Annual Report & Accounts 2014

the COVENTRY
TLC not PLC

Coventry Building Society exists solely for the benefit of current and future members, meeting their needs for savings and residential mortgages.

In 2014, the Society maintained a track record of performance that pre-dates the start of the financial crisis. It has continued to grow, remained strongly profitable and added significantly to its reserves, whilst protecting members' interests through competitive products and excellent service.

In an uncertain world, it has shown that an independent mutual building society can succeed and prosper to the benefit of an increasing membership, an expanding workforce and a diverse and robust financial services sector.

The term 'Society' is used in this Annual Report & Accounts pages 1 to 85 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).

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Performance Highlights 2014

25.4%

Highest reported Common Equity Tier 1 ratio of any top 10 building society.

0.42%

Cost to mean assets ratio[1], the lowest reported of all building societies.

89%

of all variable rate savings balances[2] earned a rate of interest that is equal to or higher than the equivalent best buy.

1.4

complaints per thousand members, one of the lowest rates of any top 10 building society[3].

£2.2m

of community investment, with 250 organisations benefiting from volunteering, fundraising or other direct involvement by staff.

84%

Employee engagement score – 10% above the average of the financial services sector[4].

Mortgages
(£bn)

2014	**27.0**
2013	24.1
2012	22.0
2011	19.2
2010	17.5

Savings
(£bn)

2014	**23.4**
2013	21.3
2012	20.1
2011	19.0
2010	17.6

Added to member reserves[5]
(£m)

2014	**151.5**
2013	101.3
2012	69.5
2011	51.4
2010	85.8

Mortgage market share[6]
(of stock) (%)

2014	**2.07**
2013	1.88
2012	1.73
2011	1.53
2010	1.41

Savings market share[6]
(of stock) (%)

2014	**1.80**
2013	1.73
2012	1.70
2011	1.66
2010	1.59

Impairment charge
(of mean loan balances) (%)

2014	**0.02**
2013	0.03
2012	0.05
2011	0.05
2010	0.07

Notes

1. Administrative expenses, depreciation and amortisation/Average total assets.
2. Compared to major banks and building societies as at 31 December 2014. Average deposit assumed as follows: Variable – £10,000 and ISAs £15,000. Excludes competitor products with restricted availability (e.g. existing customers only or reliant on maintaining or opening another product with the same provider) and Offset accounts. Source: Moneyfacts data.
3. Source: Financial Ombudsman Service data from 1 January 2014 to 30 June 2014.
4. Financial services sector benchmark used by an independent third party.
5. Profit after tax including Additional Tier 1 capital distribution (net of tax). 2010 and 2011 restated for comparative purposes to reflect accounting policy change in 2013 relating to the timing of recognition of the Financial Services Compensation Scheme Levy – see 2013 Annual Report & Accounts note 1 for further details.
6. Source: Bank of England.

Chairman's Statement

In 2014, Coventry Building Society once again delivered a very strong performance, in an environment which continues to present challenges to individuals and institutions alike.

During the year, the UK economy continued to grow, making it one of Europe's strongest performing economies. However, the Bank of England Base Rate remained at its historically low level of 0.50% as concerns remain about the sustainability of the recovery in view of the volatile international situation.

In this context the Society has continued the progress that it has maintained for many years and I am pleased to be able to report a profit before tax of £201.8 million for the year, a new record for the Society.

More members saved with us and we maintained the growth in lending which has made us a top 10 lender[1] for six consecutive years. Financially, we remain well capitalised, 'A' rated by two major credit rating agencies, and the most cost-efficient building society in the UK[2]. From a member's perspective I am particularly pleased that for customer satisfaction we were the highest scoring building society featured in the best financial brands research published by Which?.

I believe the fact that we are a mutual building society – a member-owned organisation – is central to this. The Board and executive team have absolute clarity regarding the Society's purpose, and are single-minded in pursuing a strategy which has our mission of 'Putting Members First' at its heart.

Our strength and security may be most valued by our present members in these times of uncertainty, but the values that underpin our success would be equally recognised by those who founded the Society in the 19th century. In fact, our core purpose of providing a safe home for retail savings and using this funding to provide low risk residential mortgages, has remained the same throughout our 130 year heritage.

It is our ability to take the long-term view, making decisions in the interests of our members, unhindered by the conflicting interests of shareholders that defines the Society's actions and performance.

That is why I am confident in saying that the Board is unanimous in believing that Coventry Building Society should remain an independent mutual building society.

There are those who question the role of the building society sector in today's financial services industry, and particularly its ability to compete or challenge the large high street banks. I believe that the Society's consistently strong performance, during more 'normal' times as well as the challenges of recent years, answers this question.

We have succeeded by delivering value to our members in the form of competitive savings and mortgage rates and by continuing to lend throughout the financial crisis, more than doubling the Society's share of the mortgage market since 2007[3].

It is true that building societies are different. Different in their ownership and structure and different in the way this translates to the products and services that they deliver to members.

This not only adds choice and competition to the market but helps raise standards in a financial services industry that has yet to regain the trust of the general public. I also believe these are attributes that should be recognised and encouraged as the regulation of the industry continues to develop following the financial crisis.

I am encouraged that, in consulting on a new non-risk based capital measure, the leverage ratio, the Financial Policy Committee recognised that a diversity of business models can help create a more resilient financial services sector and should be encouraged through appropriate regulation.

[1] Source: The Data/Council of Mortgage Lenders.
[2] Reported as at 26 February 2015.
[3] Source: Bank of England.

Building societies, like all financial institutions, must have appropriate levels of capital. The Society's prudent record in this regard extends from its responsible approach to lending through to a sector-leading[4] Common Equity Tier 1 ratio. During 2014 we have taken steps to strengthen the Society's leverage ratio, as increasing regulatory focus has been placed on this measure. We did this through issuing £400.0 million Additional Tier 1 capital to take the Society's leverage ratio well above the current proposed minimum requirement.

Regulatory developments bring their own risks, potentially reducing the Society's capacity to grow or restricting the competitiveness of its products. Focusing on a blunt leverage ratio may also encourage organisations to switch to riskier lending given that such a measure makes this lending appear more attractive. The Board is determined that this does not happen at Coventry Building Society.

The Board is committed to growing the Society for the benefit of existing and future members, by offering long-term value to our savers and borrowers underpinned by a caring, reliable and straightforward service – Putting Members First. This simple business model will continue to be based on spending our members' money wisely and maintaining our record as the sector's most cost-efficient Society.

This position remains unchanged, and has been endorsed by a Board that has seen significant change itself in the last 12 months.

In July Mark Parsons joined the Board as the Society's new Chief Executive. I am delighted to formally welcome Mark to the Society on behalf of the Board, members of staff and the Society's members and wish him a long and successful career as he leads the Society in the next stage of its development.

Mark's appointment followed the departure of David Stewart, our Chief Executive since 2006. I would like to take this opportunity to thank David for his outstanding leadership through arguably the most volatile period in the Society's history. That it emerged stronger, having enhanced its financial position and its reputation for protecting the interests of our members, reflects great credit on David and we wish him well in his future career.

I would also like to thank Colin Franklin, whose career at the Society spanned over 35 years and who stood down from his executive and Board responsibilities at the end of September. Colin undertook many roles during his long career, including serving as Interim Chief Executive prior to Mark's appointment. We value greatly all that Colin contributed to the Society.

In addition Feike Brouwers, our Chief Risk Officer has stated his decision to resign from the Board on 31 March, in order to spend more time with his London-based family. The Board would like to thank him for his contribution and wish him well.

It only remains for me to thank every member of staff for their commitment and contribution to what has been another extremely successful year for the Society, and our members for continuing to support the Society and trusting us with your savings and mortgage needs.

Ian Pickering
Chairman
26 February 2015

[4] Top 10 building societies.

Chief Executive's Review

When I joined Coventry Building Society as Chief Executive on 1 July 2014 I knew I was joining a strong organisation, with a clear and consistent record of success.

Throughout the financial crisis, when other financial services organisations faltered or failed entirely, the Society continued to grow its mortgage lending with a reputation for prudence and responsibility. It funded this growth by attracting and retaining increasing numbers of savers, offering them attractive interest rates and the security of a strong financial position.

Its financial strength was demonstrated by a healthy capital position and a consistent 'A' credit rating, underpinned by cost control and high quality mortgage lending.

I also knew of the importance the Board placed on its mutual ownership and the responsibility it has to protect the interests of its members.

Although mutual ownership is not a guarantee of success, the Society has proved that a business model based on doing the right things for members can flourish. In this regard its continuing strong financial performance, with an increase in profit before tax of 53% to £201.8 million, has been achieved whilst still providing long-term value to our saving and borrowing members. Indeed, of the Society's variable rate savings balances, 89% pay equal to or above best buy rates offered by any major UK bank or building society[1].

This business model will not change. In my first six months I have, in conjunction with the Board and my executive colleagues, reviewed and confirmed the strategic principles which underpin the Society's success. Central to this is the belief that our members' interests are best served by remaining an independent mutual building society. The strength of this form of ownership is the clarity of purpose it provides.

Members want their money to be safe and secure. They want long-term value for money. They want products and services that are simple to understand and easy to use. They want to be kept informed. They want their Society to be cost-efficient, to invest sensibly and lend responsibly. By delivering to these principles we will continue to attract more members, and maintain our growth.

It is a business model that works for our members, both on an individual basis and as part of a strong and secure financial institution, and in 2014 we continued to demonstrate this success in all aspects of our business.

Competitive mortgages

In 2014, we continued to grow our mortgage lending with a record £7.4 billion of advances, a 25% increase on 2013.

We expect this performance to maintain our position as one of the UK's top 10 lenders in terms of both mortgage advances and outstanding balances[2]. The overall growth in mortgages held was £2.8 billion, a 35% increase on 2013 growth, and equivalent to 13% of UK net mortgage lending[3]. With total mortgage balances up 12%, the Society now accounts for 2.1% of all UK mortgage balances[3], more than double our market share seven years ago when the financial crisis began.

The competitiveness of the Society's mortgage portfolio is not only shown by this growth in the face of increased competition, but also by the presence of its mortgages in the national press best buy tables throughout the year. In fact, our mortgages have been in the national press best buy tables for over 60 consecutive weeks.

This was achieved in a market which has seen significant change over the last 12 months. The regulatory change resulting from the Mortgage Market Review was implemented in April, representing one of the most important developments to the provision of mortgage finance in over 10 years. These new regulations have not impeded our ability to grow our mortgage lending or to meet the service expectations of new and existing members.

This is undoubtedly helped by our long-standing responsible approach to lending. Our growth in lending continues to prioritise low risk sectors of the market as a means of protecting the interests of individual members and the financial strength of the Society as a whole.

At the start of 2014 many commentators predicted the likelihood of an interest rate rise within the year. Although this did not materialise, future affordability must still be judged with interest rate rises in mind. The Society will continue to follow a prudent approach to lending in the future.

[1] As at 31 December 2014. Average deposit assumed as follows: Variable £10,000 and ISAs £15,000. Excludes competitor products with restricted availability (e.g. existing customers only or reliant on maintaining or opening another product with the same provider) and Offset accounts. Source: Moneyfacts data.

[2] Source: The Data/Council of Mortgage Lenders.
[3] Source: Bank of England.

Supporting savers

Savings members are the lifeblood of the Society – very simply, no savings would mean no lending. Whilst the general UK interest rate environment continues to favour borrowers, the Society has again delivered in supporting its savers.

In 2014, our overall growth in savings balances was £2.1 billion, a 10% increase on 2013, compared with a growth in the UK market[4] of 5%, resulting in a record of £23.4 billion total savings balances.

This growth was achieved in a market that continues to be influenced by a low Bank of England Base Rate and the Funding for Lending Scheme, the government initiative designed to stimulate lending activity. This scheme has provided UK lenders with cheaper funding to support business and personal lending, reducing interest rates to borrowers, but correspondingly reducing the need to attract savers and therefore savings rates across the market.

The fact that we continued to attract additional deposits during this period demonstrates the competitiveness of our savings interest rates. But more than this, it shows our intent to offer long-term value to savers despite the availability of cheaper alternative funding.

This is clear in the strength of our ISA rates, which became even more important to members' long-term savings plans following the welcome increase in ISA limits during the year. At the end of 2014, over 99% of the Society's variable rate cash ISA balances paid equal to or more than 2%, with a weighted average ISA rate on all ISA balances of 2.55% compared with 1.05% in the market[5]. Our ISAs have been in the national press best buy tables every week for nearly three years.

This performance was independently recognised by the Moneywise Customer Service Awards, which rated the Society the 'Most Trusted Cash ISA Provider' in 2014 and also 'Best Junior ISA 2014' for an account which has been a national press best buy since it was launched.

We also offer long-term value for money on non-ISA savings, with the average rate paid across all savings balances being the highest of any top 10 building society over the three years from 2011 to 2013[6]. Nearly 80% of non-ISA variable rate savings balances[7] paid an interest rate of 1.50% or more – three times the Bank of England Base Rate – and our non-ISA saving accounts have been in the national press best buy tables every week for over two years.

Most importantly, this strong savings performance is not skewed in favour of new members. All existing members are able to access any of our new products on the same terms as new members of the Society. In recognition of this consistently fair approach we received a gold rating from Fairer Finance, including a 97% rating for customer happiness, one of the highest scores of any bank or building society included in their research.

This fair approach to the Society's savers is also demonstrated by our simplification of the savings portfolio, which aims to reduce the number of our variable rate savings products by almost two thirds, making it easier for our members to compare different products. Unlike some other providers, we have not used this exercise to unilaterally reduce rates. Instead, over 100,000 members will benefit from a rate increase and 240,000 will have improved access to savings.

I would also like to mention a milestone about which everyone at the Society feels particularly proud. The first Poppy Bond was launched in October 2008 in aid of The Royal British Legion's Poppy Appeal. Six years and a quarter of a million Poppy accounts later, we have donated nearly £11 million to the Poppy Appeal. We have seen at first hand the difference The Royal British Legion makes and the partnership has become very important to members and staff alike.

There is no doubt that the low interest rate environment is a challenging one for savers. However, we continue to prioritise the needs of savers in terms of offering very competitive interest rates and making it easier to save with the Society. It is this combination of long-term value, simple products and fair treatment which resulted in the Society winning 'Most Trusted Savings Account Provider' in the 2014 Moneywise Customer Service Awards.

4 Source: Bank of England.
5 Source: Bank of England. Average quoted interest rate on all variable rate cash ISAs including bonus as at 31 December 2014.
6 Average rate estimate based upon interest payable on shares divided by average of opening and closing share balances, as disclosed in Annual Report & Accounts (2011 to 2013).
7 As at 31 December 2014.

Strong and secure

The financial crisis continues to cast a long shadow as regulations that aim to increase the resilience of the financial services industry are designed and implemented. The Board has long understood that its responsibility to protect the interests of members requires strong financial foundations. In recent years the Society's risk weighted capital ratio has been the strongest in our peer group, reflecting the responsible and prudent approach to lending and the resulting high quality mortgage assets. This continues to be the case with a Common Equity Tier 1 (CET 1) ratio of 25.4% expected to be the highest reported by any top 10 UK building society.

However, we have also taken steps to increase our leverage ratio by issuing £400.0 million of Additional Tier 1 (AT 1) capital in June. This capital protects the interests of savings members in the unlikely event of the Society's capital falling below certain thresholds. At the end of 2014, the Society's leverage ratio was 3.9%[8] (2013: 2.9%), well above the proposed minimum level of 3%.

However, the primary source of capital to support future growth will continue to be retained profits. It is important that we balance the requirements to generate the profits needed to meet tougher capital requirements with continuing to provide attractive savings and mortgage products. I believe the Society's performance in providing long-term value to its members proves this to be the case, and in this context the focus on low cost of operations and control of risks remains vital.

In 2014 we expect to maintain our position as the most cost-efficient in the sector with a cost to mean asset ratio of 0.42% that remains significantly better than our peers, albeit investment to improve member experience and meet changing regulations has resulted in an increase from 0.39% in 2013. This cost-efficiency underpins both competitive pricing and profitability.

In addition, the Society's responsible lending approach has resulted in a low level of mortgage arrears and impairment charges of just £5.4 million from a loan book of £27.0 billion, representing just 0.02% of average loan balances. Our focus on efficient operations and prudent lending has enabled the Society to increase profit before tax by 53% to £201.8 million. Notably this has been achieved with significantly more savings members receiving rate increases than rate decreases throughout 2014 – a very tangible indicator of our aim of Putting Members First.

The Society remains 'A' credit rated by both Fitch and Moody's, and is the only major high street bank or building society not to be downgraded by either agency in the last five years. The strength of these ratings is underpinned by the high credit quality of our borrowing members and the profits we have reported throughout the financial crisis, which have added to our reserves.

Serving our members

As I mentioned in my introduction, I knew I was joining a financially strong organisation. The Society's performance in 2014 once again underlines this fact. However, our real strength is the ability to deliver this performance whilst also delivering the right outcomes to our members.

This can be seen in the positive response of our members when asked about the service they receive, whether in branch, online or via our award-winning contact centre in Coventry. The Society has consistently achieved strong customer advocacy scores, with 9 out of 10 members who visit our branches or call our contact centre saying they would recommend us to friends and family[9]. The high level of trust and satisfaction that these figures indicate were supported by research undertaken in October 2014 by consumer champion Which? who ranked the Society as the highest scoring building society for customer satisfaction.

Our commitment to meeting the expectations of our members is also illustrated by the low levels of complaints received and, as importantly, by the actions taken to resolve these complaints when they do occur.

In common with other financial services organisations, we are required by the Financial Conduct Authority to publish the number of recordable complaints received. In the latest figures[10], the Society recorded 1.4 complaints per thousand members, one of the lowest rates of any top 10 building society.

Not only do we work hard to limit any cause of complaints, but when things do go wrong we try equally hard to put them right. The result is that, in the first half of 2014, only 3% of complaints referred to the Financial Ombudsman Service were changed in favour of the complainant, compared with an industry average of 57%[10].

[8] The leverage ratio calculations shown are in accordance with the definitions of CRD IV, on an end-point basis, as amended by the European Commission delegated regulation. The calculation reflects constraints on the inclusion of AT 1 capital as proposed by the Financial Policy Committee's review of the leverage ratio. The ratio for 2013 has been updated to reflect this definition.

[9] Source: Surveys of 142,772 branch visitors scoring 9 or 10/10 and 17,426 contact centre callers scoring 4 or 5/5 during 2014.

[10] Source: Financial Ombudsman Service data from 1 January 2014 to 30 June 2014.

To achieve the right outcomes for members consistently, the Society must have the right culture and standards of behaviour. Here too, we have firm foundations.

From the moment I joined the Society, I was struck by the commitment and enthusiasm felt by members of staff for its aims and values. At a time when there is an increasing and justifiable interest in the way an organisation conducts itself, this shared understanding of the Society's purpose, and the importance each person has in achieving it, is fundamental to our recent and future success. The 2014 employee opinion survey undertaken by a third party underlined the strength of our staff engagement with a score of 84% being 10 percentage points higher than the benchmark group used.

This engagement is also shown by the contribution made by staff on behalf of their local communities. This contribution takes many forms, from enthusiastic fundraising on behalf of BBC Children in Need or Comic Relief to the more direct support given to many small and local charities by teams across the branch network and head office. In 2014 the overall community investment supported by the Society was once again over £2.2 million, with more than 250 organisations benefiting from volunteering, fundraising or other direct involvement by staff.

Looking to the future

Underpinning all that the Society does is the clarity of its mission – 'Putting Members First'. It is what unites all employees. The environment will change as technology, regulation, competition and customer expectations change. The Society's mission will not.

My role, along with the Board, the executive team and every member of staff, is to ensure that the Society continues to meet our members' expectations. To this end we will continue to invest in the products and services we offer, to provide the long-term value and ease of interaction our members want, whilst retaining our focus on managing risk, costs and capital to ensure the safe and secure institution our members need.

Coventry Building Society is a 130 year old mutual and proud of it. We are a growth business, and the 2014 results continue a trend of growth which was maintained throughout the financial crisis. Our ability to grow rests, as it always has done, on retaining the loyalty of existing members and attracting new members to the Society. I believe that staying true to our principles, which protect the interests of all of our members, means we are well placed to continue this growth.

Mark Parsons
Chief Executive
26 February 2015

Business Review

Strategic Review

Objectives

The Society exists solely for the benefit of its current and future members, meeting their needs for savings and residential property mortgages. In delivering its strategic objectives, the Society is committed to Putting Members First in everything it does and fully embraces the mutual ethos on which it was founded.

Business model

The Society operates a very simple business model – simple products, simple ways of operating, and simple and transparent communication. It operates solely within the UK retail financial services market and only takes on risks that it understands and can manage. In order to ensure the business model is sustainable, capital is required to support future growth.

The Society accepts deposits from savings members and provides secured mortgage lending on residential properties. The difference between the rates on mortgages and savings accounts provides the Society with interest margin to cover expenses, impairment, provisions and taxation. The remaining profits provide the Society with the capital to support future growth and also protect members during periods of economic downturn.

As a mutual organisation, the Society does not have external shareholders or pay dividends; its customers have membership rights and are the 'owners' of the organisation. This creates clarity of purpose. The Society exists to serve its members and protect their interests, and strategic and operational decisions are taken with this responsibility in mind. Therefore, the Society can operate on lower levels of profit than would otherwise be the case, enabling it to provide improved pricing for its members.

