepayments based on past experience.
- Hedging derivatives with a non-zero fair value at the date of initial designation as a hedging instrument.
- Counterparty credit risk which impacts the fair value of uncollateralised swaps but not the hedged item.

Hedging instruments

The following tables contain details of the hedging instruments used in the Group's hedging strategies. The notional amount indicates the amount on which payment flows are derived at the Balance Sheet date and do not represent risk. Derivatives assets and liabilities are included in the Balance Sheet at fair value.

Notes to the accounts continued

24. Derivative financial instruments continued

Group	2019 Notional amount £m	2019 Fair value assets £m	2019 Fair value liabilities £m	2018 Notional amount £m	2018 Fair value assets £m	2018 Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate risk	33,283.4	75.7	240.6	30,676.0	121.5	166.3
Derivatives designated as cash flow hedges:						
Interest rate risk	1,684.0	8.4	–	369.0	0.4	1.1
Foreign exchange risk[1]	872.6	–	41.2	428.0	20.0	–
Foreign exchange and interest rate risk[1]	935.4	53.8	–	935.4	127.0	–
Total derivatives	36,775.4	137.9	281.8	32,408.4	268.9	167.4

1. Cash flows are expected to occur over a nine year period (2018: six).

Society	2019 Notional amount £m	2019 Fair value assets £m	2019 Fair value liabilities £m	2018 Notional amount £m	2018 Fair value assets £m	2018 Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate risk	33,283.4	75.7	240.6	30,676.0	121.5	166.3
Derivatives designated as cash flow hedges:						
Interest rate risk	1,684.0	8.4	–	369.0	0.4	1.1
Foreign exchange risk[1]	–	–	–	–	–	–
Foreign exchange and interest rate risk[1]	541.1	17.4	–	541.1	61.8	–
Other derivatives						
Interest rate basis swaps	1,250.0	1.9	–	1,150.0	2.7	–
Total derivatives	36,758.5	103.4	240.6	32,736.1	186.4	167.4

1. Cash flows are expected to occur over a one year period (2018: two).

The Society has early adopted the amendments to IAS 39 and IFRS 7 which provide temporary reliefs from the impact of IBOR reform. In applying these reliefs the Group has assumed that the LIBOR rates used in its hedging relationships are not altered by the reforms. The total Group exposure to LIBOR linked derivatives at 31 December 2019 is shown in the table below:

2019 Group	Notional Total £m	Maturity Up to two years £m	Maturity Three to five years £m
Derivatives designated as fair value hedges:			
Interest rate risk	2,962.2	2,171.1	791.1
Derivatives designated as cash flow hedges:			
Foreign exchange and interest rate risk	394.3	394.3	–
Total derivatives	3,356.5	2,565.4	791.1

The Society position is the same as Group for fair value hedges. The Society has no exposure to IBOR linked derivatives in cash flow hedges.

The Society also has intra-group interest rate basis swaps with its covered bond programme. Under these agreements, the Society receives the interest income of the subsidiaries' mortgage books and pays LIBOR on the same basis as the subsidiaries' interest expense. These swaps have a nominal principal amount of £6,489.0 million (2018: £5,067.8 million) and are treated as part of the deemed loan and not separately measured at fair value.

The following tables set out the maturity profile and average interest and foreign exchange rates of the hedging instruments used in the Group's hedging strategy at 31 December 2019. Derivative contractual maturities are included in the Risk Management Report.

2019 Group	Maturity Up to one month £m	One to three months £m	Three months to one year £m	One to five years £m	More than five years £m
Interest rate risk:					
Contract/notional amount	179.0	683.6	10,647.7	20,286.5	3,170.6
Average fixed interest rate	0.8%	1.1%	0.9%	0.9%	1.0%
Foreign exchange risk:					
Contract/notional amount	–	–	–	428.0	444.6
Average fixed interest rate	–	–	–	1.8%	1.5%
Average £/€ exchange rate	–	–	–	0.86	0.89
Foreign exchange and interest rate risk:					
Contract/notional amount	–	–	541.1	394.3	–
Average fixed interest rate	–	–	2.3%	1.1%	–
Average £/€ exchange rate	–	–	0.83	0.79	–

2019 Society	Maturity Up to one month £m	One to three months £m	Three months to one year £m	One to five years £m	More than five years £m
Interest rate risk:					
Contract/notional amount	179.0	683.6	10,647.7	20,286.5	3,170.6
Average fixed interest rate	0.8%	1.1%	0.9%	0.9%	1.0%
Foreign exchange risk:					
Contract/notional amount	–	–	–	–	–
Average fixed interest rate	–	–	–	–	–
Average £/€ exchange rate	–	–	–	–	–
Foreign exchange and interest rate risk:					
Contract/notional amount	–	–	541.1	–	–
Average fixed interest rate	–	–	2.3%	–	–
Average £/€ exchange rate	–	–	0.83	–	–

2018 Group	Maturity Up to one month £m	One to three months £m	Three months to one year £m	One to five years £m	More than five years £m
Interest rate risk:					
Contract/notional amount	55.0	1,485.5	7,735.8	18,729.4	3,039.3
Average fixed interest rate	1.5%	0.9%	0.9%	1.0%	1.5%
Foreign exchange risk:					
Contract/notional amount	–	–	–	–	428.0
Average fixed interest rate	–	–	–	–	0.5%
Average £/€ exchange rate	–	–	–	–	0.86
Foreign exchange and interest rate risk:					
Contract/notional amount	–	–	–	935.4	–
Average fixed interest rate	–	–	–	1.7%	–
Average £/€ exchange rate	–	–	–	0.81	–

Notes to the accounts continued

24. Derivative financial instruments continued

2018 Society	Maturity: Up to one month £m	One to three months £m	Three months to one year £m	One to five years £m	More than five years £m
Interest rate risk:					
Contract/notional amount	55.0	1,485.5	7,735.8	18,729.4	3,039.3
Average fixed interest rate	1.5%	0.9%	0.9%	1.0%	1.5%
Foreign exchange risk:					
Contract/notional amount	–	–	–	–	–
Average fixed interest rate	–	–	–	–	–
Average £/€ exchange rate	–	–	–	–	–
Foreign exchange and interest rate risk:					
Contract/notional amount	–	–	–	541.1	–
Average fixed interest rate	–	–	–	2.5%	–
Average £/€ exchange rate	–	–	–	0.83	–

Hedged items

The following table contains details of fair value hedged exposures at 31 December 2019:

2019 Group and Society	Carrying amount of hedged item		Accumulated amount of fair value adjustments on the hedged item	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges:				
Interest rate[1,2]	33,231.7	(15,666.8)	161.3	(44.0)

2018 Group and Society	Carrying amount of hedged item		Accumulated amount of fair value adjustments on the hedged item	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges:				
Interest rate[1,2]	28,756.1	(13,267.1)	30.2	(36.5)

1. Assets presented in Loans and advances to customers and Debt securities in the Balance Sheet.
2. Liabilities presented in Shares and Debt securities in issue in the Balance Sheet.