Central to this is the provision of long-term sustainable value to members through competitively priced mortgage and savings products. The Society balances this with the requirement to protect members' interests by remaining financially strong and secure. As a result the Society aims to achieve sustainable levels of profitability rather than maximising profit to the detriment of its members.

Future outlook

The UK economic environment has improved in 2014, with increased growth in mortgage and savings markets. There remains some uncertainty created by fragile global and European growth, the UK General Election in 2015 and the potential for a referendum on the UK's continued membership of the European Union. Together with the residual economic and regulatory impact arising from the financial crisis these factors will continue to impact monetary policy and the performance of financial services businesses within the UK.

Notwithstanding this, increasing competition is likely to emerge and either the established banking groups or new challenger organisations may be able to gain market share. This could impact the Society's growth plans particularly if competitors successfully compete in the mortgage intermediary distribution channel, which is an area of strength for the Society. The Society's focused business model, established distribution relationships and low cost base position it well to deal with these potential threats and to continue both its growth and strong financial position.

Conduct redress arising from the inappropriate distribution of financial products is expected to continue for several years. Competitors continue to be more adversely impacted by these costs as the Society's consistent focus on Putting Members First has resulted in significantly lower provisions.

Strategic focus

The Society's strategy will continue to be focused as follows:

- The provision of low risk mortgage lending primarily through mortgage intermediaries but also our branches and other direct channels. Sustainable growth will be realised without taking on excessive levels of risk in order to protect existing members during periods of economic stress, and to safeguard the Society's independent future.
- Flexible acquisition of funding by providing simple transparent retail savings products offering long-term value supported by access to long-term wholesale funding markets.
- Efficient operations with effective use of technology to allow members to self-serve where they choose to do so and to maintain a cost advantage over competitors.
- Strong ethical standards and conduct principles supporting 'Putting Members First'. This extends to how we recruit, support and reward staff, and the design of products and services, and consulting members about how we can better meet their financial needs for mortgages and savings.

Overall the Society's rate of growth and pricing will remain flexible to respond to changes in the economic, regulatory and competitive environment to ensure performance is sustainable and balances the needs of the current and future membership.

Principal risks and uncertainties

Further information on the Society's principal risks and uncertainties can be found in the Risk Management Report on pages 16 to 54.

Performance against strategic goals

In the context of the strategy noted above, the Board is pleased with the profit performance, cost-efficiency, market share and capital covered in this report, and also with customer experience and employee engagement covered in the Chief Executive's Review.

Strategic goal	Key performance indicator	Performance in 2014
Grow our membership	Demonstrate an increased share of the UK mortgage and savings markets.	The Society's share of savings and mortgage stock increased in 2014, reflecting a trend that has seen it grow its share every year over the last eight years[1]. The number of customers increased by over 46,000 during 2014, and the number with either a savings or mortgage account now totals over 1.7 million.
Competitively priced products offering long-term value	Offer mortgage and savings rates that are attractive versus market rates.	89% of all variable rate savings balances[2] earned a rate of interest that is equal to or higher than the equivalent rate available from any major bank or building society. Our mortgages have been in the national press best buy tables for over 60 consecutive weeks.
Financially strong and secure	Have a top quartile Common Equity Tier 1 (CET 1) ratio[3]. Meet non-risk based capital measures with an appropriate buffer.	Highest reported CET 1 capital ratio of our peer group[3] at 25.4%. Leverage ratio of 3.9%, on an end-point basis, exceeds regulatory minimum of 3.0%.
Low risk lending	Impairment charges in the lowest 25% of peer group average[3].	Latest impairment charge as a percentage of average total loans and advances to customers is one of the lowest reported in peer group[3] at just 0.02%.
Highly cost-efficient	Lowest reported cost to mean assets ratio[4] of our peer group[3].	At 0.42%, this measure is expected to remain comfortably the lowest of the peer group[3] and less than half of the total building society average[5].
High levels of customer satisfaction	High relationship net promoter score and low levels of complaints referred to the Financial Ombudsman.	Strong customer advocacy scores, with 9 out of 10 members who visit our branches or call our contact centre saying they would recommend us to friends and family[6]. In the latest figures, the Society recorded 1.4 complaints per thousand members, one of the lowest rates of any top 10 building society[7].

Strategic goal	Key performance indicator	Performance in 2014
Strong employee engagement	Employee engagement scores above external high performance benchmarks.	The employee engagement score in the Society's 2014 employee opinion survey was 84% – 10% above a benchmark used by an independent third party. The Society also continues to hold a Gold Award from Investors in People.
Support our communities and wider society	To continue to make a tangible difference to local communities and national charities via fundraising and volunteering activities.	In 2014, the total investment in community activity, not including affinity products, increased by 20% to £550,000. This increased to £2.2 million when affinity accounts benefiting The Royal British Legion's Poppy Appeal are included.

1. Source: Bank of England.
2. As at 31 December 2014. Average deposit assumed as follows: Variable – £10,000 and ISAs £15,000. Excludes competitor products with restricted availability (e.g. existing customers only, reliant on maintaining or opening another product with the same provider) and Offset accounts. Source: Moneyfacts data.
3. Unless otherwise stated, performance is measured against a peer group of the 10 largest building societies, by total assets from latest published annual results.
4. Administrative expenses, depreciation and amortisation/Average total assets.
5. Source: Building Societies Association: Annual Accounts Data 2013.
6. Source: Surveys of 142,772 branch visitors scoring 9 or 10/10 and 17,426 contact centre callers scoring 4 or 5/5 during 2014.
7. Latest published information: 1 January 2014 to 30 June 2014.

These goals remain the strategic priorities for 2015 to 2019.

Financial Review

Income Statement

Overview

Statutory profit before tax has increased by 53% to £201.8 million. Whilst the Society does not aim to maximise profit, it is the key source of capital to protect members' interests and to support growth. In this context both underlying and statutory profit measures show a strong performance in 2014. This continues a track record of sustainable profitability that has seen the Society achieve satisfactory levels of profits throughout the financial crisis.

Statutory and underlying profit are set out in the summarised Income Statement below:

Year to 31 December 2014	Statutory profit £m	Financial Services Compensation Scheme levy £m	Movements on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	341.3	–	–	341.3
Other income	8.2	–	–	8.2
Losses on derivatives and hedge accounting	(0.7)	–	0.7	–
Total income	348.8	–	0.7	349.5
Management expenses	(124.6)	–	–	(124.6)
Impairment charges	(5.4)	–	–	(5.4)
Provisions	(15.3)	15.3	–	–
Charitable donation to Poppy Appeal	(1.7)	–	–	(1.7)
Profit before tax	201.8	15.3	0.7	217.8

Year to 31 December 2013	Statutory profit £m	Financial Services Compensation Scheme levy £m	Movements on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	253.1	–	–	253.1
Other income	9.3	–	–	9.3
Gains on derivatives and hedge accounting	2.8	–	(2.8)	–
Total income	265.2	–	(2.8)	262.4
Management expenses	(108.9)	–	–	(108.9)
Impairment charges	(6.3)	–	–	(6.3)
Provisions	(16.3)	15.4	–	(0.9)
Charitable donation to Poppy Appeal	(1.6)	–	–	(1.6)
Profit before tax	132.1	15.4	(2.8)	144.7

Net interest income

Net interest income at £341.3 million is £88.2 million higher than the previous year and was the primary driver in the increase in both underlying and statutory profit before tax.

	Year to 2014 £m	Year to 2013 £m
Net interest income	341.3	253.1
Average total assets	29,766	27,594
	%	%
Net interest margin	1.15	0.92

The Society's net interest margin has increased by 23 basis points to 1.15% in the year to 31 December 2014; the most significant driver for this was the continuing impact of the Government's Funding for Lending Scheme (FLS) which has driven down the cost of retail savings and wholesale funding. The Board believes the alignment of rates with the market is now largely complete and does not anticipate any further material increases in net interest margin.

Although the Society's net interest margin has benefited from the FLS, it has taken decisions to restrict the growth in net interest margin, thereby delivering value to individual members through attractive savings rates and competitive mortgage products. The Board has balanced this with the need to protect the overall financial strength of the organisation by increasing reserves through retained profits, providing reassurance and security to all members and in order to meet increasing capital requirements (see page 15).

The Society's rates of interest paid to members remain extremely competitive with it paying the highest average rate of interest of any top 10 building society over the period 2011 to 2013[1]. At the end of the year, over 99% of variable rate cash ISA balances were paid at least 2% against the market rate of 1.05%[2]. Furthermore, a non-ISA savings account has been in the national press best buy tables every week for over two years.

Of the Society's variable rate balances 89% pay equal to or above the best buy rates offered by any major UK bank or building society[3] and it is estimated that if these variable rates were aligned to best buy rates, interest payable to members would be £60 million less per year (based on interest rates, balances and the market as at 31 December 2014). This demonstrates the delivery of a key strategic goal.

Other income

Other income is not a strategic priority for the Society, which remains focused on the provision of mortgage and savings products.

Following the decision during 2014 by a third party to withdraw the provision of investment advice from the branch network, other income of £8.2 million is marginally lower than in 2013 (£9.3 million).

Derivatives and hedge accounting

The Society uses derivative financial instruments to manage various aspects of risk and in doing so complies with the Building Societies Act 1986, which limits the use of derivatives to the reduction of risk (hedging) arising from changes in interest rates, exchange rates or other market indices.

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1 Average rate estimate based upon interest payable on shares divided by average of opening and closing share balances, as disclosed in Annual Report & Accounts (2011 to 2013).
2 Source: Bank of England. Average quoted interest rate on all variable rate cash ISAs including bonus as at 31 December 2014.
3 As at 31 December 2014. Average deposit assumed as follows: Variable – £10,000 and ISAs £15,000. Excludes competitor products with restricted availability (e.g. existing customers only or reliant on maintaining or opening another product with the same provider) and Offset accounts. Source: Moneyfacts data.

Even though the Society uses derivatives exclusively for risk management purposes, Income Statement volatility arises due to the accounting ineffectiveness of designated hedges. Management believes that this volatility arises from application of the accounting rules rather than reflecting economic reality and consequently it is excluded from underlying performance. An analysis of the net loss from derivatives and hedge accounting is set out in note 7 to the accounts.

Management expenses

Total expenses for 2014 were £124.6 million (2013: £108.9 million). The increase is equivalent to a 0.03% increase in the ratio of costs to mean assets and reflects the Society's continued growth, increasing regulation and focus on customer service.

There has been significant growth in staff costs in order to respond to new regulations, but also to improve the quality of service offered in customer facing areas. The Society has also invested in ensuring that its core IT infrastructure and systems are robust and secure and are able to support increased functionality and methods of distribution, including developments in online services. This is an area where investment is likely to increase. During 2014, significant cost was also incurred in meeting the requirements of the Mortgage Market Review, which has led to the introduction of an enhanced affordability assessment and all mortgage lending being undertaken on a fully advised basis. Depreciation and amortisation of property, plant and equipment and intangibles has also increased to £12.3 million (2013: £10.7 million).

However, the Society's reputation for rigorous cost control is well founded. For over 10 years it has achieved the lowest reported cost to mean asset ratio of all UK building societies and comfortably expects to retain this position in 2014, despite an increase from 0.39% to 0.42%.

We expect to see continuing cost pressures within the business arising from sustained levels of investment in technology, increased regulation and organic growth, but the Society's ability to grow whilst retaining control of costs continues to represent a significant competitive advantage.

Impairment charges

Impairment losses of £5.4 million were lower than in 2013 (£6.3 million) (see note 10 to the accounts). This equates to 0.02% of average loan balances in the year (2013: 0.03%) and 0.04% over five years[4].

The Society has a strong record on impairments, reflecting the success of its low risk lending strategy which has always been a key element of its business model. Other than as a result of small books acquired as part of the merger with Stroud & Swindon in 2010, the Society has not undertaken commercial lending or second charge lending and exposure to unsecured lending is negligible with no new lending of this type since 2009. Underlying profit before impairment and tax is over 40 times the impairment charge, reflecting the ability to remain profitable even in the event of a further downturn.

Provisions

The £15.3 million provision for liabilities and charges is in respect of the Financial Services Compensation Scheme (FSCS) levy. The £16.3 million charge in the prior year comprised £15.4 million for the FSCS and £0.9 million for Payment Protection Insurance (PPI).

The Society pays levies to the FSCS based on its share of protected deposits and such levies are excluded from underlying profit.

In contrast to the experience of many high street banks, PPI is not a material issue for the Society. This is a consequence of the design of the PPI product offered by the Society and the member-focused offer process used. No further provision for PPI claims has been made during the year.

Further information on the provisions for liabilities and charges is included in note 24 to the accounts.

Charitable donation to Poppy Appeal

The Society donated £1.7 million to The Royal British Legion's Poppy Appeal during the year (2013: £1.6 million). The contribution to this appeal since 2008 now totals £10.8 million.

Taxation

The Board believes it should contribute its fair share of tax and in 2014 the corporation tax charge arising on profits earned was £43.3 million (2013: £30.8 million). This represents an effective rate of tax of 21.5% (2013: 23.3%) which is in line with the statutory corporate tax rate of 21.5% (2013: 23.25%).

[4] Impairment losses on loans and advances to customers/Average loans and advances to customers.

Balance sheet

Overview

Mortgage balances have grown by 12% from £24.1 billion to £27.0 billion in the year, primarily funded by an increase in retail funding of £2.1 billion. Wholesale funding and equity increased by £0.2 billion and £0.6 billion respectively.

	2014 £m	2013 £m
Assets		
Loans and advances to customers	26,959.6	24,117.1
Liquidity	3,950.2	3,887.4
Other	368.5	248.8
Total assets	31,278.3	28,253.3
Liabilities		
Retail funding	23,395.6	21,311.7
Wholesale funding	5,604.3	5,438.5
Subordinated liabilities and subscribed capital	219.8	219.7
Other	567.7	388.4
Total liabilities	29,787.4	27,358.3
Equity		
General reserve	1,061.9	914.6
Other equity instruments	396.9	–
Other	32.1	(19.6)
Total equity	1,490.9	895.0
Total liabilities and equity	31,278.3	28,253.3
Unencumbered FLS Treasury bills (off-balance sheet liquidity)[1]	616.3	642.8

1. Market value.

Treasury bills obtained under the FLS provide very high quality liquidity but, in accordance with accounting standards, are not recognised on the balance sheet as the Society does not retain the risk and rewards in relation to these assets.

Loans and advances to customers

The Society's lending strategy is focused on high quality, low loan to value owner-occupied and low loan to value buy to let loans within the prime residential market, through competitively priced mortgages.

These loans are primarily distributed through UK-wide third party intermediaries, and to a lesser extent through a smaller number of advisors within the Society's network of branches and the Coventry-based contact centre.

In 2014, the Society advanced £7.4 billion of mortgages, a 25% increase on the same measure in 2013 (2013: £5.9 billion), outperforming the market growth in gross advances of 14% year-on-year[5]. This once again represents a record performance and one that continues a trend of growth that has seen us more than double our market share of UK mortgage balances over the last seven years, exceeding 2% for the first time in our history[5].

The Society's mortgage balances increased as a result of organic growth by £2.8 billion (2013: £2.1 billion). This represents a 35% increase on 2013 net mortgage lending, and was equivalent to 13% of all UK net mortgage lending[5].

The growth in the mortgage book has been achieved whilst retaining the Society's focus on low risk lending. The result is an overall indexed loan to value of the mortgage book at 31 December 2014 of 49% (simple average), a position that is largely consistent with previous years (2013: 50%).

The result of this responsible lending approach is highlighted by an arrears performance which is significantly better than that of the industry as a whole and impairment charges which are consistently amongst the lowest reported by any top 10 mortgage lender.

As at 31 December 2014, 0.40% of mortgage balances were 2.5% or more in arrears (2013: 0.57%). At the time of the latest published data[6], arrears were 38% of the industry average. At the end of 2014, just 52 properties were in possession (2013: 67) from a total population of over 200,000 accounts.

This performance underlines the Society's commitment to the UK housing market during a period in which new mortgage lending as a whole still remains lower than pre-2008 levels[5].

Additional information and analysis of the mortgage book is set out in the Risk Management Report on pages 24 to 31.

[5] Source: Bank of England.
[6] As at 30 September 2014. Source: PRA.

Liquidity

On-balance sheet liquid assets have remained broadly unchanged at around £3.9 billion, despite the growth of the balance sheet, and continue to be held primarily in deposits at the Bank of England and UK Government securities. All regulatory requirements have been met throughout 2014 and the broadly unchanged balance reflects very high surpluses at 31 December 2013.

The credit quality of liquid assets remains high with 96% of the portfolio rated Aaa–Aa3 (2013: 98%) and 2% rated A1–A3 (2013: 2%). The Society has no direct exposure to the peripheral Eurozone countries. As at 31 December 2014 no amounts in the liquid asset portfolio were either past due or impaired and as such no impairment provision has been made.

Of the £4.0 billion liquid assets, £1.7 billion are held as Available-for-sale (AFS) and under IFRS are marked to market with any changes in value recorded through other comprehensive income. The non-AFS assets are loans and advances to credit institutions or deposits with the Bank of England. As at 31 December 2014, the balance on the AFS reserve was £0.7 million loss net of tax (2013: £12.1 million loss net of tax).

Additional information and analysis of treasury credit risk and the management of liquidity and funding is set out in the Risk Management Report on pages 31 to 34 and 37 to 44 respectively.

Retail funding

The Society continues to be predominantly funded by retail savings, which have increased by £2.1 billion to a balance of £23.4 billion at 31 December 2014 (2013: £21.3 billion). We estimate our share of the growth in the UK savings market for the year to be 3.7%, over double our 1.8% share of total UK savings balances[7].

As has been the case throughout the financial crisis, the Society has maintained a competitive stance in the retail savings market and has chosen to increase retail funding despite the availability of cheaper wholesale funding. This is a reflection of one of the core objectives; that as a building society we exist not only to provide mortgages but also to offer our members an attractive rate of interest and a safe home for their savings.

The growth in retail funding in the year was driven by maintaining very competitive savings rates for both new and existing members in both ISA and non-ISA markets.

In particular, given the strength of savings rates offered, the Society benefited from the changes to ISA legislation in July. These included an increase in the annual limit to £15,000 and the ability to transfer stocks and shares ISAs into cash ISAs, resulting in ISA balances at the Society growing by 71% year-on-year compared with growth of only 10% in overall UK cash ISA balances[7].

Wholesale funding

The Society uses wholesale funding to provide diversification by source and term and also to provide value to members through lowering the overall cost of funding.

During the year, on-balance sheet wholesale funding has increased marginally by £0.2 billion with a year end balance of £5.6 billion (2013: £5.4 billion). In November 2014 the Society raised €500 million of seven year funding issued from the covered bond programme, replacing the €650 million covered bond that matured at the end of October 2014. Off-balance sheet wholesale funding through the FLS remained at similar levels in 2014, with a drawdown of £1.3 billion (2013: £1.3 billion).

The proportion of assets funded by wholesale activity remains broadly flat at 18% (2013: 19%).

Additional information and analysis of wholesale funding and the management of liquidity and funding risk is set out in the Risk Management Report on pages 37 to 44.

Equity

The Society's equity is predominantly made up of its General reserve and Additional Tier 1 (AT 1) capital (other equity) but also includes the Available-for-sale reserve and cash flow hedge reserve. In June 2014, the Society issued £400.0 million of Perpetual Capital Securities, a form of AT 1 capital, in order to strengthen its leverage ratio. The discretionary coupon paid to investors on these securities will be treated as an appropriation of profit after tax, reflecting their categorisation as capital instruments, and hence is not reflected in net interest margin. The first coupon payment of £8.9 million, covering the period from issue to 31 October 2014, was paid on 3 November 2014 and is reflected in the Statement of Changes in Members' Interests and Equity on page 92.

As a result of this issuance and retained profits generated during the period, the Society's total equity increased by £0.6 billion over the year to £1.5 billion (2013: £0.9 billion).

[7] Source: Bank of England.

Regulatory capital

The Society's capital position was regulated under the Basel II framework during 2013, but in 2014 was regulated under the Basel III framework.

Basel III was implemented through the Capital Requirements Regulation and Capital Requirements Directive (CRD IV) and became effective on 1 January 2014. The impact of CRD IV is complex, but in summary it reduces the Society's regulatory capital resources primarily through the inclusion of the negative Available-for-sale reserve, and restricting the eligibility of Permanent Interest Bearing Shares and subordinated debt on a phased basis under transitional rules which extend to 31 December 2021. A quantification of the impact of the transition is available in the Society's Pillar 3 Disclosures (coventry.co.uk/2014pillar3).

CRD IV also introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirements and was originally proposed as a 'backstop' measure. The calculation determines a ratio which measures the relationship between Tier 1 capital and exposures to on and off-balance sheet items. The leverage ratio does not distinguish between unsecured and secured loans or recognise the ratio of loan to value of secured lending. The Financial Policy Committee (FPC) has reviewed the CRD IV requirements and has proposed that the minimum level of this ratio in the UK will be 3% with additional CET 1 buffers to be required in the future based on deemed systemic importance of individual institutions, or set more widely based on the FPC view of risks to financial stability.

The FPC review published in October 2014 also restricted the amount of AT 1 capital that could be included in meeting the proposed 3% minimum leverage ratio. Whilst all of the Society's recently issued AT 1 capital meets the Basel III requirements and therefore serves to protect members' interests, only £242.5 million is currently eligible for this particular measure.

The Society's capital position as at 31 December 2014 is summarised in the table below which shows CRD IV information for the current year on an end-point basis (i.e. assuming all CRD IV regulation were in force in full with no transitional provisions permitted) and on a proforma basis for the previous year.

The increase in CET 1 capital is primarily driven by retained profit of £158.5 million. Total Tier 1 capital and total regulatory capital have additionally been increased by the issue of £400.0 million of AT 1 capital.

Risk weighted assets have increased, reflecting continuing growth of the mortgage book.

The movements described above have resulted in an increase in the Society's CET 1 ratio from 22.8% to 25.4% and in its leverage ratio from 2.9% to 3.9% (on an end-point basis). At 31 December 2014, and throughout the year, the Society complied in full with the capital requirements that were in force.

Additional information and analysis of capital and its management is set out in the Risk Management Report on pages 48 to 54.

	End-point[1] 31 Dec 2014 £m	Proforma end-point[1,2] 1 Jan 2014 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	1,011.2	855.2
Total Tier 1 capital	1,408.1	855.2
Total capital	1,414.2	857.2
Risk weighted assets	3,977.2	3,750.2
	%	%
CRD IV ratios:		
Common Equity Tier 1 (CET 1) ratio	25.4	22.8
Leverage ratio[3]	3.9	2.9

1. Grandfathered Tier 1 and Tier 2 instruments are fully amortised under the end-point basis.
2. Since the publication of the Annual Report & Accounts 2013, the ratio has been updated to reflect the most current guidance.
3. The leverage ratio calculations shown are in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation. The calculation reflects constraints on the inclusion of AT 1 capital as proposed by the Financial Policy Committee's review of the leverage ratio. The ratio for 1 January 2014 has been updated to reflect this definition.

Risk Management Report

Introduction and principal risks

This Risk Management Report explains the Society's business, the risks it is exposed to and how it manages these risks. Given capital is the means by which the Society seeks to protect members from the impact of a risk event, this report also summarises the capital position and an assessment of its adequacy.

The risks of the organisation are managed on a Group basis to include the Society and its subsidiaries. The term 'Society' is therefore used in this report to include the activities of the Society and its subsidiaries.

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

The risk classes inherent within the business are set out below and within each of these classes, the Society's principal risks are also set out. The Society defines a principal risk as 'an inherent risk exposure that could materially compromise the Society's ability to grow and provide attractive products to saving and borrowing members'.

Risk class	Brief definition
Credit risk	Credit risk is 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.
Market risk	Market risk is a collective principal risk category and is defined as the risk that the value of income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign currencies, although exposure to foreign currencies is immaterial.
Liquidity and funding risk	Liquidity and funding risk is a principal risk category. Liquidity risk is the risk 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.
Conduct risk	Conduct risk is the risk that the Society's behaviours fail to deliver good customer outcomes.
Operational risk	Operational risk is the risk of loss arising from inadequate internal processes, systems or people, or from external events. The Society assesses the risks at a more granular level against which the following are considered to be the principal operational risk categories: legal and regulatory, IT systems, information security, financial crime and people.
Business risk	Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors. The Society considers strategic risk, the risk to delivering the Strategic Plan, to be the principal business risk.

In addition to these principal risks, the Society is also exposed to model risk which is the risk that an adverse outcome occurs as a direct result of weakness or failure in the design or use of a model. Given that models are frequently used in the assessment and monitoring of principal risks, model risk is therefore a feature of each of the categories above. The Society uses a variety of techniques to mitigate model risk, including sensitivity analysis to key assumptions and applying shock stresses. A formal committee is dedicated to the oversight of the Internal Ratings Based (IRB) models and considers validation reports from third party experts.

Controlling and managing risk

Overview

Whilst the Society has not fundamentally changed its risk management approach, during the year the approach has continued to evolve. In particular during 2014 the Society has sought to better document and evidence its approach to risk management through the formalisation of an Enterprise Risk Management Framework (ERMF) and this work is ongoing. The primary purpose of the ERMF is to set out the Society's approach to managing risk and provision of oversight by defining and documenting the Society's purpose and objectives; risk strategy; governance and control; and risk management together with the principles upon which the framework is based. The ERMF should ensure a more consistent approach to risk management across all risk categories.

How the Society controls and manages risks is set out in the sections that follow.

Society purpose and objectives

The Society determines and regularly revisits its purpose and objectives through the annual strategic planning process and through defining its vision for the future. The risk management process complements and supports the Society's Strategic Plan and vision.

The Society exists solely for the benefit of its current and future members, meeting their needs for savings and residential property mortgages. In delivering its strategic objectives the Society is committed to Putting Members First in everything it does and fully embraces the mutual ethos on which the Society was founded. These objectives therefore drive the risk appetite adopted by the Society to be a 'below median risk mutual' and set a strong risk culture in which it operates.

The Society operates a very simple business model – simple products, simple ways of operating and simple and transparent communication. It operates solely within the UK retail financial services market and only takes on risks that it understands and can manage.

Risk strategy

Set by the Board, the risk strategy translates the Society's purpose and objectives into an approach to risk management that incorporates risk culture, Board risk appetite and the adoption of the 'three lines of defence' model. The risk strategy defines the set of risk principles on which the risk framework is constructed.

Risk culture

Risk culture is defined as the normal attitudes and behaviour exhibited by staff at all levels with regard to risk awareness, risk taking and risk management.

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

- Tone from the top – the Board and executive management encourage staff to act with integrity, especially in the fair treatment of customers, and to escalate observed non-compliance. Staff are encouraged to report risk incidents and 'near misses'.
- Accountability – employees understand the core values of the Society and therefore the approach to risk. This is supported by the Society's performance management process.
- Incentives – the Society's performance management arrangements promote the Society's desired risk management behaviours and attitudes. In particular, the Society does not operate any sales incentives for staff.

Board risk appetite

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

The Board has a risk philosophy to be a 'below median risk mutual' which also provides a check and balance against the underlying appetite statements and limits for each of the Society's risk categories.

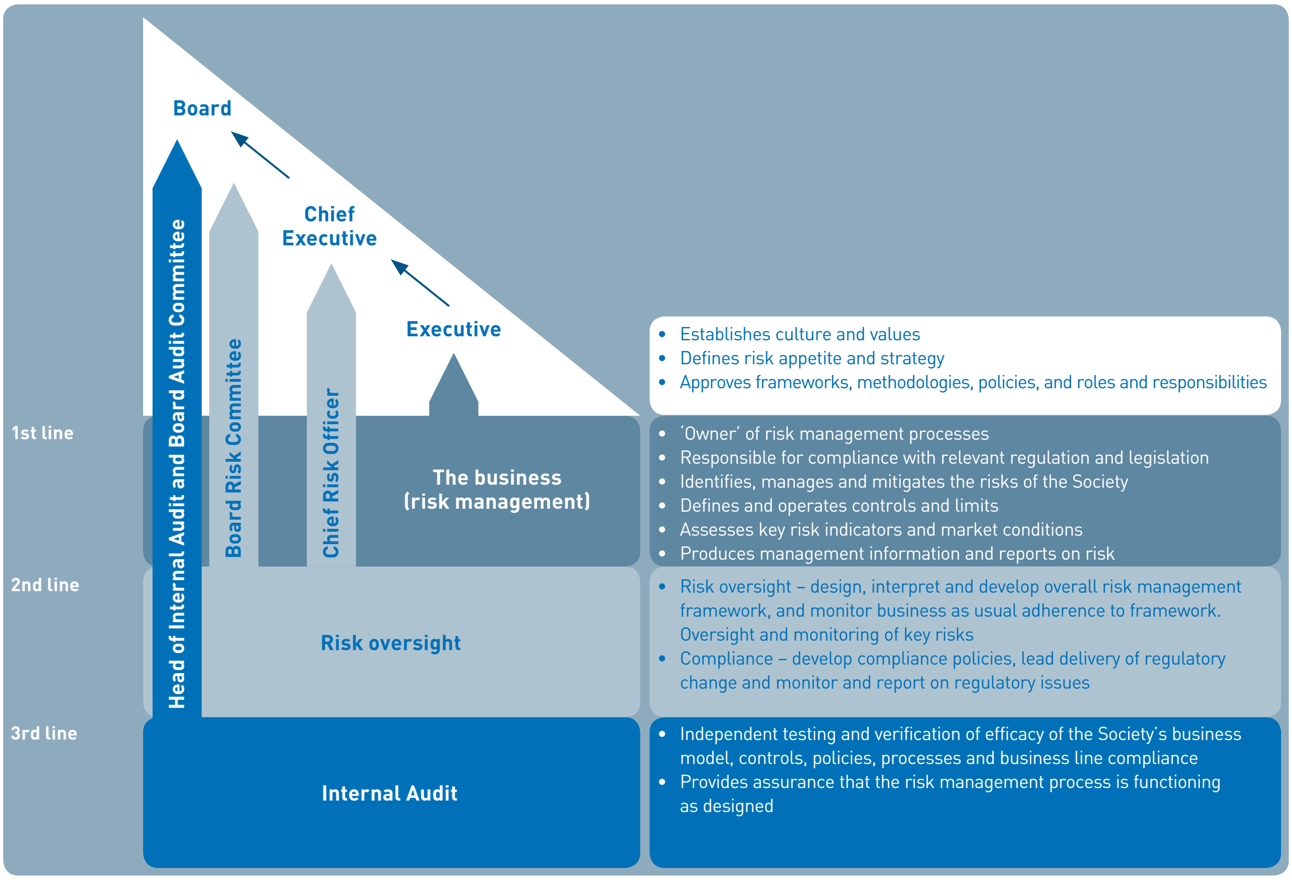
Additionally, the Board has set a boundary condition to be able to withstand a severe but plausible stress and still report an accounting profit and meet minimum capital requirements. The Society will tend to operate with a lower level of risk than its stated appetite or boundary condition, if it is possible to do so and still meet its Strategic Plan targets.

The Society's performance against Board limits is reviewed monthly as part of a consolidated risk report by both the Risk Management Committee (RMC) and Board Risk Committee (BRC).

Three lines of defence

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

The structure and responsibility of management and Board Committees are set out below:



- First line of defence – risk management is primarily the responsibility of all managers and staff of the Society. Management has a responsibility to understand how risks impact their area of the business and to put in place controls or mitigating activities.
- Second line of defence – oversight is required to challenge managers and staff effectively in their performance of risk management activities and to provide risk management expertise. This is provided through risk support functions and risk committees. The Chief Risk Officer reports to the Chief Executive and has an independent reporting line directly to the Chairman of BRC.
- Third line of defence – the Society's Internal Audit function is responsible for independently reviewing the effectiveness of the Society's risk management structure and adherence to processes. The Head of Internal Audit has an independent reporting line directly to the Chairman of the Board Audit Committee (BAC), and reports to the Chief Executive for day-to-day management. BAC approves the work programme of Internal Audit and receives reports on the results of the work performed.

Governance and control

Risk governance structure

Governance is maintained through delegation of authority from the Board, down through the management hierarchy, supported by a committee based structure designed to ensure that risk appetites, policies, procedures, controls and reporting are fully in line with regulation, law, corporate governance and industry good practice.

The risk governance structure in operation during the year is set out overleaf. This structure is being considered as part of the ERMF development and is expected to remain broadly consistent with the addition of a dedicated risk oversight committee which the Chief Risk Officer will chair to facilitate a comprehensive second line review of risk across all categories.

Further information on BRC is included in the Directors' Report on Corporate Governance on page 61 and on the Board Audit Committee in the Board Audit Committee Report on page 65.

Risk governance structure

Board

Chair: Chairman

- Sets the culture and values of the Society.
- Challenges and approves the long-term strategy of the Society.
- Determines and reviews the Society's risk appetite and the major risks faced by the Society.
- Approves Internal Capital Adequacy Assessment Process (ICAAP), Individual Liquidity Adequacy Assessment (ILAA), Strategic Plan, Risk Appetite, Recovery and Resolution Plan and stress testing.

Chief Executive

Board Risk Committee (BRC)

Chair: Non-executive director

- Overseeing and advising the Board on current and potential risk exposures to the Society, including reviewing risk appetite, risk limits and tolerances across the full range of risks to which the Society may be exposed.
- Satisfies itself on the design and completeness of the Society's internal control and assurance framework relative to the risk profile.
- Seeks assurance that the Society has an effective risk governance structure.

Risk Management Committee (RMC)

Chair: Chief Risk Officer

- Ensures that risk is being identified and managed efficiently across the Society.
- Ensures that the Society's risk management framework remains effective.
- Ensures the robustness of the overall stress testing and scenario analysis programme for risks faced by the Society.

Board Audit Committee (BAC)

Chair: Non-executive director

- Reviews the adequacy of internal control and risk management processes.
- Monitors the integrity of financial statements.

Internal Audit
Provides assurance that the risk management processes and controls are effective.

External Audit
Independently examines and expresses an opinion on the financial statements.

Conduct Risk Committee (CRC)

Chair: Chief Executive

- Oversees and monitors the Society's delivery of good customer outcomes consistent with the conduct risk appetite statement approved by the Board.

Asset and Liability Committee (ALCO)

Chair: Finance Director

- Oversees the asset and liability risks faced by the Society, specifically market risk, treasury credit risk and liquidity and funding risk.

Retail Credit Risk Committee (RCRC)

Chair: Chief Risk Officer

- Monitors the management of retail credit risk across the Society and the performance of the mortgage books to ensure compliance with limits approved by the Board.

Operational Risk Committee (ORC)

Chair: Chief Operating Officer

- Monitors operational risk, business continuity, compliance and financial crime policy, and security risk in the Society.

Models and Ratings Committee (MRC)

Chair: Non-executive director

- Monitors the Society's use of its IRB system and reviews compliance of this system with rules surrounding regulatory capital requirements e.g. with CRD IV.

Risk management

The risk management approach encompasses the requirements for identifying, assessing, managing, monitoring and reporting on risk. Techniques involved include the use of risk and control self-assessment, the use of key risk indicators, risk management information, the monitoring of risks by each of the three lines of defence, risk modelling and stress testing and planning.

The risk management processes are designed to deliver the Society's risk management objectives which at a strategic level are to:

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

Stress testing and planning

The Society recognises that stress testing is a key tool to understanding and managing risk. In support of this, the Society has developed and maintains a detailed stress testing framework that covers stress testing, scenario planning and contingency planning. As well as an understanding of the Society's resilience to internal and external shocks, stress testing provides a key input to the Society's capital and liquidity assessments and related tests of risk management and measurement assumptions.

The stress testing that the Society undertakes is designed to:

- Confirm the Society has sufficient capital and liquid resources.
- Ensure the Society remains within its risk appetite.
- Ensure the alignment between the Society's risk management framework and senior management decision making.
- Provide sufficiently severe and forward looking scenarios.

ICAAP

The Internal Capital Adequacy Assessment Process (ICAAP) is the Society's evaluation of its capital position and requirements, assessed under the Capital Requirements Regulation and Capital Requirements Directive (CRD IV) framework. The ICAAP provides details of the current approaches used to manage risk across the Society. As part of that assessment, the ICAAP has to assess capital requirements both against the Society's current position and during severe but plausible stresses.

The Society bases its capital requirements on a stressed scenario specified by the regulator overlaid with further adverse second order effects. In addition, a range of other more severe stresses are considered in support of the overall capital calculation. For example, the Society stresses its capital requirements to include scenarios in which the worst house price deflation ever observed is compounded by the worst arrears observed to date. The stresses also reflect both low rate and high rate Bank of England Base Rate scenarios.

ILAA

The Individual Liquidity Adequacy Assessment (ILAA) is the Society's documentation of its liquidity position and requirements, assessed against regulatory requirements and risk tolerance. An integral component of the approach to liquidity risk management is stress testing, some of which is prescriptive, using very detailed rules and guidance issued within prudential regulations and reported within regulatory returns. In addition to the regulatory prescribed stress testing, the Society undertakes its own stress tests and sets limits on these which tend to be more onerous than those of the regulator. The Society's stress tests and regulatory returns are completed weekly, alongside a monthly operational stress and six-monthly alternative stress tests.

Reverse stress testing

Reverse stress testing (RST) informs, enhances and integrates with the Society's existing stress testing framework by considering extreme events that could 'break' the Society. As such it complements the existing ICAAP and ILAA processes, helping to improve risk identification and risk management more generally.

The application of RST follows two basic approaches. A qualitative approach begins with executive workshops to provide an opportunity to explore the threats and issues which may sit outside routine risk reporting. The threats identified are amalgamated with risks identified in a parallel process incorporating operational risks. The combined threats and risks are then explored to see what additional events would be required to 'break' the Society and determine the feasibility of all these events occurring together. This qualitative approach is supplemented with a quantitative assessment of the risks which explores the level of capital or liquidity failure needed to 'break' the Society. A key outcome from the process is to consider whether any of the scenarios considered are sufficiently plausible to necessitate a change to the Society's risk strategy or underlying controls.

The analysis is formally undertaken every 12 months and reviewed and approved by the Board, although the scenarios are considered more frequently.

Recovery and Resolution Plans

The regulatory authorities are keen to avoid committing more taxpayers' funds towards any failed banks and building societies and are requiring them to formulate plans to avoid such eventualities. The recovery plan outlines what can be done to stop the Society from failing whilst the resolution section provides the data required to establish a resolution plan for the Society. The process of preparation for such extreme events enables the Board to plan actions it would take to recover from adverse conditions which would otherwise lead to failure. The recovery plan represents a 'menu of options' for the Society to deal with firm-specific or market-wide stresses and which can be incorporated into a credible and executable plan.

Top and emerging risks

Other than the risk of a 'yes' vote to Scottish independence, a number of the top and emerging risks affecting the Society reported in the 2013 Annual Report & Accounts and 2014 Interim Financial Report continue to apply to the Society.

However, geopolitical uncertainty has increased and there are continuing concerns over the financial situation of the Eurozone countries, as their recovery stalls.

Additionally the level of fines and regulatory action against financial firms continues. Although the Society has not been subject to any such censure, reflecting its commitment to delivering fair customer outcomes, the very adverse publicity associated with some of our competitors has the capacity to damage the reputation of the whole of the financial services sector. The Board therefore remains conscious and vigilant of the conduct risks that have the potential to impact it, and continues to take the necessary steps to mitigate such risks.

A sustained but slow UK recovery

The UK economy has performed strongly in 2014 compared with many countries in the Eurozone, with GDP back towards historic growth levels, the recovery being led principally by domestic consumer spending. The authorities have maintained official interest rates at a record low in an attempt to kick start the economy, supported by a variety of central bank initiatives to support lending to the housing market and small and medium enterprises (SMEs). Contrary to market expectations, unemployment levels have continued to fall, although this has been at the expense of wage growth. Domestic inflation has remained low, aided by cheaper commodity prices and in particular oil, slow global growth and the strength of sterling.

With the impact of cheap funding from the Funding for Lending Scheme (FLS) feeding through to retail pricing, the UK housing market witnessed a strong recovery at the end of 2013 and into early 2014 until the Mortgage Market Review contributed to a slowdown in Q2 2014. Towards the end of 2014, fears of interest rate rises and uncertainty around the 2015 General Election have seen a further reduction in activity. At the same time, competition in the market has increased with a consequential effect on pricing.

Market expectations are for a small average increase in UK property prices in 2015 but with regional variations. Certain areas of London, for example, have experienced very strong price growth in 2014 and a slowdown is entirely possible in 2015. Activity levels are expected to be broadly similar to 2014 with demand underpinned by low mortgage rates and unemployment levels.

Since the Bank of England first issued forward guidance during 2013, there has been much debate about the timing of the next Bank of England Base Rate movement. The likelihood of interest rates remaining low in Europe for an extended period, together with political uncertainty in the UK surrounding the General Election in May, have impacted on expectations of any UK rate rise, with the majority of commentators now pushing back the timing of the first move to the end of 2015 at the earliest. The Bank of England has reiterated that rate rises, when they do occur, will be gradual.

The UK has now been in a prolonged flat Bank of England Base Rate environment for six years, and the Society has continued to generate strong profits with no diminution of capital. In its assessment of the economic environment, the Society has always taken a prudent approach to possible interest rate movements and will position itself to protect against any adverse outcomes. The Society considers the inherent risks to mortgage members currently enjoying relatively low rates who could suffer with a rate 'shock' in the event that the Bank of England Base Rate begins to rise and any consequent effects on mortgage affordability. To this end, through a thorough underwriting process, the Society only lends to those members who it believes can afford repayments, and regular and extensive stress testing is undertaken on the mortgage book under various scenarios, such as increased interest rates, and movements in unemployment levels and house prices.

Risks from the Eurozone and wider geopolitical issues

While the Society is well protected from the direct impacts from global stresses, the impacts on the UK economy would affect the Society. Unemployment across the Eurozone remains high, the Eurozone economy shows no signs of sustained recovery, and political uncertainty remains over elections in a number of countries, following the change of government in Greece. The threat from a Eurozone crisis has therefore not abated but the Society has taken all reasonable measures to mitigate the risk.

The Society has minimal redenomination risk with all euro denominated exposures held with UK counterparties. There is no credit risk from any Eurozone sovereign other than through the European Investment Bank. The Society does not hold any direct sovereign securities other than those of the UK, and the Society continues to take a very cautious view towards exposure to European counterparties. The Society's analysis of counterparty risk extends to the risk from bail-in as well as to credit default events.