The accumulated amount of fair value hedge adjustments remaining in the Balance Sheet for hedged items that have ceased to be adjusted for hedging gains at 31 December 2019 is £4.2 million (2018: £1.2 million loss).

The following tables provide additional information on cash flow hedges for 2019:

2019 Group	Changes in fair value			Amounts reclassified from reserves to Income Statement		
	Hedging derivative £m	Hedged item for ineffectiveness assessment £m	Gains/(losses) recognised in OCI £m	Hedged cash flows will no longer occur £m	Hedged item affected Income Statement £m	Recognised in Income Statement[1] £m
Derivatives designated as cash flow hedges:						
Foreign exchange	(55.0)	(54.9)	(54.9)	–	(46.5)	–
Foreign exchange and interest rate	(73.3)	(73.9)	(73.9)	–	(58.9)	0.6
Interest rate	4.6	4.6	4.6	(0.6)	–	(0.6)

2018 Group	Changes in fair value			Amounts reclassified from reserves to Income Statement		
	Hedging derivative £m	Hedged item for ineffectiveness assessment £m	Gains/(losses) recognised in OCI £m	Hedged cash flows will no longer occur £m	Hedged item affected Income Statement £m	Recognised in Income Statement[1] £m
Derivatives designated as cash flow hedges:						
Foreign exchange	15.9	15.9	15.9	–	5.4	–
Foreign exchange and interest rate	9.0	10.0	10.0	–	12.6	(1.0)
Interest rate	(1.5)	(1.5)	(1.5)	0.9	–	0.9

1. Ineffectiveness is shown in note 8 Net (losses)/gains from derivatives and hedge accounting.

As at 31 December 2019, balances remaining in the cash flow hedge reserve, gross of tax, are £20.3 million credit for continuing hedges offset by £5.7 million for discontinued hedges (2018: £33.9 million, £1.1 million respectively).

2019 Society	Changes in fair value			Amounts reclassified from reserves to Income Statement		
	Hedging derivative £m	Hedged item for ineffectiveness assessment £m	Gains/(losses) recognise in OCI £m	Hedged cash flows will no longer occur £m	Hedged item affected Income Statement £m	Recognised in Income Statement[1] £m
Derivatives designated as cash flow hedges:						
Foreign exchange	–	–	–	–	–	–
Foreign exchange and interest rate	(44.1)	(44.1)	(44.1)	–	(33.3)	–
Interest rate	4.6	4.6	4.6	(0.6)	–	(0.6)

2018 Society	Changes in fair value			Amounts reclassified from reserves to Income Statement		
	Hedging derivative £m	Hedged item for ineffectiveness assessment £m	Gains/(losses) recognised in OCI £m	Hedged cash flows will no longer occur £m	Hedged item affected Income Statement £m	Recognised in Income Statement[1] £m
Derivatives designated as cash flow hedges:						
Foreign exchange	–	–	–	–	–	–
Foreign exchange and interest rate	2.4	2.4	2.4	–	7.1	–
Interest rate	(1.5)	(1.5)	(1.5)	0.9	–	0.9

1. Ineffectiveness is shown in note 8 Net (losses)/gains from derivatives and hedge accounting.

25. Provisions for liabilities and charges

Group and Society	2019 £m	2018 £m
At 1 January	3.0	5.7
Charge for the year	–	–
Provisions utilised	(2.3)	(2.7)
At 31 December	0.7	3.0

The Group's provisions throughout the year have related to Payment Protection Insurance (PPI), the Financial Services Compensation Scheme (FSCS) levy and other regulatory provisions.

PPI provisions

The Group held a provision at 31 December 2019 of £0.7 million (2018: £2.5 million) which is held is respect of circumstances that may give rise to various customer claims. No additional charge has been raised in the period (2018: £1.5 million) with the provision continuing to be utilised as PPI claims and enquiries received prior to the deadline in August 2019 are resolved.

FSCS levy provision

As at 31 December 2019, there is no provision held for the FSCS levy (2018: £0.4 million). The 2018 provision of £0.4 million related to the failure of a number of credit unions in second half of 2018 and was fully utilised in 2019.

Other regulatory provisions

There is no provision held for other regulatory items as at 31 December 2019 (2018: £0.1 million).

The Group has no contingent liabilities.

Notes to the accounts continued

26. Subordinated liabilities

Group and Society	2019 £m	2018 £m
Subordinated liabilities owed to note holders are as follows:		
Fixed rate subordinated notes 2026 – 6.327%	10.2	10.2
Fixed rate subordinated notes 2032 – 7.54%	15.3	15.3
Total	25.5	25.5

All the subordinated liabilities are denominated in sterling and are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, subject to prior consent of the Prudential Regulation Authority (PRA).

The subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members, other than holders of Permanent Interest Bearing Shares (PIBS) and Perpetual Capital Securities (PCS), for both principal and interest.

27. Subscribed capital

Group and Society	Call date	2019 £m	2018 £m
Subscribed capital owed to permanent interest holding members is as follows:			
Permanent Interest Bearing Shares 1992 – 12 1/8%	n/a	41.6	41.6
Total		41.6	41.6

Subscribed capital comprises the Permanent Interest Bearing Shares (PIBS) issued in 1992 that are only repayable in the event of the winding up of the Society. Interest is paid in arrears in half yearly instalments at 12 1/8% per annum.