Cyber threats

Due to technological evolution and increased media coverage, the risks associated with cyber-attack continue to be prominent across the globe. Financial institutions are responding to this threat and have made substantial investment in technological solutions to combat the more sophisticated high-tech financial crime threats that are faced.

The Society is determined to ensure that its defences are robust and continues to implement industry best practices.

Regulatory reforms

Over 2014 the Bank of England announced its plans to modify the CRD IV leverage ratio. The consultation closed in September and at the end of October the Financial Policy Committee (FPC) announced its findings. The FPC has proposed a minimum requirement of 3%, of which only 25% may be met using Additional Tier 1 (AT 1) capital plus countercyclical and systemic buffers, which can only be met with Common Equity Tier 1 (CET 1) capital and could increase the total requirement to 4.95%. While the Society believes it is well placed to meet the requirements given the transition time announced by the FPC, it concurs with one of the conclusions of the review – that these changes will have the greatest impact on organisations, such as the Society, operating low risk mortgage portfolios.

Work on the remaining elements of implementation of CRD IV has progressed in line with expectations.

During 2014, the European Banking Authority and the Bank of England have issued a substantial number of papers and regulation on Bank Recovery and Resolution, impacting both the requirement for recovery plans held by the Society and for additional loss absorbency (capital and liabilities). The Society continues to monitor these developments but does not anticipate any significant impact on its plans.

Changes to the regulatory regime concerning the regulatory approval and ongoing accountability of certain senior individuals working in the banking industry (Senior Manager Regime) is anticipated to have little outward impact on the Society's business activities, although the work to update policies and document compliance against the new rules, once published early in 2015, will be sizeable.

Credit risk

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

Maximum exposure to credit risk (Audited)

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

	On-balance sheet carrying value 2014 £m	Off-balance sheet exposures[1] 2014 £m	Maximum credit risk exposure 2014 £m	On-balance sheet carrying value 2013 £m	Off-balance sheet exposures[1] 2013 £m	Maximum credit risk exposure 2013 £m
Cash and balances with the Bank of England	2,114.5	–	2,114.5	2,042.1	–	2,042.1
Loans and advances to credit institutions	180.5	–	180.5	179.3	–	179.3
Debt securities	1,655.2	1,322.6	2,977.8	1,666.0	1,348.2	3,014.2
Loans and advances to customers	26,959.6	1,439.8	28,399.4	24,117.1	1,032.6	25,149.7
Hedge accounting adjustments	98.1	–	98.1	(8.4)	–	(8.4)
Derivative financial instruments	208.3	–	208.3	191.2	–	191.2
Total	31,216.2	2,762.4	33,978.6	28,187.3	2,380.8	30,568.1

1. Off-balance sheet exposures comprise loan commitments and off-balance sheet treasury bills relating to the FLS.

Retail credit risk

Retail credit risk profile

The nature of the Society's lending has remained focused on low risk residential mortgage business, including buy to let. Limited non-traditional lending in the form of near-prime mortgages and self-certification was discontinued in 2008 and 2009 respectively and these portfolios are reducing over time. Commercial loans in the Stroud & Swindon portfolio were added to the Society's assets upon merger of the two Societies in 2010. These balances also continue to reduce over time, with no new lending activity being undertaken in this portfolio. There has been no new unsecured lending since 2009.

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

Loans and advances to customers (Audited)	2014 £m	2014 %	2013 £m	2013 %
Residential mortgages: owner-occupier	16,835.2	62.4	15,161.1	62.8
Residential mortgages: buy to let	9,657.4	35.8	8,419.8	34.9
Total traditional residential mortgages	26,492.6	98.2	23,580.9	97.7
Residential near-prime mortgages	105.2	0.4	116.0	0.5
Residential self-certification mortgages	331.6	1.2	382.6	1.6
Commercial mortgages[1]	6.3	–	8.3	–
Total non-traditional mortgages	443.1	1.6	506.9	2.1
Unsecured personal loans[1]	50.0	0.2	56.7	0.2
Total gross balance	26,985.7	100.0	24,144.5	100.0

1. Legacy books of unsecured personal loans and commercial mortgages exist. The credit risks from these are immaterial and are not considered further within the report.

Geographical concentration (Audited)

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

Region	2014 %	2013 %
East of England	12.6	12.4
London	14.8	14.2
Midlands	15.1	16.0
North East	9.0	9.1
North West	8.6	8.6
Scotland & Northern Ireland	4.6	4.6
South Central	12.9	12.6
South East	10.8	10.6
South West & Wales	11.6	11.9
Total	100.0	100.0

Loan to value

The Society's low risk approach to lending is reflected in the loan to value profile of the residential mortgage book. The estimated value of the residential mortgage portfolio is updated on a quarterly basis using the Nationwide regional House Price Index.

The residential mortgage book as at 31 December 2014 is analysed below, together with an analysis of gross new lending in the year. The following tables are by value unless stated otherwise:

Total mortgage book profile (by number of accounts) (Audited)	2014 %	2013 %
Indexed loan to value:		
< 50%	48.1	45.0
50% to 65%	25.9	26.6
65% to 75%	13.0	13.7
75% to 85%	8.8	9.1
85% to 95%	3.7	4.1
> 95%	0.5	1.5
Total	100.0	100.0
Average indexed loan to value of stock (simple average)	48.6	50.0
Average indexed loan to value of stock (balance weighted)	55.6	57.7

New business profile (Gross lending[1]) (Audited)	2014 %	2013 %
Owner-occupier purchase	38.8	36.7
Owner-occupier remortgages	23.8	24.0
Buy to let	37.4	39.3
Total	100.0	100.0
Average loan to value (simple average)	64.6	63.6
Average loan to value (balance weighted)	66.6	66.5

1. New business and average loan to value of new business excludes further advances (2014: £152.4 million, 2013: £141.7 million).

Retail credit risk management – residential mortgages

The Society operates a simple business model, focusing on its principal objectives, one of which is to meet its current and future members' needs for residential mortgages. Credit risk for the Society is therefore most likely to present itself in the potential inability of a borrower to repay their mortgage, and will materialise if that inability to repay results in repossession of the borrower's property, and subsequent loss if the value of the property upon sale is insufficient to pay the mortgage balance in full.

Exposure to this risk is monitored and managed by a specialist department that reports to the Chief Risk Officer, and is overseen by the Retail Credit Risk Committee (RCRC). RCRC's activities and decisions are overseen by RMC and BRC.

RCRC is tasked with ensuring that the quality and mix of new lending and overall portfolio exposures are within the prudent limits and risk appetite set by the Board, and ensuring that adequate controls are in place to maintain the quality of lending. This includes setting, reviewing and monitoring lending policy, comprehensive credit risk management information, and trend analysis on both new lending and the loan portfolio, including monitoring against available comparative data.

With respect to controlling the quality and mix of new lending and ensuring that it is within limits and the risk appetite set by the Board, the Society operates a combination of statistical modelling (credit scoring) and assessment of applications against lending policy criteria which are embedded as rules within the Society's automated decision system. This system uses information from the statistical modelling and assessment against policy rules to provide consistent lending decisions, and helps determine when manual intervention is required by skilled underwriters.

Since the Mortgage Market Review came into force in April 2014, for all owner-occupier mortgages the Society has also operated an affordability model. This seeks to determine on new applications, if the borrower's income, after considering key spending requirements, is sufficient to meet both the current mortgage payment and future payments in the event of interest rates rising, by the inclusion of a stressed rate in the assessment of affordability.

Buy to let mortgages are assessed principally against the ability of rental income to meet likely mortgage payments in a higher interest rate environment. The buy to let lending undertaken is low risk, low loan to value business, and the amount of equity within the property means that even in the event of default, typically credit losses are low. Along with assessing rental income and stipulating conservative minimums that are acceptable, which helps protect the mortgage repayments independently of the borrower's circumstances, the Society also limits the number of properties it will consider in lending to individual landlords. Additionally, the Society considers the value of the property on the basis of whether it can be resold into the owner-occupier market. This therefore gives recourse to two markets (buy to let and owner-occupier) in the event that the property was to move into Society ownership. For these reasons the risks from the Society's buy to let portfolio are in many respects comparable to standard owner-occupier mortgages.

There is also a comprehensive quality assurance programme to monitor the quality of lending decisions (owner-occupier and buy to let) and adherence to lending policy.

The Society's mortgage lending is only secured against properties in the UK. The Society's natural concentration in the UK market could then be exacerbated by overexposure to one geographical location or counterparty, or reliance on particular product types within the portfolio. The Society manages this risk by monitoring the geographical distribution of lending, the distribution of gross lending by channel of acquisition and by setting new lending risk limits in specific segments of the mortgage market.

Regular stress testing is undertaken on the mortgage book which seeks to establish the extent to which losses may emerge under a range of macroeconomic and specific stress scenarios and to ensure that the Society continues to remain within its retail credit risk appetite. These stress tests primarily consider the impact of economic events on the probability of default and on house price movements.

RCRC monitors arrears and the policy and strategy for managing members in payment difficulties. A specialist department works with borrowers in financial hardship or difficulty to resolve matters and each case is reviewed on its own merit. The overarching aim is to collect arrears and to regularise payments, using possession as a last resort or where it is the only credible option. Reasonable and realistic arrangements will be accepted, based on what the customer can afford, provided in the longer term there is a high degree of confidence the debt will reduce. Additional information on the extent and use of forbearance is set out later in this section.

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

Regular reviews of the Society's arrears management function and processes are independently undertaken to ensure that borrowers are being treated fairly, appropriately and sympathetically and in line with established policies and procedures and regulatory guidance. Where shortcomings are identified, action plans are put in place to rectify the issue. These are monitored and closure is subject to oversight.

Identifying impaired loans (Audited)

Loans are categorised by arrears status in line with industry practice and are identified as being either not past due and not impaired (if up to date at the balance sheet date), past due up to three months but not impaired, or impaired if more than three months in arrears or in possession.

In terms of impaired mortgages, the Society's performance is compared with figures published by the Council of Mortgage Lenders (CML). From these figures it can be seen that the performance of the Society has remained strong, with arrears reducing over the year, and favourable to the industry.

The Society's number of accounts in arrears as a percentage of loans and advances to customers compared with the CML data is shown below:

(Audited)	2014 Society %	2014 CML[1] %	2013 Society %	2013 CML[1] %
Greater than three months	0.68	1.33	0.90	1.68
Greater than six months	0.26	0.70	0.41	0.91
Greater than one year	0.08	0.28	0.12	0.37
In possession	0.02	0.06	0.03	0.08

1. Council of Mortgage Lenders' data as at 31 December 2014 (31 December 2013).

An analysis of past due and impaired loans by loan to value is shown below:

As at 31 December 2014 (Audited) Indexed loan to value:	Not impaired: Not past due £m	Not impaired: Past due up to three months £m	Impaired: Past due over three to six months £m	Impaired: Past due over six months or in litigation £m	Impaired: In possession £m	Impairment provision £m	Total £m
< 50%	9,697.5	97.3	24.3	10.9	0.1	(3.7)	9,826.4
50% to 65%	8,324.8	92.7	28.3	16.6	0.2	(4.3)	8,458.3
65% to 75%	4,228.2	62.4	19.9	15.5	0.4	(2.7)	4,323.7
75% to 85%	2,871.0	50.7	14.9	13.3	0.2	(3.0)	2,947.1
85% to 95%	1,140.5	28.5	15.1	11.7	0.9	(2.8)	1,193.9
> 95%	131.6	15.2	8.4	8.7	5.9	(5.2)	164.6
Unsecured	45.6	3.5	0.6	0.3	–	(4.4)	45.6
Total	26,439.2	350.3	111.5	77.0	7.7	(26.1)	26,959.6

As at 31 December 2013 (Audited) Indexed loan to value:	Not impaired Not past due £m	Past due up to three months £m	Impaired Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
< 50%	7,360.5	71.6	17.2	15.2	0.2	(2.2)	7,462.5
50% to 65%	7,821.3	80.6	26.3	17.8	–	(4.0)	7,942.0
65% to 75%	4,181.5	68.9	21.1	21.0	0.2	(3.5)	4,289.2
75% to 85%	2,673.3	60.2	22.2	18.9	0.3	(3.0)	2,771.9
85% to 95%	1,101.3	49.8	20.1	19.8	0.7	(4.0)	1,187.7
> 95%	338.7	31.0	16.8	21.7	9.6	(9.6)	408.2
Unsecured	51.7	4.0	0.6	0.4	–	(1.1)	55.6
Total	23,528.3	366.1	124.3	114.8	11.0	(27.4)	24,117.1

The Society held properties valued at £6.4 million (2013: £9.1 million) pending their sale against balances of £5.8 million (net of provisions) (2013: £8.2 million). Shortfalls between expected sale proceeds (less anticipated costs) and the balance outstanding are fully provided.

The table below provides further information regarding the impaired status of mortgages and loans. Balances are shown gross of impairment provisions.

As at 31 December 2014 (Audited)	Not impaired Not past due £m	Past due up to three months £m	Impaired Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Residential mortgages							
Owner-occupier	16,484.3	223.1	73.6	51.6	2.6	(9.0)	16,826.2
Buy to let	9,562.9	69.9	13.1	9.4	2.1	(9.5)	9,647.9
Non-traditional mortgages							
Residential near-prime	57.9	22.7	14.1	9.2	1.3	(1.1)	104.1
Residential self-certified	283.1	30.3	10.1	6.4	1.7	(1.3)	330.3
Commercial lending	5.5	0.8	–	–	–	(0.8)	5.5
Unsecured	45.5	3.5	0.6	0.4	–	(4.4)	45.6
Total	26,439.2	350.3	111.5	77.0	7.7	(26.1)	26,959.6

As at 31 December 2013 (Audited)	Not impaired		Impaired				
	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Residential mortgages							
Owner-occupier	14,758.4	238.1	89.2	69.5	5.9	(11.9)	15,149.2
Buy to let	8,325.9	62.8	12.3	15.9	2.9	(9.4)	8,410.4
Non-traditional mortgages							
Residential near-prime	62.0	25.7	10.8	16.7	0.8	(1.9)	114.1
Residential self-certified	322.9	34.6	11.4	12.3	1.4	(2.1)	380.5
Commercial lending	7.4	0.9	–	–	–	(1.0)	7.3
Unsecured	51.7	4.0	0.6	0.4	–	(1.1)	55.6
Total	23,528.3	366.1	124.3	114.8	11.0	(27.4)	24,117.1

Movement in impaired loans

The table below reconciles the movements in impaired loans in the year:

As at 31 December 2014 (Audited)	Traditional residential mortgages		Non-traditional mortgages				
	Owner-occupier £m	Buy to let £m	Residential near-prime £m	Residential self-certified £m	Commercial lending £m	Unsecured £m	Total £m
Impaired at 1 January 2014	164.6	31.1	28.3	25.1	–	1.0	250.1
Classified as impaired during the year	118.6	33.7	22.3	27.8	0.1	1.5	204.0
Transferred from impaired to unimpaired	(130.1)	(34.8)	(24.9)	(31.5)	(0.1)	(0.7)	(222.1)
Amounts written off	(3.8)	(1.2)	(0.2)	(0.6)	–	(0.3)	(6.1)
Charged to impaired loans	2.2	0.7	0.5	0.4	–	–	3.8
Repayments and other movements	(23.7)	(4.9)	(1.4)	(3.0)	–	(0.5)	(33.5)
Impaired at 31 December 2014	127.8	24.6	24.6	18.2	–	1.0	196.2

Loan balances are shown gross of provisions. The balances reflect impaired loans at the start and end of the year. Amounts written off reflect losses on loans sold from possession where the balances on these loans were in excess of the sale proceeds. Repayments and other movements include disposals (sale proceeds from properties in possession), and repayments (from customers reducing the outstanding balances). Amounts charged to impaired loans include interest accrued and charges.

The movement in impairment provisions on loans and advances to customers is further detailed in note 10 to the accounts.

Extent and use of forbearance (Unaudited)

Forbearance occurs when, for reasons relating to the actual or apparent financial stress of a borrower, the Society grants a concession to that borrower, but only where the Society is satisfied that the mortgage can revert back to sustainable terms within a reasonable period.

Forbearance is most commonly associated with the treatment of arrears cases, which are looked at on an individual case by case basis. Should borrowers find themselves in financial difficulty resulting in arrears, the Society will seek to help and work with them to resolve matters subject to the mortgage being put back on to a sustainable footing in the longer term.

The principal forbearance measures provided by the Society on arrears cases are as follows:

- Arrangements, where monthly payments are maintained and the arrears are repaid over a period of time.
- Concessions, where it is agreed to accept the normal monthly payment, reduced payments, or in exceptional circumstances no repayments for a short period.
- Mortgage term extensions to reduce the amount of the monthly payment may be considered as part of a longer-term solution, provided that payments will be sustainable over the life of the mortgage.

With regard to cases that are not past due, forbearance may be granted to members as a means of helping them overcome temporary financial difficulties. The vast majority of cases of this type are payment holidays granted by the Collections department. Payment holidays are a contractual feature on most of the mortgage products offered by the Society, but where a customer requests a payment holiday and it has been determined that financial difficulties are the reason for the request, the action is recorded as being a forbearance measure.

In rare cases, the Society may also capitalise arrears and schedule repayment of the balance over the remaining term of the loan when the period of financial difficulty has ended, provided that the customer has made at least six consecutive monthly payments and payments will be sustainable over the remaining life of the mortgage. Capitalisation will only be allowed once on each loan. In 2014 the Society capitalised arrears on 25 accounts (2013: 13) in total, of which 22 are currently performing and up to date (2013: 10). Comparison with industry data show that arrears capitalised by the Society measured as a percentage of the loan book by value are less than 5% of the industry average.

The Society no longer lends on an interest-only basis for owner-occupier mortgages. The option to transfer members on to temporary interest-only payments has been curtailed accordingly and is only used in very rare situations. During 2014 only four mortgages were put on to a temporary interest-only basis (2013: four) of which three are currently performing and up to date (2013: three).

	2014 No. of accounts	2014 Carrying value £m	2013 No. of accounts	2013 Carrying value £m
Forbearance: Accounts past due				
Arrangements	2,355	266.4	2,789	323.4
Concessions	109	11.9	208	22.2
Term extensions[1]	15	1.6	41	4.6
Capitalisation of arrears[1]	3	0.3	3	0.4
Temporary transfer to interest-only[1,2]	1	0.1	1	0.1
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	1,152	138.6	1,605	197.5
Term extensions[1]	52	6.7	61	7.0
Capitalisation of arrears[1]	22	3.2	10	1.1
Temporary transfer to interest-only[1,2]	3	0.4	3	0.3

1. Granted in the last 12 months.
2. The option to transfer members on to temporary interest-only payments is only used in very rare situations.

The Society holds a £6.8 million provision (2013: £9.9 million) in total for all cases in these forbearance categories.

The number of accounts in the various forbearance categories has fallen compared with the previous year end reflecting the improving economic environment and improved credit risk profile of the Society's borrowers.

Whilst accounts not past due are not considered to be individually impaired, it is recognised that collectively impairment exists. Provisions have therefore been raised against accounts subject to a forbearance measure (see note 10 to the accounts). In addition the Society has identified the following situations as indicating potential impairment amongst members whose mortgages are nonetheless not past due:

- Accounts where direct debits had been cancelled or returned but payment was subsequently made.
- Payments were being made by the Department for Work and Pensions.
- The Society has paid ground rent on behalf of members living in leasehold properties.

Members whose mortgage accounts display these potential impairment indicators have a higher than expected propensity to go into arrears, but the increased propensity is not so high as to consider these loans as being impaired.

The analysis of these potential impairment indicators assesses the performance of any mortgage that has had one of these situations arise in the previous 12 months. As at 31 December 2014 there were 2,714 members with such potential impairment indicators, to the value of £280.0 million (1.0% of the mortgage book). A collective provision of £0.2 million is being held, which reflects the low probabilities of default (since 31 December 2013, only 19 cases in these categories had gone into arrears by six or more months) and high collateral values (the average simple loan to value is 45.9% and only 35 cases are above 95% loan to value) of these mortgages.

The Society has also put in place systems to collect information on all requests by borrowers for changes to the terms and conditions of their mortgage, and is tracking the performance of these changes over time to determine if there are further incidences of potential impairment that are not immediately evident at the time of the request. Examples of the types of changes include changes to payment date or method, drawdown requests (where allowed for by the product), and requests for permission to temporarily let the (owner-occupier) borrower's property.

Outlook

The Society continues to focus its lending on low loan to value business to protect it from loss, and assesses affordability under a higher interest rate environment to protect the borrower. The principal risk to future performance of the Society's mortgage book nonetheless comes from the increasingly likely prospect of interest rate rises. The Society has undertaken analysis to understand the vulnerabilities faced by its borrowers in the event of interest rates increasing, and has plans to proactively contact those members most at risk with the aim of raising awareness amongst its borrowers and to reassure them that we will continue to support them if financial difficulties do arise. In this way the Society seeks to protect its members' interests whilst at the same time helping to mitigate the scale of adverse impacts on the financial performance of the Society.

While the Society anticipates that any rate rises will initially at least be gradual, it undertakes stress testing as part of its corporate planning process, and is prepared for much more rapid rises should they materialise.

Treasury credit risk

Management of treasury credit risk

Credit risk within the Treasury function (wholesale credit risk) arises from the portfolio of liquid and other financial assets held, and represents the risk that counterparties will fail to repay amounts when due. The Society has a low appetite for this form of risk. As such, exposures are restricted to good quality counterparties with a low risk of failure, and limits and exposures are set accordingly.