PIBS rank equally with each other and PCS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than holders of PCS) for both principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

28. Other equity instruments

In June 2014, the Society issued £400.0 million of new PCS capital. Following receipt of permission from the PRA, a tender offer for the PCS was completed in April 2019 with £385.1 million of the £400.0 million PCS tendered, which the Society repurchased for £391.3 million (net of tax). The combined cost of tender and initial issuance fees of £9.3 million (net of tax) has been recognised within the Society's general reserve. The remaining £14.9 million was redeemed by the Society in November 2019 on the optional redemption date of the bonds.

In April 2019, the Society issued £415.0 million of new PCS capital. These PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum with an optional redemption in September 2024. The rate will reset on 18 September 2024 and every five years thereafter to the prevailing rate on a benchmark gilt plus 6.111%. Coupons are paid semi-annually in September and March. The cost of issuance of £2.5 million (net of tax) has been recognised within the Society's general reserve.

The returns paid to holders of PCS are treated as an appropriation of profit after tax, reflecting their categorisation as equity instruments, distributed directly from the general reserve. During 2019, coupon payments of £24.6 million (2018: £25.6 million) were approved and have been recognised in the Statements of Changes in Members' Interests and Equity.

The instruments have no maturity date. They are repayable at the option of the Society in 2024 and on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an Individual consolidated or a consolidated basis, falls below 7% they convert to Core Capital Deferred Shares (CCDS) at the rate of one CCDS for every £67 PCS held.

The PCS rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS) for both principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

29. Financial commitments

The Group and Society are committed to the following undrawn mortgage loan facilities relating to equity release and flexible mortgage products, which are subject to the satisfaction of previously agreed loan to value ratios:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Undrawn mortgage loan facilities	34.3	43.3	34.3	39.5

In addition, the Group has also committed to advance £1,641.6 million (2018: £1,694.2 million) in respect of loans and advances to customers for mortgages which have been approved but not completed.

30. Capital and leasing commitments

Capital commitments

Group and Society	2019 £m	2018 £m
Capital expenditure contracted but not provided for in the accounts	1.4	43.8

In 2018, the capital commitments included £43.0 million relating to the Society's strategic investment programmes. Capital commitments have reduced significantly since 2018 following replanning of strategic investment activity.

Leasing commitments

Following transition to IFRS 16, lease liabilities are presented on the Balance Sheet within Other liabilities as shown below:

	Group 2019 £m	Group 2018 £m	Society 2019 £m	Society 2018 £m
Other taxation and social security	3.7	4.4	3.7	4.4
Lease liabilities[1]	28.7	2.1	28.7	2.1
Other creditors	3.3	4.0	3.0	4.0
Total	35.7	10.5	35.4	10.5

1. 2019 balance reflects the transition to IFRS 16 from 1 January 2019; the comparative includes only 'finance leases' under IAS 17 Leases. For further information on transition see note 1.

The table below shows the maturity profile of the gross contractual cash flows, including interest charge, of the lease liabilities held at 31 December 2019. This analysis differs from the lease liabilities balance above as these represent discounted future cash flows.

Group and Society	2019 £m	2018[1] £m
Amounts falling due:		
Less than three months	1.4	0.9
Greater than three months and less than one year	3.9	2.6
Between one and five years	18.8	12.1
After five years	6.9	4.4
Total	31.0	20.0

1. 2018 comparative remains under IAS 17 and only includes future minimum lease payments under non-cancellable operating leases relating to land and buildings.

The Society has elected to adopt the exemption for short term leases or leases of low value. Payments of this nature are made through the Income Statement as an expense and were £0.1 million and £nil respectively. Variable lease payments are not included as lease liabilities and are expensed as incurred and they amount to £0.1 million for the year. In 2018, the Society recognised £4.7 million of lease payments as an expense in the period under IAS 17.

The Society currently sublets four of its lease properties. The income received from this is negligible and is regarded as rental income.

Notes to the accounts continued

31. Financial instruments – fair value of financial assets and liabilities

For the purpose of calculating fair values, fair value is assessed as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: unadjusted quoted prices in active markets for identical instruments.
- Level 2: valuation techniques for which all significant inputs are based on observable market data.
- Level 3: valuation techniques for which significant inputs are not based on observable market data.

Where applicable, the Group measures fair value using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Where this is not applicable, the Group determines fair values using other valuation techniques.

The following table summarises the fair value of the Group's financial assets and liabilities measured at amortised cost in the Group's Balance Sheet by the fair value hierarchy.

The Society position is not materially different to that of the Group except that it excludes £15,575.8 million (2018: £14,604.4 million) of loans and advances to customers with a fair value of £15,574.4 million (2018: £14,614.2 million) and £42.2 million (2018: £73.2 million) of deposits from banks with a fair value of £42.3 million (2018: £73.2 million) which are held in subsidiaries of the Society. The Society includes within Loans and advances to financial institutions a balance of £88.9 million (2018: £nil) held in collateral accounts relating to swap agreements held in securitisation programmes which are eliminated at Group level. In the prior period the Society held a deposit within Amounts owed to other customers of £92.4 million which was a cash deposit from a subsidiary eliminated at Group level which does not exist this year.

2019 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	336.1	–	336.1	–	336.1
Loans and advances to customers	42,234.7	–	–	42,147.7	42,147.7
Debt securities	16.0	–	9.2	6.6	15.8
Financial liabilities					
Shares	36,238.1	–	–	36,158.5	36,158.5
Deposits from banks	5,318.6	–	5,326.9	–	5,326.9
Other deposits	8.5	–	8.5	–	8.5
Amounts owed to other customers	462.7	–	462.7	–	462.7
Debt securities in issue	4,815.6	–	4,901.3	–	4,901.3
Subordinated liabilities	25.5	–	30.0	–	30.0
Subscribed capital	41.6	82.2	–	–	82.2

2018 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	231.3	–	231.3	–	231.3
Loans and advances to customers	39,264.6	–	–	39,175.5	39,175.5
Debt securities[1]	16.3	–	9.4	7.1	16.5
Financial liabilities					
Shares	33,281.6	–	–	33,369.4	33,369.4
Deposits from banks	5,453.8	–	5,453.8	–	5,453.8
Other deposits	9.5	–	9.5	–	9.5
Amounts owed to other customers	496.5	–	496.5	–	496.5
Debt securities in issue[1]	4,353.9	–	4,419.1	–	4,419.1
Subordinated liabilities	25.5	–	27.6	–	27.6
Subscribed capital	41.6	77.0	–	–	77.0

1. In 2019, certain Debt securities and Debt securities in issue have been classified within level 2. Comparative information has been updated to reflect this.