Treasury exposures and limits are focused in the main on UK institutions, with additional limits extended to a small number of highly rated banks in Europe and other developed economies such as Australia and Canada. Limits are set in line with a Board approved wholesale credit policy, which sets maximum limits taking into account internal analysis, external credit ratings, country of domicile and any other relevant factors. All credit limits require Board approval, and are subject to an initial assessment of the creditworthiness of the counterparty, with the approved limit then subject to at least an annual review. Exposures are reviewed on a daily basis to ensure that they remain within the approved limits.

Ongoing developments for treasury counterparties are closely monitored, and are reported to, and reviewed by the Treasury Credit Committee. This Committee meets weekly and is chaired by the Chief Risk Officer. The Committee is empowered to take immediate action to reduce or suspend limits where this is warranted by adverse changes in the creditworthiness of counterparties or market or local developments. The Committee reports through the Asset and Liability Committee (ALCO) to RMC and BRC.

Derivatives are only executed with organisations that have a Board approved credit limit, and the vast majority include arrangements requiring that any movement in the value of the derivative be offset by the placing of cash collateral to reduce the resulting credit exposure on a weekly basis.

As part of its liquidity management, the Society also enters into sale and repurchase (repo) transactions where highly rated assets such as gilts are sold with an agreement to repurchase at an agreed price on a later date. The cash received may be less than the market value of the asset creating a credit exposure. Any subsequent market movements in the value of the asset will alter this exposure and is therefore subject to daily collateralisation to mitigate this position. All repo counterparties are subject to review by the Treasury Credit Committee and approval by the Board.

The Society has no exposure to emerging markets, hedge funds, non-UK Residential Mortgage Backed Securities (RMBS), non-UK covered bonds or credit default swaps and well over 99% of exposures have an investment grade rating.

Treasury liquid assets profile (Audited)

The Society's treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions, debt securities, and Treasury bills drawn under the FLS.

Analysis of the Society's treasury assets by credit rating is set out below:

	Exposure value by Moody's rating				
2014 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	4,652.9[2]	–	–	–	4,652.9
Multilateral development banks (supranational bonds)	70.5	–	–	–	70.5
Financial institutions	213.7	110.8	113.7[3]	1.7	439.9
Mortgage backed securities	105.0	4.5	–	–	109.5
Total	5,042.1	115.3	113.7	1.7	5,272.8

	Exposure value by Moody's rating				
2013 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	4,537.1[2]	–	–	–	4,537.1
Multilateral development banks (supranational bonds)	95.7	–	–	–	95.7
Financial institutions	323.6	90.7	4.1	1.6	420.0
Mortgage backed securities	177.9	4.9	–	–	182.8
Total	5,134.3	95.6	4.1	1.6	5,235.6

1. Unrated institutions comprise smaller building societies.
2. Balance includes the off-balance sheet Treasury bills of £1,322.6 million (2013: £1,348.2 million) drawn under the Bank of England's FLS.
3. Credit Support Annexes (CSAs) in relation to derivative liabilities.

The following table summarises the Society's exposure to institutions split by geographic domicile:

2014 (Audited)	Liquid assets					Of which, debt securities		
	Sovereign £m	Supranational £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	4,652.9[1]	–	424.1	109.5	5,186.5	2,790.6	116.7	2,907.3
Denmark	–	–	3.4[2]	–	3.4	–	–	–
France	–	–	4.3[2]	–	4.3	–	–	–
Germany	–	–	1.4[2]	–	1.4	–	–	–
Switzerland	–	–	6.4[2]	–	6.4	–	–	–
Supranational[3]	–	70.5	–	–	70.5	70.4	0.1	70.5
Canada	–	–	0.3[2]	–	0.3	–	–	–
Total	4,652.9	70.5	439.9	109.5	5,272.8	2,861.0	116.8	2,977.8

2013 (Audited)	Liquid assets					Of which, debt securities		
	Sovereign £m	Supranational £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	4,537.1[1]	–	310.6	182.8	5,030.5	2,874.2	35.3	2,909.5
Denmark	–	–	2.4[2]	–	2.4	–	–	–
Germany	–	–	2.3[2]	–	2.3	–	–	–
Netherlands	–	–	9.0	–	9.0	9.0	–	9.0
Switzerland	–	–	0.6[2]	–	0.6	–	–	–
Supranational[3]	–	95.7	–	–	95.7	95.5	0.2	95.7
Australia	–	–	65.1	–	65.1	–	–	–
Canada	–	–	30.0	–	30.0	–	–	–
Total	4,537.1	95.7	420.0	182.8	5,235.6	2,978.7	35.5	3,014.2

1. Balance includes the off-balance sheet Treasury bills of £1,322.6 million (2013: £1,348.2 million) drawn under the Bank of England's FLS.
2. Credit Support Annexes (CSAs) in relation to derivative liabilities.
3. Supranational relates to amounts held with the European Investment Bank, which is guaranteed by a number of European sovereigns.

Credit risk mitigation

Debt securities are generally unsecured with the exception of securitisation and covered bond positions which are secured by pools of financial assets.

The Society has entered into International Swaps and Derivatives Association (ISDA) master netting agreements for all of its derivatives (other than swaps undertaken by Coventry Building Society Covered Bonds LLP), whereby outstanding transactions with the same counterparty can be settled 'net' following a default or other predetermined event. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements which typically provide for the exchange of collateral on a weekly basis to mitigate net mark to market credit exposures.

Coventry Building Society Covered Bonds LLP undertakes each swap it executes under a separate ISDA agreement. Each agreement includes a CSA which either provides for full collateralisation of the swap, or for full collateralisation when the counterparty bank credit rating falls below a certain threshold. Substantially all of the net derivative credit exposure in the following table relates to this latter arrangement. The counterparty has a credit rating of Aa3.

The Society has entered into Global Master Repurchase Agreements for all of its repurchase transactions. These are legal agreements that cover the terms of transactions between the two parties, including standard provisions that are generic to the market. One such provision covers the requirement for both parties to enter into an exchange of collateral. For the Society, this is calculated on a daily basis to mitigate against net exposure arising from changes in market value.

Counterparty credit risk – derivative financial instruments (Audited)

Counterparty credit risk includes the risk of default of a counterparty to such a derivative instrument. All counterparties are subject to credit assessments. All of the Society's derivatives are over-the-counter (OTC). The balance sheet credit exposure values of derivative instruments are given in the following table:

(Audited)	2014 Exposure value £m	2013 Exposure value £m
Gross positive fair value of contracts	208.3	191.2
Netting benefits	(125.8)	(102.8)
Net credit exposure	82.5	88.4
Collateral held	(39.5)	(46.4)
Net derivative credit exposure	43.0	42.0

As at 31 December 2014, all counterparties with whom the Society has a net derivative credit exposure had a Moody's credit rating of A2 or above. The derivative exposure can only be settled net following a default or other predetermined event, and therefore there is no right of set-off in the balance sheet.

Impairment provisions: Available-for-sale assets

Unrealised gains and losses arising from changes in fair values are recognised directly in the Available-for-sale (AFS) reserve, 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 AFS assets, including any cumulative gains or losses previously recognised in the AFS reserve, are recognised in the Income Statement.

When a decline in the fair value of an AFS financial asset has been recognised directly in equity reserves and there is objective evidence that the asset is impaired, the cumulative loss recognised in equity reserves is removed and recognised in the Income Statement. In assessing impairment, the Society considers the credit ratings of the counterparties, current market valuations (such as negative fair value adjustments) as well as the extent to which coupon payments have been made on a timely basis. As at 31 December 2014 no amounts in the treasury portfolio were either past due or impaired, and as such no provision has been made.

Outlook

Global financial markets and economies across the world continue to face substantial stresses, as has been the case since the onset of the financial crisis. Whilst economic data suggests the US and UK economies are on a path to recovery, mainland Europe (and the Eurozone in particular) has been hard hit by this continued stress, and is struggling to establish any more than a fragile recovery, with unemployment and debt levels (both private and public) remaining high, and with the threat of deflation now emerging.

Ongoing central bank actions, including a continuation of the low interest rates seen since the financial crisis took hold, and further asset purchase programmes announced by the European Central Bank have contributed to lower perceived credit risk and a continued easing of refinancing conditions for both banks and sovereigns.

The ongoing uncertainties support the Society's consistently cautious approach to credit risk in its Treasury operations.

Market risk

Management of market risk

Market risk is the risk that the amount of net income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign exchange rates. Market risk only arises in the banking book as the Society does not have a trading book, and is mainly related to interest rates as the Society has an immaterial foreign currency risk exposure. The Society does not trade or take speculative positions in derivatives.

The Society's policy is to manage its exposure to these risks within prudent limits. It does this through a combination of matching assets and liabilities with offsetting interest rate or exchange rate characteristics and by the use of derivative financial instruments such as interest rate swaps, interest rate options, cross currency interest rate swaps, equity release swaps and foreign exchange contracts.

Control of market risk exposure is overseen by ALCO, which reports to RMC and BRC. The accounting policy for derivatives and hedge accounting is described in the accounting policies in note 1 to the accounts.

Interest rate risk (Audited)

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 and deposits respectively.

For example, where the Society has issued fixed rate mortgages, the risk is that a general increase in interest rates would leave the Society facing higher interest expense on its funding, but without a compensating increase in interest income. Where the opportunity exists, the Society will offset assets and liabilities with similar interest features. Alternatively the Society may take out an interest rate swap with a counterparty bank under which the Society's fixed rate income is exchanged for one based on a variable rate which would be expected to follow the general pattern of interest rate movements and thereby reduce the Society's exposure.

This risk increases with the term of the asset and is particularly relevant for equity release mortgages (£314.5 million) held by the Society; however approximately £150 million of this balance was hedged with balance tracking swaps, while the remainder is matched against reserves. Similarly, in cases of issuing fixed rate savings products, the Society may take out an interest rate swap under which it receives a fixed rate of interest and pays a variable rate.

The Society also continues to ensure that it has a significant proportion of discretionary variable rate savings and mortgages on its balance sheet, which has given it flexibility to manage a prolonged low interest rate environment, or the impacts from a Bank of England Base Rate rise or fall.

The Society has a series of Board approved limits that ensure the impact of a change in general interest rates has limited effects on both the net interest income generated and present value (PV) of its balance sheet re-pricing gaps. In addition, the Society forecasts monthly the impact of movements in the Bank of England Base Rate on the Society's net interest income to ensure any potential adverse impact can be anticipated. This information is reported to ALCO monthly and by exception to BRC.

The following tables show the impact of a 200 basis points parallel shock to interest rates on the value of the assets and liabilities (PV200) and net interest income (200 basis points) throughout the reporting period:

Shock applied	+200bps 31 Dec 2014 £m	+200bps 31 Dec 2013 £m
PV200 results	(13.7)	(5.4)

	+200bps 2014 £m	-200bps 2014 £m	+200bps 2013 £m	-200bps 2013 £m
Impact on profit and loss	30.9	(8.3)	26.0	(7.6)

The PV200 measures the impact of a rate change on the value of the assets and liabilities and incorporates Board approved duration for the investment of reserves. The impact on profit and loss reflects the changes in interest income on the assets and liabilities and the expected consequential effects that would occur (such as changes in customer behaviour) over the accounting period following a rate shock. In a low interest rate environment, interest rates are floored at zero. The reported sensitivity will vary over time due to strategic changes to the balance sheet mix and general market conditions and should not be considered predictive of future sensitivity.

Basis risk

Variable rate instruments may also cause interest rate risk where the underlying basis of the rate differs from the prevailing variable rate of the balance sheet. The risk is driven from market influences on the different basis which may not operate in an equal manner, creating uneven changes in the rates (e.g. Bank of England Base Rate, LIBOR and SONIA). This risk is characterised as basis risk and is measured by applying to the financial forecast an uneven change to different variable rates i.e. a basis spread shock. This includes behavioural assumptions and current business plans but excludes the impact of any consequential response.

The Board has defined limits for the level of reduction in net interest income each quarter that arises from the basis shock applied. These limits are reviewed by ALCO monthly and by BRC by exception.

Swap spread risk

In order to diversify its liquidity holdings the Society holds a part of its liquidity portfolio in gilts, which have associated derivatives (swaps), in order to hedge the interest rate risk. The hedging undertaken to mitigate interest rate movements (which follow the swap curve) will provide some protection against offsetting movements in the value of the gilts (which follow the government securities curve). However, the credit element of gilt value movements arising from perceptions of sovereign quality remains unprotected and it is this which creates 'swap spread risk'. This risk only crystallises if the gilts are sold. Generally they are held to term as part of the Society's liquidity resources; however, under CRD IV the net difference is deducted from capital as part of the Available-for-sale reserve. Swap spread risk is monitored through a Board limit and is reviewed monthly by ALCO and reported by exception to BRC.

Product option risk

Prepayment risk is a category of product option risk, sometimes referred to as a behavioural risk, which arises from product features available to the Society's members.

Members have the option, albeit sometimes with penalties, to reduce their mortgage loan (full or partial prepayment) or withdraw their savings at their discretion, representing prepayment or repayment risk to the Society.

These risks are managed through a combination of the following:

- Redemption charges on mortgage products and repayment charges on savings products to reflect the risk.
- Offering products whose behaviour may be more predictable under the anticipated future interest rate outcomes.
- Monitoring past trends and stress testing future forecasts.
- Matching hedging to the expected attrition profile of the product.
- Balance tracking hedges for equity release mortgages.

Product option risk also includes pipeline risk, the risk that between the point of application for a product and completion, customers choose not to take the product. If this potentially occurs during a period in which interest rate expectations may have moved, this could leave the Society with an imbalance of funding or hedging that is no longer at prevailing interest rates.

The risk is managed by restricting allocations to individual products and undertaking hedging activity whilst applications are received. The risk is further mitigated by keeping the pipeline small compared with the overall balance sheet and through close monitoring during early product stages.

Concentration risk

One particular type of concentration risk is the risk arising when the quantity of retail or wholesale assets or liabilities re-pricing within a specified period reaches a size that means the Society is exposed to the risk of loss if interest rates reset at abnormally high or low rates. The risk is managed through ALCO limits on the size and time period for exposures resetting at money market rates, as well as separate limits on the concentration of maturing fixed rate mortgages and savings.

Foreign currency risk (Audited)

Foreign currency risk arises as a result of the Society's activities in raising funds and making investments in foreign currencies. This is primarily undertaken to ensure wholesale funds are obtained cost-effectively across a wide pool of potential providers, but exposes the Society to the risk of an appreciation in the value of foreign currency denominated liabilities or a deterioration in the value of the foreign currency denominated assets if exchange rates change.

The Society has a very low risk appetite for foreign currency risk and manages this through the use of currency swaps and foreign currency forward contracts. The Society also offsets foreign currency liabilities with foreign currency assets where appropriate.

After taking into account the effects of cross currency swaps, the Society has no material net exposure to foreign exchange risk fluctuations or changes in foreign currency interest rates.

Redenomination risk

Redenomination risk is the risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent). The Society has minimal redenomination risk, as all euro denominated asset exposures are held with UK institutions.

Outlook

Despite localised movements in swap and LIBOR rates, and the view during much of 2014 that rates were likely to rise in 2015, the Board anticipates flat or low Bank of England Base Rates will dominate the market outlook over the next year. While the Board is comfortable that it has the necessary tools to manage through a protracted low rate environment, its balance sheet is positioned to take advantage of a rising rate environment should the economy support such a rise.

Liquidity and funding risk

Strategy

The Society has a strong and diversified funding base and continues to be predominantly funded by retail savings, reflecting its long-term strategy and traditional building society model.

Retail funding consists of a mix of variable rate products, fixed rate bonds and ISAs. The Society has a strong record of attracting and retaining savings balances and continues to organically grow its savings book.

Wholesale funding is used to provide diversification by source and term, and value to members through lowering the overall cost of funding. The Society continues to retain proven access to wholesale funding markets, but is not reliant on wholesale funding. Bank of England programmes such as the FLS facility have been accessed to ensure that our borrowing members are not disadvantaged and to manage liquidity and funding risk. There has been a net £25 million FLS repayment in the year and the amount drawn at the year end was £1,325 million (2013: £1,350 million).

The Society's policy is to hold sufficient quality and quantity of liquidity to withstand the most severe, but plausible, combined market-wide and Society-specific stress that would last for a three month period. In addition the Society is obliged to meet regulatory requirements set by the Prudential Regulation Authority (PRA).

Liquidity resources

Liquidity risk for all subsidiaries is managed centrally by the Society and covers liquidity requirements throughout the Group. Liquidity risk is managed principally by holding funds in cash accounts and other easily realisable liquid assets. Bank of England approved mortgage portfolios, self-issued covered bonds and self-issued RMBS notes are also retained to enable access to the Bank of England's liquidity facilities. These assets are termed 'contingent liquidity'.

Liquidity risk is managed through four different categories of resources reflecting different features and the time taken to convert the resource into cash. Separate limits are applied to each category. All liquidity is held for the principal purpose of meeting expected and unexpected cash flow requirements subject to the Society's defined tolerance. The amount of liquidity held in each category is principally managed with regard to the requirements derived from internal risk based measures and regulatory requirements. In addition, treasury credit risk, encumbrance associated with the liquidity and the cost of holding such liquidity are also considered. The amount of the requirement is regularly updated and varies in line with business activity, in particular with the timing of retail and wholesale bond maturities.

The Society's liquidity resources at 31 December 2014 are set out in the table below, split by the four key categories. This table is not a representation of the accounting balance sheet as it includes Treasury bills drawn under the FLS which are not recognised on the balance sheet and 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.

		Notes to the Accounts[1]	2014 £m	2013 £m	2014 Average[2] £m
(i)	Cash and balances with the Bank of England	12	1,871.2	1,848.4	1,683.0
(ii)	UK Government securities and multilateral development banks				
	Securities – on-balance sheet[3]	14	744.2	1,165.1	1,190.2
	Securities – FLS Treasury bills[3]	14	616.3	642.8	392.4
Total Liquid Assets Buffer (LAB)			3,231.7	3,656.3	3,265.6
(iii)	Other securities (on-balance sheet[3])	14	151.3	236.5	185.7
(iv)	Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS[4]	15	4,323.3	4,959.2	4,898.2
Total			7,706.3	8,852.0	8,349.5

1. Refer to notes to the accounts for reconciliation to on-balance sheet liquid assets.
2. Average of monthly values in the year.
3. Market value.
4. Nominal value of Notes and mortgage portfolio. Total amount of asset collateral is £4,426.9 million (see page 42).

(i) The first category consists of cash held at the Bank of England and in accounts with UK clearing banks. All of this is held in sterling, with the exception of £1.6 million which is held in euros.

(ii) The second category consists of securities that are accepted by the PRA in the definition of the 'Liquid Assets Buffer' (LAB). The total LAB assets are the sum of the first and second categories and represent the most liquid assets held by the Society. Securities comprise highly rated debt issued by either the UK Government or certain PRA approved multilateral development banks. This second category of liquidity is held entirely in sterling.

(iii) The third category consists of other liquid assets where the Society can be reasonably certain that they could be realised in a liquidity stress. This includes highly rated covered bonds and mortgage backed securities. Prudent assumptions are made regarding the cash that could be generated from such assets in a liquidity stress and the time that this would take, having particular regard to the eligibility of the assets in Bank of England liquidity facilities. All covered bonds and mortgage backed securities are issued by UK entities and were rated Aaa on issue. Most of the liquidity is held in sterling with £12.3 million held in euros to part match a euro denominated wholesale debt issuance.

(iv) The fourth category consists of approved portfolios of mortgage collateral that could be used to access Bank of England liquidity facilities and self-issued covered bonds and RMBS that could be used in Bank of England facilities or sold to and repurchased from third parties under repo agreements.

The amount of liquidity resources held is also subject to regulatory requirements set by the PRA. At 31 December 2014, and throughout the year, the Society complied in full with the liquidity requirements that were in force.

CRD IV contains new requirements on liquidity and stable funding based on the principles issued by the Basel Committee on Banking Supervision. These include two new measures:

- Liquidity Coverage Ratio (LCR) – a new 30 day short-term liquidity measure. The LCR will become a requirement from October 2015 and the PRA has set a minimum requirement of 80% from October 2015 rising thereafter to 100% from 1 January 2018. The regime for the LCR is still subject to ongoing development so there remains uncertainty as to its final form. The Society monitors compliance against this measure and, based on its current understanding at 31 December 2014, the Society's LCR was in excess of 100%.
- Net Stable Funding Ratio (NSFR) – a measure of stable funding. This is currently expected to be implemented from 2018. The Society continues to monitor its position relative to the anticipated requirement of the NSFR. Based on its current interpretation, the Society holds sufficient stable funding to meet the new requirement.

Wholesale funding

An analysis of the Society's wholesale funding is set out in the table below:

	Notes to the accounts	2014 £m	2014 %	2013 £m	2013 %
Deposits from banks, including repo agreements	21	1,479.0	26.4	1,032.6	19.0
Other deposits and amounts owed to other customers		459.8	8.2	341.1	6.3
Debt securities in issue	22				
Certificates of deposit		3.0	0.1	13.8	0.3
Medium term notes		1,687.6	30.1	1,762.8	32.4
Covered bonds		1,660.6	29.6	1,817.3	33.4
Residential Mortgage Backed Securities		314.3	5.6	470.9	8.6
Total		5,604.3	100.0	5,438.5	100.0

In November 2014 the Society raised €500 million of seven year funding issued from the covered bonds programme, replacing the maturity of €650 million covered bonds which matured in October 2014, and repaid £25.0 million from the Bank of England's FLS (net of drawdowns).

The currency analysis of wholesale funding outstanding at the end of 2014 was:

	GBP £m	EUR £m	Total £m
Deposits from banks, including repo agreements	1,479.0	–	1,479.0
Other deposits and amounts owed to other customers	459.8	–	459.8
Debt securities in issue			
Certificates of deposit	3.0	–	3.0
Medium term notes	777.1	910.5	1,687.6
Covered bonds	1,274.3	386.3	1,660.6
Residential Mortgage Backed Securities	314.3	–	314.3
Total as at 31 December 2014	4,307.5	1,296.8	5,604.3
Total as at 31 December 2013	3,908.2	1,530.3	5,438.5

All of the euro denominated wholesale funding has been swapped back into sterling, except for £13.7 million which has been matched with euro denominated liquidity.

As at 31 December 2014, the only significant maturity of wholesale funding in the following 12 months was a £500 million covered bond which matured on 10 February 2015.

An expected maturity analysis for wholesale funding is shown below. This is based upon the earlier of first call date or contractual maturity.

	2014 £m	2014 %	2013 £m	2013 %
Less than one year	1,803.2	32.2	1,269.6	23.3
One to two years	13.7	0.2	523.4	9.6
Two to five years	2,183.8	39.0	2,359.5	43.4
More than five years	1,603.6	28.6	1,286.0	23.7
Total	5,604.3	100.0	5,438.5	100.0

Maturity profile of financial assets and liabilities

The table below analyses the carrying value of financial assets and financial liabilities into relevant maturity groupings based on the remaining period to the contractual maturity date. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required. Likewise, in practice, customer assets may be repaid ahead of their contractual maturity. As such, the Society uses past performance of each asset and liability class along with management judgement to forecast likely cash flow requirements.

At 31 December 2014 (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]	2,114.5	–	–	–	–	2,114.5
Loans and advances to credit institutions	180.5	–	–	–	–	180.5
Debt securities	–	127.2	20.1	405.3	1,102.6	1,655.2
Loans and advances to customers	42.0	545.9	1,532.9	7,196.7	17,642.1	26,959.6
Derivative financial instruments	–	–	2.6	151.3	54.4	208.3
Other financial assets	–	0.3	1.4	61.4	35.0	98.1
Total financial assets	2,337.0	673.4	1,557.0	7,814.7	18,834.1	31,216.2
Liabilities						
Shares	19,693.9	–	1,410.7	2,291.0	–	23,395.6
Sale and repurchase agreements[2]	–	710.5	–	698.2	–	1,408.7
Deposits from banks – other	3.0	67.3	–	–	–	70.3
Other deposits	–	5.5	2.0	–	–	7.5
Amounts owed to other customers	17.4	390.3	44.6	–	–	452.3
Secured debt securities in issue – RMBS and covered bonds	–	502.2	24.7	748.5	699.5	1,974.9
Senior unsecured debt funding	–	6.0	29.7	750.8	904.1	1,690.6
Derivative financial instruments	–	0.5	1.7	99.0	222.1	323.3
Other financial liabilities	–	–	1.7	111.6	48.7	162.0
Subordinated liabilities	–	0.8	0.6	22.0	34.8	58.2
Subscribed capital	–	1.6	0.1	119.9	40.0	161.6
Total financial liabilities	19,714.3	1,684.7	1,515.8	4,841.0	1,949.2	29,705.0
Net liquidity gap	(17,377.3)	(1,011.3)	41.2	2,973.7	16,884.9	1,511.2

1. Includes £41.2 million mandatory reserve with the Bank of England.
2. Included in Deposits from bank on the Statement of Financial Position.

At 31 December 2013 (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]	2,042.1	–	–	–	–	2,042.1
Loans and advances to credit institutions	84.2	70.0	25.1	–	–	179.3
Debt securities	–	62.1	42.5	352.6	1,208.8	1,666.0
Loans and advances to customers	30.6	499.0	1,410.1	6,609.8	15,567.6	24,117.1
Derivative financial instruments	–	–	1.6	137.4	52.2	191.2
Other financial assets	–	0.6	5.6	(23.2)	8.6	(8.4)
Total financial assets	2,156.9	631.7	1,484.9	7,076.6	16,837.2	28,187.3
Liabilities						
Shares	17,940.1	–	1,470.7	1,900.9	–	21,311.7
Sale and repurchase agreements[2]	–	249.5	1.4	697.8	–	948.7
Deposits from banks – other	16.6	67.3	–	–	–	83.9
Other deposits	–	4.0	–	–	–	4.0
Amounts owed to other customers	17.9	308.8	6.4	4.0	–	337.1
Secured debt securities in issue – RMBS and covered bonds	–	2.5	568.3	1,247.5	469.9	2,288.2
Senior unsecured debt funding	–	13.9	12.9	463.8	1,286.0	1,776.6
Derivative financial instruments	–	0.6	35.1	29.4	148.5	213.6
Other financial liabilities	–	–	1.2	44.3	44.0	89.5
Subordinated liabilities	–	0.8	0.6	22.0	34.8	58.2
Subscribed capital	–	1.6	0.1	120.0	39.8	161.5
Total financial liabilities	17,974.6	649.0	2,096.7	4,529.7	2,023.0	27,273.0
Net liquidity gap	(15,817.7)	(17.3)	(611.8)	2,546.9	14,814.2	914.3

1. Include £40.5 million mandatory reserve with the Bank of England.
2. Included in Deposits from bank on the Statement of Financial Position.

The following is an analysis of gross contractual cash flows payable under financial liabilities:

At 31 December 2014 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	19,677.5	1,466.6	2,354.9	–	23,499.0
Deposits, amounts owed to other customers and debt securities	1,745.7	250.8	2,815.2	1,615.1	6,426.8
Other liabilities and adjustments	110.1	100.6	259.3	107.1	577.1
Subordinated liabilities	0.9	3.3	42.5	35.3	82.0
Subscribed capital	2.4	9.7	143.1	40.0	195.2
Total liabilities	21,536.6	1,831.0	5,615.0	1,797.5	30,780.1
Undrawn loan facilities	86.7	–	–	–	86.7
Leasing commitments	0.8	2.0	7.7	5.7	16.2

At 31 December 2013 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	17,925.4	1,516.5	1,965.5	–	21,407.4
Deposits, amounts owed to other customers and debt securities	719.9	763.5	3,133.2	1,614.4	6,231.0
Other liabilities and adjustments	76.6	106.3	180.7	49.7	413.3
Subordinated liabilities	0.9	3.3	44.9	37.1	86.2
Subscribed capital	2.4	9.7	150.4	40.0	202.5
Total liabilities	18,725.2	2,399.3	5,474.7	1,741.2	28,340.4
Undrawn loan facilities	97.7	–	–	–	97.7
Leasing commitments	0.8	2.3	9.0	7.3	19.4

These results do not directly align to those presented for the balance sheet as they include interest relating to future periods. In addition, the tables above exclude cash flows beyond five years (other than the repayment of principal) that relate to subscribed capital.

Asset encumbrance

Society assets can be used to support collateral requirements for secured funding, central bank operations or third party repo transactions. Encumbrance benefits the Society as it provides cheaper and more stable funding. However, depositor members and other senior unsecured creditors are unable to benefit from the liquidation of encumbered assets in the event of insolvency, and risk bearing losses from a forced sale. Encumbrance is therefore reported and the associated risks are managed. An analysis of how the Society has used its balance sheet in this regard at 31 December 2014 is set out in the table below:

	Encumbered		Unencumbered		
	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total 2014 £m
Cash and balances with the Bank of England	–	243.3	1,871.2	–	2,114.5
Loans and advances to credit institutions	180.5	–	–	–	180.5
Debt securities	712.7	47.0	895.5	–	1,655.2
Loans and advances to customers	5,141.5	–	4,426.9	17,391.2	26,959.6
Derivative financial instruments	–	–	–	208.3	208.3
Hedge accounting adjustments	–	–	–	98.1	98.1
Non-financial assets	–	–	–	62.1	62.1
Total	6,034.7	290.3	7,193.6	17,759.7	31,278.3
FLS Treasury bills	706.3	–	616.3	–	1,322.6
Total as at 31 December 2014	6,741.0	290.3	7,809.9	17,759.7	32,600.9
Total as at 31 December 2013	6,357.4	268.3	8,971.3	14,004.5	29,601.5

1. Assets that have been utilised 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 utilised 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 those that although technically encumbered are held in respect of retained self-issued notes in the Society's covered bond and securitisation programmes and Bank of England approved mortgage portfolios. The total of unencumbered available collateral is therefore referable to the total of on-balance sheet liquid resources in the table on page 38, the difference being £103.6 million of additional collateral.
4. Unencumbered other assets are therefore conservatively defined as not readily available for use as collateral. The loans and advances in this category include £7.9 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 perceived strength of the Society is a key mitigant to funding risk. Short and long-term credit ratings as at 27 February 2015 are set out below:

	Long-term	Short-term	Subordinated	Date of last credit opinion
Moody's	A3	P-2	Baa1	January 2015
Fitch	A	F1	N/A	January 2015
The outlook for Moody's and Fitch is stable				

Management of liquidity and funding risk

The function of the Society's business is 'maturity transformation', whereby the Society borrows for relatively short terms and lends on mortgages for much longer periods. This mismatch generates liquidity risk, the risk that the Society has insufficient funds to meet its obligations as and when they fall due. This could manifest itself in an inability to raise new wholesale funding and replace existing funding as it matures, due to a severe liquidity crisis in the money markets, or in a loss of member confidence that causes a 'run' on retail funds. The Society maintains at all times liquidity resources which are adequate, both as to amount and quality, to ensure that the Society's liquidity risk is managed to an acceptable residual level.

Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Funding risk is managed by ensuring that reliance on any single funding provider is minimised. This is principally achieved by limiting wholesale funding to a level lower than that imposed by the Building Societies Act and that agreed with the PRA. Diversifying the source of retail deposits is achieved by having a broad customer base spread throughout the UK. The Society is predominantly funded through retail deposits reflecting its long-term strategy. Wholesale funding is used to provide diversification and lower the overall cost of funding. Funding is managed centrally enabling it to be used to fund assets throughout the Society.

Determining the appropriate mix and amount of liquidity to hold is a key decision for the Board, which recognises the Society must remain a safe and attractive home for members' retail deposits. However, the more assets that are held in liquid form, the less that are available for the Society to lend to borrowing members. This conflicts with one of the core objectives of the Society which is to provide finance to help people purchase residential properties. The more liquidity that is held, the lower the profitability of the Society and the less capital it generates. If capital is reduced then the capacity for new mortgage lending is restricted. Therefore, it is in the best interests of the Society's members as a whole for the Society to hold sufficient but not excessive levels of liquidity.

The Society's appetite for liquidity risk is set out in the Liquidity Risk Tolerance Statement which has been approved by the Board following a recommendation from BRC. The tolerance statement is kept under regular review and revised in line with changes to the risk environment and regulatory context. The tolerance statement was last reviewed by the Board in December 2014 and is set with reference to the ability to meet all cash requirements throughout a prolonged combination stress as detailed later in this section. The tolerance statement is also set against the regulatory requirements, driven by the Individual Liquidity Guidance (ILG) and the Liquidity Coverage Ratio (LCR) ahead of its implementation in October 2015.

Liquidity adequacy

The Board determines the level of liquid resources required to support the Society's business objectives through undertaking an annual Individual Liquidity Adequacy Assessment (ILAA) as part of the development of the Strategic Plan. In this process the Society reviews its liquidity risk management framework, together with the financial projections developed for the Strategic Plan, in order to assess the significant risks to which it is exposed and the adequacy of its liquid resources.

The ILAA considers a range of time horizons, in particular intra-day, one day, two weeks, three months and five years. The ILAA is compliant with Chapter 12 of the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU) introduced by the FSA in 2010. The main 'combination stress' assessed in the ILAA estimates the impact from a two week Society-specific stress combined with a three month market-wide stress.

The ILAA also assesses the adequacy of the liquidity policies that are included in the Treasury and Prudential Policy Statement. These policies set out various minimum criteria for the amount and quality of liquidity that must be held at all times and the programme for testing the periodic realisation of the various liquidity types. In addition, the Policy Statement incorporates various triggers and target operating levels that guide appropriate management actions.

Liquidity is held for each of the principal drivers of liquidity risk with the main risk to the Society being large unexpected withdrawal of retail deposits.

With regard to the combination stress, which considers a Society-specific stress for a period of two weeks at the same time as a prolonged market-wide stress for a period of three months, the following key assumptions are made:

- The Society's credit ratings are downgraded by two long-term notches.
- Long-term wholesale funding matures on its earliest call date and no additional issuance occurs.
- Severe retail outflows occur having regard to the mix of deposits, in particular those that are considered to be most sensitive to a stress event.
- Mortgage applications that have been received by the date of the stress are honoured through to completion at the normal completion rate.

The ILAA is reviewed by the PRA through their Supervisory Liquidity Review Process (SLRP), an in-depth periodic review and assessment of a firm's quantitative and qualitative liquidity risk management processes and operations. Following the SLRP, the PRA provides the ILG, which sets out the amount and composition of eligible liquidity that the PRA requires the Society to hold. This measure uses a three month time period and assesses similar liquidity requirements. The Society is required to meet a set percentage of the calculated liquidity requirement through eligible LAB assets (the first and second categories of liquidity set out on page 38). Following the initial expansion of eligible liquidity to include pre-positioned mortgage assets and self-issued covered bonds, the PRA further extended the amount of off-balance sheet collateral that could be used to meet the ILG requirement but the Society has chosen not to apply to take up this relaxation. The ILG will ultimately be replaced by the CRD IV equivalent: the Liquidity Coverage Ratio (LCR), which is based on a 30 day time period. The ILG and current liquidity regime will continue at least until the LCR is made binding by the European Banking Authority in the third quarter of 2015. The ILG and the LCR are currently assessed within the ILAA document alongside the combination stress and reported weekly to the Financial Management Committee.

The requirement to meet this guidance primarily through a tightly defined LAB has resulted in a greater proportion of liquidity being represented by UK Government securities or invested with the Bank of England via a reserve account. Whilst these assets realise a relatively low yield, this reflects the very low credit risk represented by a highly rated sovereign entity, such as the UK Government, and ensures the assets can readily be converted into cash to meet liabilities as they fall due.

Day-to-day management of the Society's liquidity position is the responsibility of the Liquidity Planning department working closely with the Treasury Front Office and overseen by the Society's Prudential Risk & Compliance department. Adequacy is assessed against a variety of limits and measures to ensure compliance with Board approved policy. The frequency of the assessment varies from daily to monthly dependent on the measure. Liquidity positions and the results of the combination stress, LCR and ILG are monitored regularly by ALCO and, through this Committee, by RMC, BRC and the Board. All limits were in surplus as at the year end and throughout the year.

As part of this Recovery and Resolution Plan, there are a number of contingent funding options designed to deal with liquidity or funding stress, which are evaluated on a regular basis through the Society's periodic realisation programme.

Outlook

The continued availability of funding through central bank schemes (such as the FLS) has led to a sustained benign funding environment for solvent UK banks and building societies. The end of these schemes has been delayed; however, other initiatives such as the introduction of the Pensioner Bonds could lead to increased competition which could threaten this outlook.

The Society has a strong track record of being able to access the retail funding markets before and since the financial crisis began and with a competitive offering is well placed to withstand any deterioration in markets. The 'A' ratings held by the Society support access to wholesale markets giving further availability to funding sources. The Society continues to monitor regulatory changes in relation to bail-in requirements and Minimum Requirements for Own Funds and Eligible Liabilities (MREL) which could have an impact on pricing within the unsecured wholesale markets. The Society's credit ratings of A/F-1 from Fitch and A3/P-2 from Moody's remain strong and stable relative to other banks and building societies, supported by the quality of the loan portfolio, diversified funding, low cost base and resilient earnings.

Conduct risk

Overview

The Board defines conduct risk as the risk that the Society's behaviours fail to deliver good customer outcomes.

Conduct risk within financial services refers to the way in which firms treat their customers, their behaviour towards each other and the way they operate in the market. In recent years, issues associated with non-compliant processes and failure to meet the legitimate expectations of customers have proven to be a significant source of redress costs for the industry. In addition to direct fines from regulatory actions and costs of remediation, the industry has accrued considerable reputational damage. Conduct risk and culture are therefore a particular focus of the Financial Conduct Authority (FCA).

The Group's mutual ethos, further reinforced through its 'Putting Members First' philosophy, means that the Society is well placed to meet its conduct risk responsibilities and ensure the fair treatment of members. 'Putting Members First' provides a clear understanding and expression of the Society's purpose which informs strategy, day-to-day decision making, the products offered and operations across the Society. The Society's focus on simple and transparent mortgage and savings products and not providing investment advice also mitigates against conduct risk and reduces the risk from third party provision of services to our customers.

Following the implementation of the Mortgage Market Review during the year there has been continued focus on the application of processes to ensure that customer needs are clearly identified, explored and understood. The Society continues to invest in training programmes, first line quality assurance and second line oversight to mitigate conduct process risks with a focus on ensuring good customer outcomes.

Management of conduct risk

Recognising its increasing importance, conduct risk ceased to be overseen by the Operational Risk Committee from early 2014 and is now overseen by a dedicated Conduct Risk Committee which provides oversight of conduct risk matters and developments.

During 2014, the Society has introduced a Conduct Risk Framework through which it has identified the potential conduct risks arising from its products, services and the documentation it provides to its members, and the control measures to manage, mitigate and monitor such risks. This has provided a robust governance structure to reinforce the Society's inherent low risk appetite in this area.

Over the first six months of 2014 the financial services industry has seen an increase in the proportion of customer complaints upheld by the Financial Ombudsman Service from 51% to 57%[1]. By contrast, the Society has maintained a very low uphold rate of 3%. Since 2009, when the Financial Ombudsman Service started to publish industry tables, it has asked for the outcome of referred Coventry Building Society customer complaints to be changed on just 50 occasions.

In contrast to the experience of many high street banks, Payment Protection Insurance (PPI) is not a material issue for the Society. Out of total PPI provisions of £27 billion for the industry as a whole, the Society has set aside only £2.2 million in total and no additional provision has been made this year. This is a consequence of the design of the PPI product and the member-focused approach in distributing the product provided by the Society.

Sales incentives schemes have frequently been cited as a major reason for customer detriment. By contrast the Society's customer facing staff do not have any targets, and the Society largely moved away from even modest individual bonus arrangements in 2008.

Outlook

Given the long-term nature of many financial products, and cultural weaknesses in many organisations for a long period, it is anticipated that redress payments and fines will continue to be a key feature of the financial services sector for many years to come. In parallel the FCA will continue to develop the regulatory regime around culture and conduct risk.

The Society will continue to 'Put Members First' placing customer outcomes at the heart of its decision making.

[1] Source: Financial Ombudsman Service

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Operational risk

Overview

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

The table below defines each of the Society's five principal operational risk categories:

Risk category	Brief definition
Legal and regulatory	Fines, censure, supervisory intervention or legal enforcement action due to failure to comply with applicable laws, regulations, codes of conduct or legal obligations.
IT systems	Failure in the development, delivery and maintenance of effective IT solutions for the Society.
Information security	Failure to ensure the security, confidentiality, availability and completeness of its data and information.
Financial crime	Criminal conduct relating to money or to financial services or markets, including offences involving fraud or dishonesty (including bribery), handling the proceeds of crime and/or the financing of terrorism. This also includes the risk that the Society fails to prevent or detect such activities.
People	An inability to recruit, develop or retain the appropriate human resources. Also includes failure to ensure the health and safety of colleagues, customers or third parties in the workplace.

The Society also manages and monitors operational risks associated with property and physical security, third party suppliers, business processes, financial reporting, and change.

Management of operational risk

Operational risks are managed as an integral part of the Society's operations. Management has a responsibility to understand how operational risk threatens the area of the business for which it is responsible, and for putting in place controls or mitigating activities, which are overseen and challenged by the Operational Risk function acting as the second line of defence. The Operational Risk Committee continues to provide oversight of all principal operational risk categories.

In addition to any direct loss attributable to risks in these categories, the reputational impact of such an event may damage the business leading to secondary impacts.

The Society stress tests such risks in order to better understand and manage the impact of their occurrence and their quantification to support regulatory capital allocation. The impact of a loss of confidence caused by reputational risk is often material to these scenarios. For these more severe scenarios the Society has developed a Recovery and Resolution Plan that details options available to the Society and any obstacles to successful resolution.

Legal and regulatory

The Society is committed to meeting its legal and regulatory responsibilities and has departments dedicated to overseeing regulatory change and monitoring compliance.

The financial services industry is undergoing transformational reforms. The general objectives of regulatory bodies are to improve consumer protection and to promote more stable and transparent financial markets.

The Society's simple business model and 'Putting Members First' principles mitigate some of these risks and the Society's Compliance functions support business line management by ensuring appropriate policies are in place and by providing challenge where necessary. The functions are organised to recognise the different objectives of the Society's regulators. The Compliance Policy & Change department focuses on retail conduct, consumer and product regulation. The Prudential Risk & Compliance department focuses on prudential and wholesale conduct regulation. Both departments review government and regulatory proposals for reform, and engage with the Society's trade associations on initiatives that impact the building society sector as a whole. The Compliance functions also support business change projects that have a regulatory dimension. In 2014, the Society successfully implemented on time the systems and process changes required to meet the new regulatory requirements arising from the Mortgage Market Review.