Loans and advances to credit institutions

The fair value of loans and advances to credit institutions over the longer term is estimated by discounting expected cash flows at a market discount rate. Amounts maturing in the short term are valued at carrying amount.

Loans and advances to customers

The fair value of loans and advances to customers is assessed as the value of the expected future cash flows, projected using contractual interest payments and repayments and the expected prepayment behaviour of borrowers. Conservative assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The estimated future cash flows are discounted at current market rates for the loan types and adjusted where necessary to reflect any observable market conditions.

Debt securities

Debt securities for which no market price or executable bid is available at the year end date are valued by one of two methods. Where there are recent market prices or executable bids for the security, these are used as the basis for establishing a year end valuation. Otherwise, a security is valued based on its relative value to comparable bonds.

Shares

The fair value of shares available on demand approximates to the carrying value. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows discounted at the current market rates for those types of deposit.

Deposits from banks, other deposits and amounts owed to other customers

The fair value of deposits taken from wholesale counterparties over the longer term is estimated by discounting expected cash flows at a market discount rate. Amounts maturing in the short term are valued at carrying amount.

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer-dated liabilities is calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those liabilities where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate to the remaining term to maturity.

The following table summarises the fair value of the Group's financial assets and liabilities measured at fair value on the face of the Group's Balance Sheet by fair value hierarchy and product type.

The Society position is not materially different to that of the Group except that it excludes Level 2 cross currency liabilities of £41.1 million (2018: £85.2 million), which are held in subsidiaries of the Society, and Level 2 cross currency assets of £36.5 million (2018: £nil), and includes a fair value asset of £1.9 million (2018: £2.7 million fair value asset) relating to Level 2 intercompany interest rate basis swaps.

2019 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments:				
Interest rate swaps	–	84.1	–	84.1
Cross currency swaps	–	53.8	–	58.8
Total	–	137.9	–	137.9
Debt securities:				
UK Government investment securities	864.8	–	–	864.8
Other listed transferable debt securities	399.3	12.5	–	411.8
Total	1,264.1	12.5	–	1,276.6
Investment in equity shares:				
Investment in equity shares	0.6	–	2.9	3.5
Total	0.6	–	2.9	3.5
Financial liabilities				
Derivative financial instruments:				
Interest rate swaps	–	178.7	62.0	240.7
Cross currency swaps	–	41.1	–	41.1
Total	–	219.8	62.0	281.8

Notes to the accounts continued

31. Financial instruments – fair value of financial assets and liabilities continued

2018 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets:				
Derivative financial instruments				
Interest rate swaps	–	121.9	–	121.9
Cross currency swaps	–	147.0	–	147.0
Total	–	268.9	–	268.9
Debt securities:				
UK Government investment securities	859.8	–	–	859.8
Other listed transferable debt securities	75.1	–	–	75.1
Total	934.9	–	–	934.9
Investment in equity shares:				
Investment in equity shares	0.4	–	2.7	3.1
Total	0.4	–	2.7	3.1
Financial liabilities:				
Derivative financial instruments				
Interest rate swaps	–	110.3	57.1	167.4
Total	–	110.3	57.1	167.4

Financial instruments recorded at fair value

The determination of fair value for financial instruments which are recorded at fair value using valuation techniques is described below, including the assumptions that a market participant would be expected to make when valuing the instruments:

Level 1: Debt securities and Investment in equity shares – fair value through other comprehensive income – Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2: Derivatives

Derivative products utilise observable market inputs for interest rate swaps and cross currency swaps. Valuations are generated by swap models which use present value calculations and incorporate assumptions for interest rate curves and foreign exchange spot and forward rates.

Level 3: Investment in equity shares – fair value through profit and loss – Unlisted

Investment in equity shares represent the Group's holding in Visa Inc. and VocaLink Holdings Limited shares. These shares are valued based on future cash consideration which the Group expects to receive on sale of these instruments, or the underlying market value.

Level 3: Derivatives

The items included within Level 3 are balance tracking swaps, which have remained in place during the year. These are valued using present value calculations based on market interest rate curves. The unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. Projected mortgage prepayment amounts are used in the modelling of the mortgage portfolio profile. A change of 10% in the prepayment rates used results in a £0.5 million change in the value of the swaps. However, changes in the projection of interest and prepayment rates of the underlying mortgage portfolio affect both the swap and hedged item so that the net Income Statement and Balance Sheet impact would be minimal.

The following table analyses fair value movements in the Level 3 portfolio for both the Group and the Society:

Group and Society	Investment in equity shares 2019 £m	Debt securities 2019 £m	Derivative financial instruments 2019 £m	Investment in equity shares 2018 £m	Debt securities 2018 £m	Derivative financial instruments 2018 £m
As at 1 January	2.7	–	(57.1)	2.5	7.5	(63.5)
Reclassification on IFRS 9 transition	–	–	–	–	(7.5)	–
Gains/(losses) recognised in the Income Statement						
Interest receivable and similar income	–	–	–	–	–	–
Interest payable and similar expense	–	–	(5.3)	–	–	(5.6)
Net unrealised gains/(losses)	0.2	–	5.3	0.2	–	6.2
Settlements	–	–	(4.9)	–	–	5.8
As at 31 December	2.9	–	(62.0)	2.7	–	(57.1)

Transfers between fair value levels

Transfers between fair value levels occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. Transfers are considered to have occurred at the end of the reporting period for the purposes of this disclosure.

32. Offsetting financial assets and liabilities

The Group and Society do not have any financial assets or financial liabilities that are offset with the net amount presented in the Balance Sheets. IAS 32 Financial Instruments: Presentation states that there should be both an enforceable right to set-off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously to apply this treatment and neither of these conditions is met.

The Group has entered into master netting arrangements such as International Swaps and Derivatives Association (ISDA) master agreements for its derivatives, other than derivatives held by Coventry Building Society Covered Bonds LLP. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements, which typically provide for the exchange of collateral to mitigate net mark to market credit exposure.