Regulatory reforms concerning capital are considered to be a strategic risk and discussed later in this report.

IT systems

The Society recognises the risks of not keeping pace with technology and is investing significant resources in ensuring the speed, efficiency, reliability and robustness of its IT systems and controls and their ongoing monitoring. Key to establishing a low risk environment is the maintenance of a single core system.

During 2014, the Society enhanced its governance over the development of IT systems and implemented more rigorous controls over changes to its systems and its reporting of systems availability.

Information security

The Society recognises the importance of information management and security for the protection of the Society and its members and utilises vulnerability and penetration tests of systems from a number of different specialist third parties, as part of validating the strength of its defences.

The Society is determined to ensure that its defences remain robust. In this rapidly changing world, the Society remains vigilant and will continue to evaluate and enhance its controls to ensure that appropriate protection is provided. This includes the continual measurement against industry best practices and use of tools and practices aligned to the environment in which it operates, and to its low risk appetite.

Financial crime

Financial crime risk is managed by the Society's experienced Financial Crime department. In December 2014, this specialist department became part of the Chief Operating Officer's 'first line of defence' management team, acknowledging the operational nature of many of the department's activities. Within this new reporting line, the Financial Crime department continues to operate as a separate discipline with dedicated expertise to respond to the evolving and substantial threat to the security and the safe operation of financial institutions and their customers. Given the rapidly growing developments in technology, cybercrime and social media, the Society pays close attention to the source, likelihood and impact of financial crime generally and the various ways in which this could manifest itself.

People

The Society manages its people risk by having rigorous recruitment selection processes, providing an induction programme before new employees commence work, and providing courses and other opportunities for staff to develop their skills and experience throughout their time with the Society.

The Society benchmarks its reward strategy against others in the financial services sector, and offers a range of support services under the Society's 'Wellbeing Programme and Policy'. More generally, procedures and policies are designed to minimise employee dissatisfaction with the objective of attracting and retaining high performing staff. The Society periodically undertakes a survey of staff satisfaction and engagement with the Society's values and responds positively to any issues revealed.

An area of focus during 2014 that will continue in 2015 was development of the Society's succession plans to strengthen its resilience to staff movements.

It is the policy of the Society to ensure as far as is practicable the health, safety, security and welfare of all employees and others affected by its activities and services. The Society has a Committee dedicated to ensuring sufficient appropriate attention to these matters which is chaired by the Chief Operating Officer.

Operational risk outlook

The pace of regulatory change is expected to continue for the foreseeable future and for prudential regulation includes the further embedding of the CRD IV reporting framework and the new Common Reporting Standard.

Further changes will arise from the Mortgage Credit Directive, Deposit Guarantee Schemes Directive and the Senior Managers and Certification Regimes, as well as the introduction of a new Payments System Regulator.

It is expected that the PRA will continue to focus on two areas of operational risk: systems' resilience and cyber security.

The Society recognises that the cyber threat remains a key industry concern and will continue to adopt additional controls in line with industry best practice.

Notwithstanding substantial investments by financial institutions in technological solutions to combat the more sophisticated financial crime threats, we continue to witness an increasing trend of deception crimes targeting the consumer directly. Thus the Society continues to strengthen its control environment to protect those who are most vulnerable to financial abuse, and continues to work collaboratively with industry partners to further improve controls and enhance customer education.

In addition, the Society has conducted a strategic review of its IT capabilities, including the identification of improvements to enhance members' experience when interacting with the Society.

Business risk

Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors. The Society considers strategic risk, the risk to delivering the Strategic Plan, to be the principal business risk. Strategic risk includes reputational risk.

Strategic risk

Strategic risk focuses on large, long-term risks that could become a material problem for the Society in delivering its corporate strategy. The management of strategic risk is intrinsically linked to and is supported by the provision of consolidated business performance and risk reporting data to the Board and senior risk committees whose remit encompasses all risk categories.

A number of the top and emerging risks have the potential to affect more than one risk category and crystallise strategic risk. In addition, regulatory changes have the potential to threaten the viability of the Society's low risk mutual model through the leverage ratio requirement which could encourage riskier lending in some firms and the considerable and increasing costs associated with prudential and regulatory compliance. The sheer volume and complexity of prudential and regulatory changes also represent a strategic risk.

In recent years there have been a considerable number of material operational and other risk events impacting the reputation of the financial services industry. The mutual sector has not been immune to these. Although the Society has not been subject to such events, it will continue to carefully manage its reputational risk and invest significant resources in enhancing the robustness of its systems and controls, governance, product set and ongoing monitoring. Key to establishing a low risk environment is a focus on member outcomes, simple low risk product offerings and the maintenance of a single core system.

Outlook

The Society is cognisant of increasing competition in its core savings and lending markets through the emergence of 'challenger banks' and from mainstream UK banks as they focus on service delivery and non-investment activities.

The Society expects to retain its low cost position compared with its peers and will continue to focus on efficiency and cost control. It is inevitable, however, that cost pressures within the business will continue to increase arising from the pace and complexity of regulatory change, required levels of investment in technology and organic growth.

The Society plans to expand its buy to let activity in line with the projected growth in its overall balance sheet, but is aware that any moves to regulate the market could have an adverse impact on this strategy. Alternatively the strong performance of this market could result in greater competition potentially eroding the Society's market share.

Overall the Society will continue to only take on risks that it understands and can manage. It will continue to maintain its core mutual values, offering good quality products through a simple business model and providing strong support for local and national community and charity work.

Capital

Capital management

The Society holds capital to protect its depositors, by ensuring that there will be sufficient assets to repay liabilities even in the face of unexpected losses. When assessing the adequacy of its capital, the Society considers the material inherent risks to which it is exposed and also the need for capital to be available to support the development of the business.

Post the financial crisis and CRD IV, a regulatory capital framework is emerging comprising:

- A risk weighted capital requirement.
- A stress testing process to assess capital required to provide resilience for future adverse scenarios.
- A leverage ratio set in proportion to exposures regardless of their relative risk, which guards against underestimation of risk in risk weighted models.

The risk weighted and leverage ratio requirements are discussed below and the stress testing process in the stress testing and planning section on page 21 of this Risk Management Report. Further narrative information on capital management is also included in the Society's 2014 Pillar 3 Disclosures (coventry.co.uk/2014pillar3).

Transition from Basel II to Basel III

In 2013 the Society's capital position was regulated under the Basel II framework but during 2014 was regulated under the Basel III framework.

Basel III was implemented through CRD IV which came into force on 1 January 2014. It is supervised in the UK, together with local implementing rules and guidance, by the PRA. The CRD IV framework is supplemented by a number of technical standards published by the European Banking Authority. The objective of CRD IV is to improve the banking sector's ability to absorb shocks arising from financial and/or economic stress, thus reducing the risk of spill-over from the financial sector into the wider economy.

The impact of CRD IV is complex, but in summary it reduces the Society's capital resources primarily through the inclusion of the negative Available-for-sale reserve, and restricting the eligibility of Permanent Interest Bearing Shares and subordinated debt on a phased basis under transitional rules which extend to 31 December 2021. A quantification of the impact of the transition is available in more detail in the Society's 2014 Pillar 3 Disclosures (coventry.co.uk/2014pillar3).

Additionally, CRD IV also introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirement. The FPC has proposed the minimum requirement for this measure to be 3%, applicable immediately to the largest global banks, and domestically significant banks and building societies. It is not yet clear whether the Society will be classified as domestically significant but in any event the minimum requirement will become binding no later than 2018. This measure has the most significant impact for the Society and is considered further below.

Risk weighted capital requirements

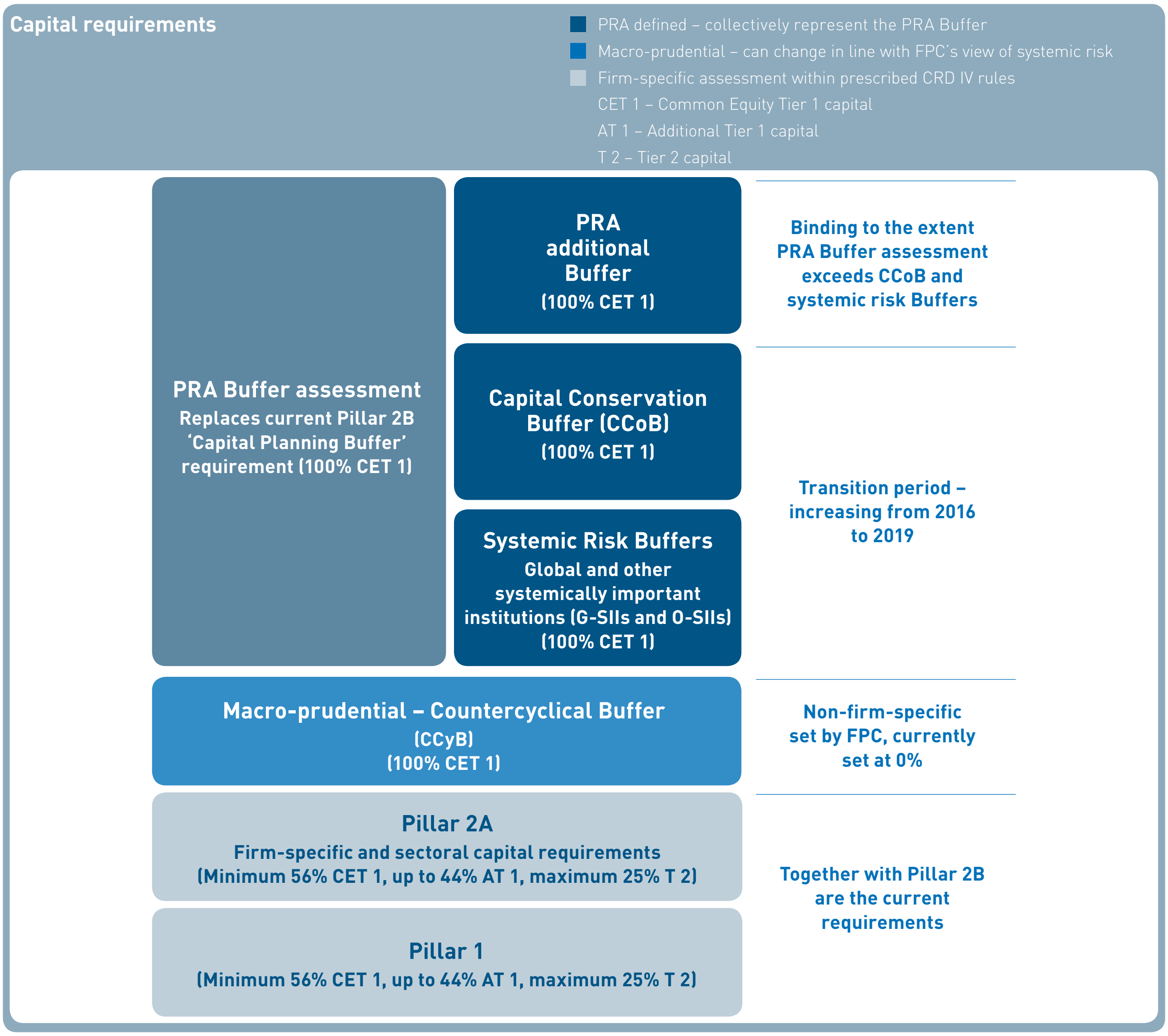
From 1 January 2008 the FSA granted the Society permission to use the Basel II Internal Ratings Based (IRB) approach to retail credit risk and capital management and this permission was extended by the PRA in July 2013 to include the mortgages transferred from the Stroud & Swindon Building Society in 2010. This permission was updated to become a Capital Requirements Regulation IRB permission from 1 January 2014. This approach allows the Society to calculate capital requirements for prime owner-occupied and buy to let mortgage exposures (excluding the £0.5 billion mortgage book acquired from Bank of Ireland in 2012) using internally developed models that reflect the credit quality of the Society's mortgage book. This permission reflects the Society's detailed understanding of its customer base and credit risk profile. For other exposures and risk areas the Society follows the standardised approach which uses capital risk weighting percentages set by the PRA.

CRD IV sets a minimum for Tier 1 capital of 6% of risk weighted assets (RWAs) of which CET 1 is required to be a minimum of 4.5% of RWAs. The total of Tier 1 and Tier 2 capital must be a minimum of 8% RWAs and this is referred to as the Pillar 1 requirement.

The Pillar 2 capital requirement encompasses firms' internal capital assessment and the supervisory review of those assessments and is intended to ensure that firms have adequate capital to support all the relevant risks in their business. The Pillar 2 requirement is divided into capital held against risks not captured or not fully captured by the regulations (Pillar 2A) and risks to which a firm may become exposed over a forward looking planning horizon (Pillar 2B). The PRA announced in December 2013 that the total Pillar 2A capital requirement should be met with a minimum level of CET 1 (56%) up to 44% AT 1 capital, and a maximum of 25% Tier 2 capital.

To promote the conservation of capital and the build-up of adequate buffers that can be drawn down in periods of stress, CRD IV implements the use of supplementary common equity capital buffers. These comprise a capital conservation buffer of 2.5% of RWAs to be built up from 2016 to 2019; a systemic risk buffer applied to institutions judged to be systemically important; and macro-prudential countercyclical buffers (CCyB) and sectoral capital requirements (SCR). The FPC published a Policy Statement in January 2014 explaining the circumstances in which the SCR and CCyB may be applied, to counter emerging threats to financial stability. The SCR can be applied by amending the Society's 'risk weights' which affect RWAs and minimum capital requirements or via capital buffers (within Pillar 2A) which apply over and above minimum capital requirements.

Capital utilised in meeting the firm-specific Pillar 1 and Pillar 2A capital requirements, which may include a firm-specific buffer, may not be used in meeting the additional CRD IV supplementary buffers. The following diagram shows the constituent elements of the CRD IV capital requirements that could impact the Society combined with the quality of capital that can be used to meet the minimum requirements.



Leverage ratio

CRD IV introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirements and was originally proposed as a 'backstop' measure. The calculation determines a ratio based on the relationship between Tier 1 capital and exposures to on and off-balance sheet items. The leverage ratio does not distinguish between unsecured and secured loans or recognise the ratio of loan to value of secured lending. The FPC has reviewed the CRD IV requirements and has indicated that the proposed minimum level of this ratio in the UK will be 3%. Following the issue of AT 1 capital in June 2014 the Society comfortably meets this minimum requirement with a ratio of 3.9% (on an end-point basis) at 31 December 2014.

The FPC set out the UK leverage ratio requirements following a review of the leverage ratio during 2014.

This framework is more complex than the regime envisaged by the Basel Committee and is intended to 'mirror' aspects of the risk weighted capital requirement. The components of the proposed leverage ratio requirement are a minimum ratio of 3%, of which 25% may be met using high quality AT 1 capital, and two additional buffers that are to be met using CET 1 capital: a supplementary leverage buffer, which will apply to the largest UK banks and building societies and be implemented from 2019 (from 2016 for firms deemed globally significant), and a countercyclical leverage buffer that will apply to all firms. The levels of these buffers will be set to 35% of the corresponding risk weighted systemic risk buffer and CCyB. The CCyB is set by the FPC and is currently zero (maximum 0.9% leverage impact). Given the size of the Society, it is anticipated it will qualify for a supplementary buffer but the level is uncertain and could have a maximum additional leverage requirement of 1.05%.

The FPC has indicated it will provide up to 24 months' notice for any increase in the CCyB and therefore the minimum requirement currently proposed for the Society is 3% but could increase to a minimum of 4.95% from 1 January 2019. The Board is confident that the Society will meet the requirements that are imposed on it with an appropriate level of headroom.

Regulatory capital analysis

There is a requirement to calculate and maintain regulatory capital ratios on both a Group, including all subsidiary entities, and Individual Consolidated (or solo) basis, which only includes those subsidiaries meeting particular criteria contained within CRD IV (for which the Society has been granted a waiver by the PRA). However, for the Society there are no significant differences between the Group and Individual Consolidated basis and the detailed capital disclosures in this report are therefore on a Group basis only.

The following table shows CRD IV information for the current year on an end-point basis (i.e. assuming all CRD IV requirements were in force in full with no transitional provisions permitted) and on a proforma basis for the prior year (restated to reflect the most current guidance). Further information on CRD IV disclosures on a transitional basis are included in the Society's 2014 Pillar 3 Disclosures (coventry.co.uk/2014pillar3).

Capital position	End-point 31 Dec 2014 £m	(Proforma) End-point 1 Jan 2014 £m
Common Equity Tier 1 (CET 1)		
General reserve	1,061.9	914.6
Available-for-sale reserve	(0.7)	(12.1)
Cash flow hedge reserve	32.8	(7.5)
Common Equity Tier 1 prior to regulatory adjustments	1,094.0	895.0
Common Equity Tier 1 regulatory adjustments		
Prudent additional valuation adjustment[1]	(1.7)	(1.7)
Intangible assets[2]	(15.9)	(12.2)
Cash flow hedge reserve[2]	(32.8)	7.5
Pension fund surplus adjustment[2]	(1.3)	(4.1)
Deferred tax assets[3]	–	(1.4)
Excess of expected loss over impairment[4]	(21.1)	(27.9)
Foreseeable distributions[5]	(10.0)	–
Common Equity Tier 1	1,011.2	855.2
Additional Tier 1 capital (AT 1)		
Additional Tier 1 – Perpetual Capital Securities	396.9	–
Total Additional Tier 1	396.9	–
Total Tier 1	1,408.1	855.2
Tier 2		
Collective provisions for impairment	6.1	2.0
Total Tier 2 capital	6.1	2.0
Total capital	1,414.2	857.2
Risk weighted assets		
IRB approach		
Credit risk – retail exposures	3,020.4	2,787.5
Standardised approach		
Credit risk – retail exposures	361.6	387.4
Credit risk – liquidity book	112.8	185.7
Credit risk – other	39.4	56.8
Credit valuation adjustment risk	46.5	82.0
Operational risk	396.5	250.8
Total risk weighted assets	3,977.2	3,750.2
Common Equity Tier 1 ratio	25.4%	22.8%

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. An adjustment is required for deferred tax assets that rely on future profitability.
4. The expected loss over accounting provisions is deducted, gross of tax.
5. Foreseeable distributions in respect of AT 1 securities are deducted, net of tax.

The following table details the leverage ratio on an end-point basis. The calculation has been performed in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation. The calculation reflects constraints on the inclusion of AT 1 capital as proposed by the FPC's review of the leverage ratio. Prior year figures have been restated to reflect the most current guidance:

Leverage ratio	End-point 31 Dec 2014 £m	End-point 1 Jan 2014 £m
Total Tier 1 capital	1,408.1	855.2
Adjustment for AT 1 restriction	(154.4)	–
Total Tier 1 capital for leverage ratio	1,253.7	855.2
Leverage ratio exposures		
Total balance sheet assets	31,278.3	28,253.3
Mortgage pipeline[1]	684.3	477.4
Other committed facilities (undrawn lending)[1]	33.8	38.9
Repurchase agreements[2]	392.2	398.3
Netted derivative adjustments[3]	(27.1)	(32.4)
Items included in the capital calculation[4]	(33.9)	(45.3)
Total leverage ratio exposures	32,327.6	29,090.2
Leverage ratio	3.9%	2.9%

1. Mortgage pipeline and other commitments are subject to a 50% risk weighting as per the delegated regulation amending CRD IV.
2. Repurchase agreements represents 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. Adjustments to asset balances that have already been included in the capital calculation are removed from the total balance sheet assets figure.

The increase in CET 1 capital is primarily driven by retained earnings of £158.5 million. Total Tier 1 capital and total regulatory capital have additionally been increased by the issue of £400.0 million (£396.9 million net of issuance costs) AT 1 capital.

The Society issued £400.0 million of AT 1 capital in the form of marketable Perpetual Capital Securities in June 2014. These capital securities bear a discretionary distribution coupon of 6.375%, and have no fixed repayment date, although the Society retains the right to repay them in November 2019, with PRA approval. The capital securities are convertible into Core Capital Deferred Shares (the equivalent of common shares for a building society, with a capped return) if the CET 1 capital ratio of the Society should fall below 7%. Due to the low risk nature of the Society's lending, the Society already has a high CET 1 ratio with significant excess capital to meet risk based requirements. The Society issued AT 1 capital to strengthen the leverage ratio to a level that exceeds current proposed minimum regulatory requirements.

The FPC review published in October 2014 proposed restricting the amount of AT 1 capital that could be included in meeting the minimum 3% leverage ratio. Whilst all of the Society's recently issued AT 1 capital meets the Basel III requirements and therefore serves to protect members' interests, only £242.5 million is currently eligible for this particular measure.

RWAs increased by £227.0 million, primarily driven by an increase in IRB risk weighted assets, reflecting continuing growth in the mortgage book, and an increase in the capital allocation for operational risk, calculated under the standardised approach. Capital allocation for operational risk is calculated using a prescribed formula which is based on the Society's net income over a three year period. Therefore in line with the growth of the Society, operational RWAs have also increased.