The Group has also entered into Global Master Repurchase Agreements, including margin collateralisation arrangements, whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event.

Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the covered bonds programme. However, it has entered into a separate ISDA agreement in respect of each of the derivatives it has transacted with external counterparties. Each agreement includes a CSA which provides for full collateralisation of the swap exposure with exposure thresholds in place for a single agreement before collateral is exchanged. The £6.6 million net derivative credit exposure in the table below includes £3.6 million in respect of this arrangement which will only be fully collateralised if the counterparty is downgraded to below its specified credit rating.

The table below shows the net exposure for sale and repurchase agreements or derivative contracts after any netting benefits and collateral. The Group did not enter into securities lending or reverse sale and repurchase agreements during 2019 (2018: nil).

2019 Group	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	137.9	(66.5)	(64.8)	6.6
Total financial assets	137.9	(66.5)	(64.8)	6.6
Financial liabilities				
Derivative financial instruments	281.8	(66.5)	(163.5)	51.8
Total financial liabilities	281.8	(66.5)	(163.5)	51.8

2018 Group	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	268.9	(85.5)	(166.0)	17.4
Total financial assets	268.9	(85.5)	(166.0)	17.4
Financial liabilities				
Derivative financial instruments	167.4	(85.5)	(78.1)	3.8
Sale and repurchase agreements	623.8	–	(623.8)	–
Total financial liabilities	791.2	(85.5)	(701.9)	3.8

1. As reported on the Balance Sheet.
2. The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

Notes to the accounts continued

32. Offsetting financial assets and liabilities continued

As at 31 December 2019, £3.6 million of the £6.6 million exposure is to A1 rated institutions with a further £2.9 million to above A2 rated and £0.1 million to A3 rated financial institutions.

2019 Society	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	103.4	(66.5)	(28.3)	8.6
Total financial assets	103.4	(66.5)	(28.3)	8.6
Financial liabilities				
Derivative financial instruments	240.6	(66.5)	(163.5)	10.6
Total financial liabilities	240.6	(66.5)	(163.5)	10.6

2018 Society	Gross amounts[1] £m	Master netting arrangements £m	Financial collateral[2] £m	Net amount £m
Financial assets				
Derivative financial instruments	186.4	(85.5)	(93.6)	7.3
Total financial assets	186.4	(85.5)	(93.6)	7.3
Financial liabilities				
Derivative financial instruments	167.4	(85.5)	(78.1)	3.8
Sale and repurchase agreements	623.8	–	(623.8)	–
Total financial liabilities	791.2	(85.5)	(701.9)	3.8

1. As reported on the Balance Sheet.
2. The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

For derivative financial assets, collateral received can be in the form of cash and UK Government investment securities. Where cash is received it is included as a liability within deposits from banks (see note 22). Where UK Government investment securities are received, these are not recognised on the Balance Sheet, as the Group does not obtain the risks and rewards of ownership.

For derivative financial liabilities, collateral paid is in the form of cash and is included as an asset in Loans and advances to credit institutions.

For sale and repurchase agreements (repos), collateral provided is predominantly in UK Government investment securities with the remainder in cash. Again, cash paid is included as an asset in Loans and advances to credit institutions. UK Government investment securities are not derecognised as the Group retains substantially all the risks and rewards of ownership.

Cash collateral held and cash collateral pledged are not restricted and are returned at the end of the contract.

33. Capital management

As at 31 December 2019, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on the Group's capital resources and capital management can be found in the Capital section of the Risk Management Report.

34. Related party transactions

The Group is controlled by Coventry Building Society registered in England and Wales, which is also considered to be the ultimate parent.

	Group undertakings		Key management	
	2019 £m	2018 £m	2019 £m	2018 £m
Loans payable to the Society				
Loans outstanding as at 1 January	14,224.6	12,549.5	1.0	0.8
Loans issued during the year	858.2	1,675.1	0.4	0.7
Impairment credit	–	–	–	–
Repayments during the year[1]	–	–	(0.1)	(0.5)
Loans outstanding as at 31 December	15,082.8	14,224.6	1.3	1.0
Deposits payable by the Society				
Deposits outstanding at 1 January	–	–	2.8	2.5
Deposits received during the year[2]	–	–	2.2	0.7
Repayments during the year[1]	–	–	(2.6)	(0.4)
Deposits outstanding at 31 December	–	–	2.4	2.8
Net interest income				
Interest receivable	299.4	323.2	–	–
Interest payable	–	–	–	–
Foreign currency (loss)/gain[3]	(62.7)	10.9	–	–
Total	236.7	334.1	–	–
Other income and expenses				
Fees and expenses paid to the Society	38.6	10.3	–	–

1. Includes loans and deposits for key management on retirement.
2. Includes existing deposits for key management on appointment.
3. Foreign currency gains and losses are presented on a net basis within Interest payable and similar charges in 2019.

Interest on outstanding loans and deposits accrues at a rate agreed between the Society and its subsidiaries in the normal course of business.

Deposits payable by the Society to Group undertakings relate to amounts owing to the Society's structured entities, in accordance with the accounting policy set out in note 1. These intercompany balances have been presented within Other liabilities on the Society Balance Sheet.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The Board of directors is considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24 Related Party Disclosures. No director has any interest in the shares or debentures of any connected undertaking of the Society. See the Directors' Remuneration Report in the Governance section for information on Directors' remuneration for 2019.

In accordance with Section 68 of the Building Societies Act 1986, the Society maintains a register of loans falling within Section 65 made to directors and connected persons. A statement containing requisite particulars of such transactions may be inspected by members at the Society's Annual General Meeting (AGM) or at the Principal Office of the Society during the period 15 days prior to the AGM.

Transactions with related undertakings

Transactions are entered into with related parties in the normal course of business. These include loans, deposits, and the payment and recharge of interest and administrative expenses. Where these charges are associated to Group subsidiaries they are settled through the intercompany accounts.

Annual Business Statement

For the year ended 31 December 2019

1. Statutory percentages

	2019 %	Statutory limits %
Lending limit	1.0	25.0
Funding limit	22.6	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of the business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus loan impairment less liquid assets, intangible assets and property, plant and equipment. The value of X used is the value at 31 December 2019.

Y = the principal value of, and interest accrued on, loans owed to the Group which are fully secured on residential property. The value of Y used is the value at 31 December 2019.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = shares and borrowings, being the aggregate of:

I. The principal value of, and interest accrued on, shares in the Society.

II. The principal value of, and interest accrued on, the amounts deposited with the Society or any subsidiary undertaking, by banks, credit institutions and other customers.

III. The principal value of, and interest accrued on, the amounts of debt securities of the Society or any subsidiary undertaking.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals other than bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons that include bodies corporate.

2. Other percentages

	2019 %	2018 %
As a percentage of shares and borrowings:		
Gross capital	4.84	5.02
Free capital	4.60	4.82
Liquid assets	14.6	14.7
As a percentage of mean total assets:		
Profit for the financial year[1]	0.25	0.37
Management expenses	0.48	0.50
Net profit[1] as a percentage of total Balance Sheet	0.25	0.35

1. Taxation and Profit for the financial year have been restated in the comparative periods following amendments to IAS 12. See note 1 for more information.

Shares and borrowings represents the total of shares, deposits from banks, other deposits, amounts owed to other customers and debt securities in issue.

Gross capital represents the aggregate of reserves, other equity instruments, subordinated liabilities and subscribed capital.

Free capital represents the aggregate of gross capital and collective impairment less intangible assets and property, plant and equipment.

3. Principal Office

Coventry Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of the principal office is: Economic House, PO Box 9, High Street, Coventry CV1 5QN.

4. Information relating to directors

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Iraj Amiri, BSc, MSc, ACA (20.02.1954)	Company Director	Development Bank of Wales National Employment Savings Trust Woodford Lake Limited	28.06.2018
Peter Ayliffe, BA (Hons), FCIBS, CMgr (05.03.1953)	Company Director	The Pennies Foundation TruRating Limited (Director to 30.9.19)	01.05.2013
Andy Deeks, BA (Hons), MBA (18.03.1981)	Building Society Product, Marketing and Strategy Director	None	27.04.2017
Catherine Doran, BA (11.09.1956)	Company Director	None	01.08.2016
Michele Faull, FCCA (24.11.1960)	Building Society Chief Financial Officer	Arkose Funding Limited Bow Arts Trust Coventry Cathedral Finance Committee Coventry Financial Services Limited Coventry Property Services Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Mortgages Limited Godiva Savings Limited Godiva Securities and Investments Limited ITL Mortgages Limited	27.04.2017
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer	None	01.11.2012
Gary Hoffman, MEcon, MBA (21.10.1960)	Company Director	Choice Matters Limited Hastings Group Holdings plc Monzo Bank Limited Football Foundation (Trustee to 31.12.19)	26.01.2018
Joanne Kenrick, LLB (21.09.1966)	Company Director	Dŵr Cymru Cyfyngedig Glas Cymru Holdings Cyfyngedig Global Charities Global Charities (Trading) Limited Lynmouth Colossus Way Management Limited Mobile Payments Service Company Limited Rhapsody Court Freehold Limited Safestore Holdings plc	06.11.2017
Shamira Mohammed ACA (17.11.1968)	Company Director	ACS UK Limited Aviva Europe SE Aviva International Holdings Limited Friends Life Holding plc General Accident plc Pezula Limited	01.05.2019
Mark Parsons, BA (Hons), FCMA (24.10.1961)	Building Society Chief Executive	Godiva Mortgages Limited ITL Mortgages Limited UK Finance Limited	01.07.2014
Martin Stewart, MEng (08.09.1966)	Company Director	Clayton Stewart	01.09.2018

Documents may be served on the above named directors at: Coventry Building Society, c/o PricewaterhouseCoopers LLP, One Chamberlain Square, Birmingham B3 3AX.

The Society has entered into service contracts with the following directors: Peter Frost (Chief Operating Officer); Mark Parsons (Chief Executive); Andrew Deeks (Product, Marketing and Strategy Director) and Michele Faull (Chief Financial Officer). These are terminable by the individual on six months' notice and by the Society on one year's notice.

Glossary

The following glossary defines terminology within the Annual Report & Accounts to assist the reader and to facilitate comparison with publications by other institutions:

Additional Tier 1 (AT 1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to a form of Common Equity Tier 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Average loan to value	The average of individual loan to values (simple average). The average loan to value of the residential mortgage book, weighted by balance (balance weighted). For indexed loan to value – see 'Indexed loan to value'.
Basel IV	The alternative industry name given to the Basel Committee's final implementation of its Basel III Banking Supervision reforms published in December 2017 addressing credit risk (standardised approach with floors, and IRB), operational risk and the leverage ratio. They are applicable from January 2022 and are phased in over five years.
Basis point	One hundredth of a percent (0.01 percent). Used when quoting movements in interest rates and yields on securities.
Brexit	The process of the UK leaving the European Union on 31 January 2020 and the subsequent trading relationship currently being negotiated between the two parties.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital Conservation Buffer (CCoB)	A CRD IV risk adjusted capital requirement for all banks that can be used to absorb losses whilst avoiding breaching minimum capital requirements.
Capital requirements	Amount of capital required to be held by the Group to cover the risk of losses and to protect against excessive leverage. The level is set by regulators and the firm's own assessment of its risk profile.
Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)	CRD IV is the European Union legislation (part regulation and part directive) which came into force from 1 January 2014 to implement Basel III, revising the capital requirements framework and introducing liquidity requirements, which regulators use when supervising firms.
Capital Requirements Regulation (CRR) leverage ratio	A ratio defined by the Capital Requirements Regulation (CRR) which measures Tier 1 capital as a proportion of total CRR leverage ratio exposures. These exposures are the sum of the on-balance sheet exposures, adjusted for derivatives and securities financing transaction exposures, and off-balance sheet items.
Capital resources	Capital comprising the general reserve, fair value through other comprehensive income reserve, eligible Additional Tier 1 capital less all required regulatory adjustments.
Central clearing	The process by which parties to an over-the-counter derivative contract replace this with a separate contract with a central counterparty, which takes over each party's positions under the original contract.
Certificates of deposit	Bearer-negotiable instruments issued on the receipt of a fixed term deposit at a specified interest rate.
Collateral	Security pledged by the borrower to the lender in case of default.
Common Equity Tier 1 (CET 1) capital	Common Equity Tier 1 capital comprises general reserve and the fair value through other comprehensive income reserve, less regulatory deductions. Common Equity Tier 1 must absorb losses on a going concern basis.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.

Conduct risk	The risk that the Society's behaviour and decision making fails to deliver good customer outcomes.
Contractual maturity	The date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.
Core Capital Deferred Shares (CCDS)	A form of Common Equity Tier 1 (CET 1) capital. The Society's Perpetual Capital Securities (PCS) convert into CCDS at the rate of one CCDS for every £67 PCS held if the end-point CET 1 ratio, calculated on either an individual or consolidated basis, falls below 7%.
Countercyclical Buffer (CCyB)	A CRD IV risk adjusted capital requirement for all banks that is varied over the financial cycle to match the resilience of the banking system to the scale of risks faced.
Countercyclical Leverage Buffer (CCLB)	A leverage capital requirement under the UK leverage regime that is set at 35% of the corresponding risk adjusted Countercyclical Buffer (CCyB).
Covered bonds	Debt securities that are backed by both the resources of the issuer and a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual principal risk categories.
Credit valuation adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty.
Currency swap	An arrangement in which two parties exchange equivalent principal amounts of different currencies at inception and subsequently exchange interest payments on the principal amounts. At the maturity of the swap, the principal amounts are re-exchanged at the original rates, protecting the participants from changes in exchange rates.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	Liabilities of the Group that are transferable by external investors that operate within the global financial markets.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods as a result of the carry-forward of tax losses or unused tax credits, or from deductible (or taxable) temporary differences between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit pension plan resulting from past employee service.
Defined benefit pension scheme	A pension or other post-retirement benefit plan offering guaranteed benefits, usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.

Glossary continued

Effective Interest Rate (EIR)	The rate of interest earned over the life of an instrument that is equivalent to the discounted rate of projected cash flows of the instrument, adjusted for compounding.
Effective tax rate	The tax charge in the Income Statement as a percentage of profit before tax.
Encumbered assets	Assets used to secure liabilities or otherwise pledged. This excludes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes.
End-point	Full implementation of regulation (for example, CRD IV) with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A Board approved framework which provides the context, guidance and principles needed for cohesive risk management activity across the Society and its subsidiaries.
European Banking Authority	An independent European Union authority which works to ensure effective and consistent financial regulation and supervision across the European banking sector.
EURIBOR	The Euro Interbank Offered Rate is a daily reference rate, published by the European Money Markets Institute, based on the averaged interest rates at which Eurozone banks offer to lend unsecured funds to other banks in the Euro wholesale money market.
Eurozone	An economic and monetary union of European Union member states that have adopted the euro (€) as their common currency and sole legal tender.
Expected credit loss (ECL)	The present value of all cash shortfalls over the expected life of a financial instrument. The term is used for the accounting for impairment provisions under the 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 calculation of the amount expected to be outstanding at the time of default.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.
Fair value through other comprehensive income (FVOCI)	Financial assets held at fair value on the Balance Sheet with changes on the fair value recognised through other comprehensive income.
Fair value through profit and loss (FVTPL)	Financial assets held at fair value on the Balance Sheet with changes in fair value being recognised through the Income Statement.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
Financial Ombudsman Service	The Financial Ombudsman Service provides an independent and impartial service to resolve individual complaints that consumers and financial institutions have been unable to settle themselves.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.

Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every deposit taking firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Fitch	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
Foreign currency risk	The risk of loss arising as a result of movements in exchange rates on investments, obligations or derivatives in foreign currencies.
General reserve	The general reserve is the accumulation of historical and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Government investment securities (gilts)	The name given to long term fixed income debt securities (bonds) issued by the UK Government.
Gross capital	The aggregate of reserves, other equity instruments, subscribed capital and subordinated liabilities.
IBOR	The Interbank Offered Rate (IBOR) is the interest rate at which banks lend to and borrow from one another in interbank markets. IBORs serve as an indicator of levels of demand and supply in all financial markets.
IFRIC	The International Financial Reporting Interpretations Committee. IFRIC interprets the application of IAS and IFRS and provides timely guidance on financial reporting issues not specifically addressed in IAS and IFRS, in the context of the International Accounting Standards Board framework.
IFRS/IAS	International Financial Reporting Standards/International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are defaulted loans in IFRS 9 stage 3.
Impairment provision	Either 12 months or life time expected credit losses (ECLs) 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.
Individual Liquidity Guidance (ILG)	Guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.
Interest rate risk	Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of differences between interest rates received and paid on mortgages, deposits and financial instruments.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.

Glossary continued

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 derivatives and providers of the industry-standard documentation for derivative transactions.
Leverage ratio	A calculation brought in as part of CRD IV which measures the relationship between eligible Tier 1 capital and exposures to on and off-balance sheet items. There are two bases of calculation – see Capital Requirements Regulation (CRR) leverage ratio and UK leverage ratio.
LIBOR	London Interbank Offered Rate. A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market. This is expected to cease at the end of 2022.
Liquid assets	An amount as defined by the Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including Government investment securities (gilts)), loans to credit institutions and other liquid assets.
Liquidity and Funding risk	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Liquidity and Funding risks are principal risks of the Society.
Liquidity Coverage Ratio (LCR)	A measure brought in as part of CRD IV which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprise cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and self-issued covered bonds, RMBS and Bank of England approved mortgage portfolios.
Loan to value (LTV)	The amount of mortgage loan as a percentage of the value of the property.
Loss given default (LGD)	A parameter used to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	Market risk is defined as the risk of a reduction in Society earnings and/or value resulting from adverse movements in financial markets.
Medium-term notes	Securities offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.

Minimum Requirement for own funds and Eligible Liabilities (MREL)	A requirement under the Bank Recovery and Resolution Directive which requires deposit takers to hold minimum levels of capital plus debt eligible for bail-in.
Model risk	The risk that an ineffective model or incorrectly interpreted model output leads to a loss, reputational damage or regulatory censure.
Moody's	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of average total assets.
Net Promoter Score (NPS)	A measure of customer advocacy that ranges between -100 and +100 and represents how likely a customer is to recommend a brand, product or service to a friend or colleague. Net Promoter®, Net Promoter Score® and NPS® are trademarks of Satmetrix Systems , Inc., Bain & Company, Inc., and Fred Reichheld.
Net Stable Funding Ratio (NSFR)	A ratio which assesses the amount of stable funding in place as a proportion of the on and off-balance sheet funding requirements of an institution. The requirement is still to be formally implemented.
Open Banking	The term used to describe activity mandated by the Competition and Markets Authority through the Retail Banking Market Investigation Order 2017. This requires the nine largest UK banks and building societies to develop and use open standards to enable the sharing of customer payment account data. The term 'open banking' is also used to refer to the elements of Payment Services Directive II (PSD2) that oblige financial institutions such as the Society to provide authorised third party organisations with payment account transactional data, or the ability for them to initiate a payment, where the member has requested this and provided consent.
Operational risk	The risk of loss arising from inadequate internal processes, systems or people, or from external events.
Output floor	A future requirement of Basel IV that sets a floor on the determination of risk weights. The floor will be a proportion of the standardised approach and will be phased in for firms using IRB models.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Pension fund surplus	The assets in a pension fund that are in excess of its liabilities.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. Under Basel III, PIBS are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society and qualify as Additional Tier 1 capital.

Glossary continued

Pillar 1/2/2A/3	Components of the Basel capital framework. Pillar 1 covers the minimum requirement, Pillar 2 covers capital requirement of risks not covered in Pillar 1 and Pillar 3 covers disclosures.
PRA buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
PRA/FCA Remuneration Code	The PRA Remuneration Code sets out the expectations of firms in relation to: proportionality; material risk takers (MRTs); application of malus and clawback to variable remuneration; governing body/remuneration committees; risk management and control functions; remuneration and capital; risk adjustment (including long term incentive plans); personal investment strategies; remuneration structures (including guaranteed variable remuneration, buy-outs and retention awards); deferral; and breaches of the remuneration rules.
Probability of default (PD)	An estimate of the probability that a borrower will default on their credit obligations over a fixed time period. With respect to impairment provisions under IFRS 9, 12 month ECLs use 12 month PDs, whilst a lifetime ECL uses the estimated PD over the remaining contractual life of the loan. With respect to IRB, PD is the probability of a loan defaulting in the next 12 months calculated as an average over an economic cycle.
Principal risk	Principal risk is a class of significant inherent risk which could materially compromise the Society's ability to grow and provide attractive products to savings and borrowing members.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
PV100	Present Value 100. A calculation of the theoretical change in the net present value of financial instruments for a 100 basis point (1%) parallel shift in yield curves.
PV200	Present Value 200. A calculation of the theoretical change in the net present value of financial instruments for a 200 basis point (2%) parallel shift in yield curves.
Research and development expenditure credit	A UK Government tax incentive that rewards companies for investing in research and development.
Residential Mortgage Backed Securities (RMBS)	Securities issued with interest and principal backed by 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. It is responsible for taking control of the resolution process which may include recapitalising and/or restructuring, as a result of a realised or expected failure.
Retail deposits	See Shares.
Reverse stress test	Regulatory stress test that requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.
Risk appetite	An articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving its business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.

Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a structured entity which then issues securities (RMBS) backed by the assets. The Group has used residential mortgages as the loan pool for securitisation purposes.
Self-certified mortgage	An owner-occupier mortgage where the lending decision with respect to affordability has been based solely on the borrower's declaration of their income.
Senior unsecured debt funding	Bonds issued by corporate bodies and financial institutions, which are not secured by any collateral and are not subordinated to any other wholesale liabilities of the issuer.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities of the Society.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
Significant increase in credit risk	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment, using quantitative and qualitative factors, identifies at a reporting date that the credit risk has increased significantly since the asset was originally recognised.
SONIA	A rate reflecting the interest earned or paid in respect of sterling overnight interbank loans.
Solely payment of principal and interest (SPPI) test	An assessment of whether the contractual terms of the financial asset give rise to cash flows that are in substance solely payment of principal and interest.
Sovereign exposure	Exposures to governments and on account of cash balances and deposits with central banks.
Stage 1	Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the Balance Sheet. 12 month ECLs are recognised as the impairment provision for all financial assets on initial recognition. Interest revenue is the EIR on the gross carrying amount.
Stage 2	Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision. Interest revenue is EIR on the gross carrying amount.
Stage 3	Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECL is also recognised as an impairment provision. Interest revenue is the EIR on the net carrying amount.
Standardised approach	The basic method used to calculate capital requirements for credit and operational risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
Strategic investment	A significant one-off programme instigated from strategic intent rather than business as usual or regulatory change activity.
Strategic risk	Strategic Risk is the risk that changes to business model or macroeconomic, geopolitical, regulatory or other factors may lead to the business model, strategy or Strategic Plan becoming inappropriate. This includes the risk of an overly ambitious Strategic Plan as well as unforeseen market, consumer, competitor or regulatory changes.
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.

Glossary continued

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 they are included as Tier 2 under transitional rules only.
Subscribed capital	See Permanent Interest Bearing Shares.
Supplementary Leverage Ratio Buffer (SLRB)	Applied to systemically important banks and building societies. As a guiding principle, the FPC sets the buffer at 35% of the risk weighted Systemic Risk Buffers.
Surcharge	An 8% surcharge on the profits of banking companies which was introduced from 1 January 2016 by the Finance (No. 2) Act 2015.
Systemic Risk Buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.
Term Funding Scheme (TFS)	The Term Funding Scheme 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).
UK Corporate Governance Code (the Code)	The code (formerly known as the Combined Code), issued by the Financial Reporting Council, that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.
UK Finance	A trade association that incorporates residential mortgage lending.
UK leverage ratio	A ratio prescribed by the PRA based on the CRR leverage ratio but modified to restrict the amount of AT 1 capital that can be included in Tier 1 capital and to exclude eligible central bank holdings from leverage ratio exposures.
Unencumbered assets	Assets readily available as collateral to secure funding. This includes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes and are therefore readily available as collateral to secure funding or to pledge as collateral against margin calls.
Wholesale funding	Funding received from external counterparties that operate within the global financial markets (for example insurance companies, pension funds, large businesses, financial institutions and sovereign entities).
Write off	To write off a financial asset when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery.

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