The movements above have resulted in the Group's CET 1 ratio increasing from 22.8% to 25.4% (on an end-point and transitional basis) and its leverage ratio from 2.9% to 3.9% (on an end-point basis). At 31 December 2014, and throughout the year, the Group complied in full with the capital requirements that were in force.

The Individual Consolidated CET 1 ratio on an end-point basis at 31 December 2014 was 0.5% higher than the Group ratio due to assets held by entities that sit outside of the Individual Consolidation.

Outlook

Whilst CRD IV and the PRA's policy statement have been published, a number of the technical standards being published by the European Banking Authority have not been finalised and the Basel Committee is still consulting on a number of topics. In addition the PRA will be consulting on the use of the supplementary leverage buffer in 2015 and a further full review of the leverage ratio is due to be undertaken in 2017.

During 2014 further details were provided on initiatives to address the 'too big to fail' issue. This is likely to have implications for creditor hierarchy in the event of insolvency and requirements will be imposed on firms to have minimum amounts of funding (loss absorbing capacity) that could be 'bailed-in' at the point of failure. This is to reduce the likelihood of taxpayer support being required. These changes are still subject to legislation within the UK and the extent to which the Society will be captured by new requirements is not yet clear.

Consequently the final capital requirements remain unclear and the Society continues to monitor regulatory changes at a UK, European and global level. Based on the Board's current understanding of the reforms, the Board is confident the Society is well positioned to maintain its overall capital strength as the regulatory framework continues to evolve. All of the above regulatory changes are reflected in the Society's capital management plans based on its understanding of the latest developments.

Corporate Responsibility Report

Staff

In October 2014, the consumer champion Which? identified Coventry Building Society as having the highest level of customer satisfaction of any UK building society surveyed.

This exceptional performance is testament to the commitment and excellence of the Society's staff and it remains a priority for the Society to maintain an environment in which our people are motivated to achieve the right outcomes for our members.

Central to this is the ability to attract, develop, engage and retain people who want to achieve the Society's objective of 'Putting Members First'. The clarity and simplicity of this objective has helped build a level of engagement with staff that exceeds many financial services organisations.

In 2014, the employee opinion survey was completed with a response rate of 90%, itself a measure that illustrates the importance the Society attaches to the views and opinions of its people, and well above the average achieved by other firms in the financial services sector.

The survey, which is undertaken by an independent research company, also delivers a comparative engagement index score which, in 2014, was 84% – it is worth noting that the average engagement score for those UK financial services organisations surveyed by the same research company is 74%. The connection between this high level of staff engagement and the importance staff attach to 'Putting Members First' is shown by the very positive responses to questions about the Society's approach to members.

Some 95% of staff participants believe that the Society treats members fairly and 96% think that the Society is committed to member satisfaction. Furthermore 90% of staff would recommend the Society's products and services.

These figures underline a fundamental point. It would not be possible to achieve high levels of customer satisfaction if staff did not believe in and, as a result, commit to the Society's actions.

However, this is not sufficient on its own. The directors recognise the importance of continuing to invest in the Society's staff, to provide opportunities for personal and professional development, to maintain an appropriate and competitive approach to rewarding and recognising staff, as well as supporting them through a broad range of initiatives that encompasses flexible benefits, health and wellbeing, a positive working environment and flexible working.

As the UK economy continues to recover, competition for talented people will heighten. The Society continues to grow and its record of success, combined with a positive approach to its people, means it is well placed to attract and retain members of staff who share the commitment to 'Putting Members First'.

The outcome is a motivated and engaged workforce that delivers a consistently high level of performance and exceptional levels of member satisfaction.

Community and environment

The Society's community programmes also support staff engagement, with approximately half of staff taking an active role in these programmes during 2014.

The Society focuses on specific areas, including supporting national and local charities, delivering financial literacy and preparation for work courses in local schools, as well as supporting staff who volunteer and raise funds for their own charitable interests.

At a national level the Society has developed a very successful partnership with The Royal British Legion, which began in 2008 with the launch of the first Poppy Bond. 70 products and six years later, the Society has donated nearly £11 million to the Poppy Appeal as a result of its members' support for our award-winning range of Poppy products.

In 2014, marking the 100th anniversary of the start of World War I, staff at the Society undertook a wide range of activities in support of The Royal British Legion, including volunteering at Gardens of Remembrance, fundraising and planting some of the ceramic poppies at the Tower of London. Nearly 30 members of staff took part in the Legion's sponsored Pedal to Paris bike ride, supported by a campaign that helped raise over £50,000.

To highlight the practical support provided by The Royal British Legion, the Society also supported the first expedition by the Legion's Battle Back Centre, which helps rehabilitate wounded soldiers. The expedition, which successfully climbed the highest active volcano in Ecuador, included instructors and soldiers, Members of Parliament and two members of staff.

In 2014, the Society also served as an official BBC Children in Need call centre for the first time. This provides another excellent example of the engagement that is achieved through community activities, with over 200 volunteers from across the Society taking and supporting calls on the night. A record amount of over £40,000 was also raised on the day by staff and members.

In addition to the support provided to national charities, the Society has prioritised support to local communities, often charities or groups that are known to members of staff. Support is provided through community partnerships established by staff, or grants offered through the Society's charitable foundation, which has received £1 million from the Society since its launch in 1998.

The Society is also working with a number of partners including the Alzheimer's Society, the Shaw Trust, local Citizens Advice Bureaux and the Coventry Law Centre to support vulnerable members of society through staff training, improving the accessibility of online services and funding specialist debt support.

A key activity within the Society's community programme is the work undertaken with local schools to improve financial literacy and support greater access to career opportunities. The latter activity is becoming increasingly important, with a range of initiatives from providing initial career guidance, practice interviews and assessment, to offering internships and full apprenticeships.

In 2014, the community investment supported by the Society, not including affinity donations, rose to nearly £550,000, with the overall community investment exceeding £2.2 million.

The Society has a proactive approach to its environmental responsibilities, recognising that the improvements in its management of energy, its use of paper and the expansion of online services present both environmental benefits and potential improvements to the customer experience.

We will continue to look for opportunities to reduce the amount of paper used in account servicing and encourage members to take the opportunities presented by transacting and receiving information from the Society online.

In addition, environmental benefits continue to be realised when opportunities are presented by developments to the Society's buildings. As an example, an upgrade of systems at the Society's data centre is expected to deliver over £20,000 in annual efficiency savings, with a reduction in CO_2 emissions calculated at over 100 tonnes.

Awards

The Society's strong performance has once again been recognised by a number of independently assessed industry awards and commendations.

These are particularly relevant when based on significant research. One such survey was conducted by consumer champion Which? and involved asking more than 20,000 members of the public about their level of satisfaction with UK financial services providers. Coventry Building Society was the highest scoring building society featured in the results table for customer satisfaction.

Further notable awards, particularly considering the difficult environment for savers, were made at the 2014 Moneywise Customer Service Awards.

The Society won the overall award as 'Most Trusted Savings Account Provider' and, perhaps not surprisingly given the Society's strong record of support for ISA savers, also won the categories for 'Most Trusted Cash ISA Provider' and 'Best Junior ISA' in these awards.

We were also very pleased to be awarded 'Employer of the Year' in the 2014 European Contact Centre & Customer Service Awards, reflecting the excellent performance of our Coventry-based call centre.

Directors' Report on Corporate Governance

'Putting Members First'

The Board places the highest priority on effective corporate governance as part of its commitment to Putting Members First in everything the Society does. The Board is accountable to the Society's members (being the majority of its customers) for the operation of the Society and the Board encourages feedback from them on all aspects of the Society's activities.

This report explains how the Board applies the principles of the UK Corporate Governance Code 2012 (the Code) and the Building Societies Association Guidance for Building Societies on the Code. The Board has considered the requirements of the Code and will continue to comply in a manner which is proportionate to the Society's size and scale.

In 2014 the Society complied with the provisions of the Code with the exception of provisions relating to dialogue with shareholders (which are not applicable due to the Society's mutual status) and the requirement for an externally facilitated review of Board effectiveness. Given the appointment of a new Chief Executive in 2014, the Board determined that it would be more appropriate to conduct the review in 2015.

This report also contains disclosures under Part Eight of the Capital Requirements Regulation (Pillar 3) relating to corporate governance.

The role of the Board

The Board of directors is responsible for the overall direction and management of all affairs and business of the Society and its subsidiaries. The Board has a general duty to ensure that the Society acts in accordance with its Rules, the binding document which sets out what activities the Society can undertake as well as all applicable laws, together with regulations and guidance issued by relevant regulatory authorities.

In particular it is responsible for:

- Setting the culture and values of the Society.
- Challenging and approving the long-term strategy of the Society and its subsidiary companies and reviewing the Strategic Plan and annual budget.
- Determining and reviewing the Society's risk appetite and the major risks faced by the Society.
- Monitoring the performance of the Society and holding the Chief Executive and the executive team to account on behalf of the members of the Society.
- Approving the Society's Remuneration Policy and the remuneration for directors and certain other members of senior management.
- Communications with stakeholders by approving the annual financial statements and communications with members through the Annual General Meeting (AGM).

The Board of directors

The Society's Rules require that the Board comprises between six and twelve directors. The Board currently comprises a Chairman, six independent non-executive directors and four executive directors. The Board has determined that its current composition is appropriate.

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose. The Chairman is responsible for leading the Board and ensuring that it acts effectively. The Chief Executive has overall responsibility for managing the Society and for implementing the strategies and policies agreed by the Board.

The role of the Deputy Chairman is to provide support to the Chairman in his role of leading and managing the Board. The role of the Senior Independent Director is to ensure the views of members and other key stakeholders are conveyed and, in conjunction with the other directors, evaluate the performance of the Chairman and lead succession planning for the Chairman.

The following persons served as directors of the Society during the year: Janet Ashdown, Peter Ayliffe, Bridget Blow, Feike Brouwers, Roger Burnell, Colin Franklin, Peter Frost, Ian Geden, John Lowe, Mark Parsons (since 1 July 2014), Ian Pickering, Glyn Smith and David Stewart. David Stewart and Colin Franklin retired as directors on 31 March 2014 and 30 September 2014 respectively.

Following the departure of David Stewart as Chief Executive in March 2014, Colin Franklin acted as Chief Executive in an interim capacity until the appointment of Mark Parsons in a permanent capacity to this role in July 2014. Odgers Berndtson were engaged to assist the Society in identifying and recruiting a candidate for Chief Executive. This company has no other connection with the Society. Colin Franklin then undertook the role of Deputy Chief Executive from July 2014 to September 2014.

On 9 February 2015 Feike Brouwers announced his decision to resign as an executive director on 31 March 2015.

In the opinion of the Board, Janet Ashdown, Peter Ayliffe, Bridget Blow, Roger Burnell, Ian Geden and Glyn Smith are independent in character and judgement based on guidance in the Code. The Board considered Ian Pickering satisfied the test of independence at the time of his appointment as Chairman on 1 January 2013.

Letters of appointment for the non-executive directors are available from the Secretary on request.

The directors and secretary

Ian Pickering, Chairman (59)

Ian Pickering joined the Board as a non-executive director in 2005 and was appointed Chairman of the Board on 1 January 2013. He also is Chairman of the Nominations and Governance Committee and is a member of the Remuneration Committee and the Non-Executive Directors' Remuneration Committee.

A graduate of Cambridge University, Ian is a qualified Chartered Accountant and has held a number of other non-executive directorships, He worked in senior positions in the engineering industry for much of the last 25 years. He was formerly a chief executive of Manganese Bronze Holdings plc.

Bridget Blow CBE, Deputy Chairman and Senior Independent Director (65)

Bridget Blow joined the Board as a non-executive director in 2007. Bridget was the Society's Deputy Chairman from 2009 until May 2012 and subsequently reappointed to this role on 1 January 2013. She is also the Senior Independent Director and the Chairman of the Remuneration Committee and is a member of the Board Audit Committee and the Nominations and Governance Committee.

Bridget is an experienced company director, with a strong information technology background, having been chief executive of ITNET plc. Bridget was a non-executive director of the Bank of England between 2000 and 2005 and chairman of Trustmarque Group until June 2013. She is a past president of the Birmingham Chamber of Commerce and Industry, the chair of the City of Birmingham Symphony Orchestra and is currently a non-executive director of Birmingham Hippodrome.

Janet Ashdown, Non-executive Director (55)

Janet Ashdown joined the Board as a non-executive director in September 2013. She is a member of the Remuneration Committee and the Board Risk Committee.

Janet worked for BP for 30 years until 2010, with experience in the UK and overseas. Her last role in BP was as head of BP's UK retail and commercial fuel marketing and supply business. She also spent over 10 years in BP's oil global trading business as a trader and trading manager. On leaving BP Janet became chief executive of Harvest Energy, a UK-based oil distribution and marketing business.

Janet is currently a non-executive director of SIG plc (a member of the FTSE 250).

Peter Ayliffe, Non-executive Director (61)

Peter Ayliffe joined the Board as a non-executive director in May 2013. He is a member of the Board Audit Committee and the Nominations and Governance Committee.

Peter was president and chief executive officer of Visa Europe from March 2006 to September 2013. Prior to joining Visa Europe, Peter spent over 30 years in retail banking and was for the last two of those years a main board director at Lloyds TSB with responsibility for the UK retail bank. He has also been a member of the board of Investors In People (UK), Visa International and Visa Europe and president of the Chartered Management Institute. Peter is currently chairman of Monitise plc and a trustee of the charity Pennies.

Roger Burnell, Non-executive Director (64)

Roger Burnell joined the Board as a non-executive director in 2008. Roger is Chairman of the Board Risk Committee and is a member of the Board Audit Committee.

Roger is a Chartered Accountant with over 25 years' senior executive experience. He worked as finance director and managing director of several businesses within the Thomson Travel Group before becoming group chief operating officer in 1998.

Since retiring from his executive roles Roger has continued to work at board level through a number of non-executive directorships, including previously as chairman of International Life Leisure Group, The First Resort and HomeForm Group as well as senior independent director of Thomas Cook Group Plc.

Ian Geden, Non-executive Director (61)

Ian Geden joined the Board as a non-executive director in 2008. Ian is a member of the Board Risk Committee, the Nominations and Governance Committee and the Remuneration Committee.

Ian has over 30 years' experience in the financial services sector, primarily in the mutual sector, including NFU Mutual where he was chief executive before retiring at the end of 2008. Ian was also vice chairman of the Association of British Insurers (ABI) and chairman of the Association of Mutual Insurers. Ian is a non-executive director of The Police Mutual Assurance Society Limited.

Glyn Smith, Non-executive Director (62)

Glyn Smith joined the Board as a non-executive director in 2010. Glyn is Chairman of the Board Audit Committee and the Models and Ratings Committee and is a member of the Board Risk Committee.

Glyn has over 30 years' experience in the financial services sector, most notably as a senior executive at Barclays Bank PLC and as finance director of Portman Building Society. He was previously a non-executive director at Stroud & Swindon Building Society.

A graduate of Cambridge University, Glyn is a Chartered Accountant, with over 10 years' experience as a non-executive director in both the public and private sectors. He is currently a non-executive director of Covent Garden Market Authority, FCO Services and the Reclaim Fund.

Mark Parsons, Chief Executive (53)

Mark Parsons joined the Board as Chief Executive in July 2014. Mark is Chairman of the Non-Executive Directors' Remuneration Committee.

Mark was previously chief financial officer for retail and business banking at Barclays Bank. Mark worked at Barclays for eight years, having joined as managing director of the home finance division of the UK retail bank. He later served as deputy chief executive of the UK retail bank.

Mark is a graduate of Sheffield University and a Chartered Global Management Accountant. He began his career as an economist at Abbey Life before joining Abbey National, where he worked for 18 years in roles including branch network director, retail finance director, personnel director, regional director and head of investor relations. He then moved to PricewaterhouseCoopers, working in its retail banking consulting practice, before joining Barclays. He has previously served as deputy chairman of the Council of Mortgage Lenders.

John Lowe, Finance Director, Executive Director (42)

John Lowe joined the Board as Finance Director in 2010. John is a member of the Non-Executive Directors' Remuneration Committee.

John joined the Society in 2007, initially to manage the Corporate Planning and Product Development functions, before assuming the role of Deputy Finance Director in 2009. A graduate of Oxford University, John is a Chartered Accountant and since qualifying with Deloitte, has over 18 years' experience of financial services gained across a broad range of businesses.

Feike Brouwers, Chief Risk Officer, Executive Director (47)

Feike Brouwers joined the Board in April 2013 as the Society's Chief Risk Officer.

A graduate of Vrije Universiteit, Amsterdam, Feike trained as a Certified Public Accountant in the Netherlands and has more than 20 years' experience of the financial services industry. Following several years with Price Waterhouse he joined ING Group in 1997 where he spent more than four years as group financial controller and head of strategy and business development at the ING Direct headquarters in Amsterdam. He then became chief financial officer of ING Direct France and subsequently chief financial officer at ING Direct UK from October 2007 until March 2013.

Peter Frost, Chief Operating Officer, Executive Director (49)

Peter Frost joined the Board in November 2012 as the Society's Chief Operating Officer and has responsibility for all aspects of the Society's operations, including IT and Change.

A graduate of Liverpool University, Peter has over 25 years' experience in financial services. Prior to joining the Society, Peter worked at Barclays where he was operations director for the UK retail bank. Before this he had a number of positions at Woolwich Building Society and Woolwich plc. Peter has also held a number of non-executive directorships including roles at Vaultex and iPSL.

Thomas Crane, Secretary (42)

Thomas Crane is a qualified solicitor. He was appointed as Secretary to the Society on 22 November 2013 following more than eight years working for other financial services institutions. He started his career at Theodore Goddard in London in 1998 and has subsequently undertaken a number of different roles in private practice and in house before joining the Society.

In his capacity as the Society's General Counsel, Thomas is the principal legal advisor to the Board. In addition to his role as a member of the senior executive team, he serves as Secretary to the Board and all its Committees.

Further information about the directors, including a full list of other directorships, can be found in the Annual Business Statement on pages 136 and 137.

How the Board fulfils its role

The Board has a formal schedule of matters that are reserved to it, and it has also delegated authority in other matters to a number of Board Committees, as described below. The Board has set terms of reference for each of the Board Committees and has a clearly documented delegated authority to the executive directors and senior management together with reporting systems for financial results, risk exposure and control assessment.

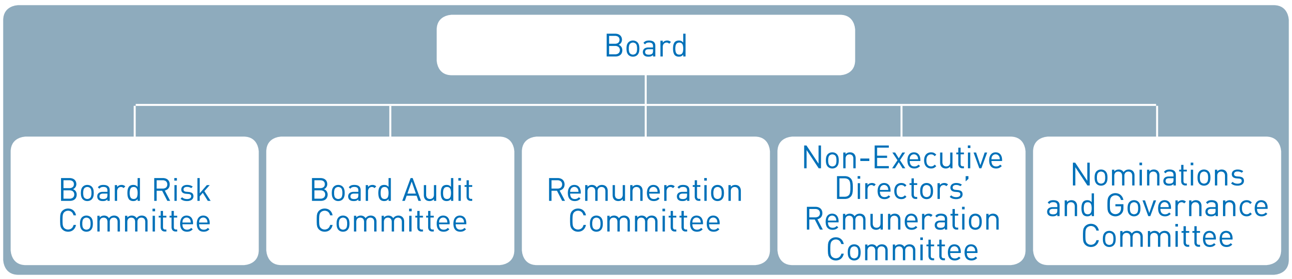
The Board applies principles of good governance by adopting the following procedures:

- The Board meets regularly and holds two strategy review days each year outside the formal meeting cycle, which gives the non-executive directors an opportunity to develop and challenge proposals on strategy.
- The non-executive directors meet, without executive directors present, at least once a year as required by the Code but in practice meet more frequently.
- The Chairman sets the tone of the Board meetings to ensure, amongst other things, that there is a culture of openness and constructive challenge from both non-executive and executive directors. This is assessed through the annual Board effectiveness review process.
- Directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this information is considered by the Board.
- The size and composition of the Board and the senior management team are kept under review to ensure that there is adequate succession planning for executive and non-executive directors and that the Board has the appropriate skills and experience for the direction of the Society's activities. See page 62 relating to the Nominations and Governance Committee for more information on this area.
- All directors have access to the advice and services of the Secretary, whose appointment is a matter for the Board. The Secretary is responsible for ensuring compliance with Board procedures and advising the Board, through the Chairman, on governance related matters.
- All directors have access to independent professional advice at the Society's expense in order to fulfil their responsibilities as directors.

The Society maintains liability insurance cover for directors and officers as permitted by the Building Societies Act 1986.

Board Committees

The Board has established a number of Committees:



Summaries of each committee's remit and activities during the year are set out on the following pages. The terms of reference of each committee are available on the Society's website (thecoventry.co.uk/corporategovernance) and from the Secretary on request. During the year the terms of reference of each Committee were reviewed and updated when appropriate to ensure effectiveness of decision making and oversight.

Board Risk Committee

The Board Risk Committee met 10 times during the year. Members of the Committee are:

Roger Burnell (Chairman of the Committee)
Janet Ashdown
Ian Geden
Glyn Smith

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

- Overseeing and advising the Board on current and potential risk exposures to the Society, including reviewing risk appetite, risk limits and tolerances across the full range of risks to which the Society may be exposed.
- Satisfying itself on the design and completeness of the Society's internal control and assurance framework relative to the risks that it faces, including culture, policy, processes, structure and systems.
- Seeking assurance that the Society has an effective risk governance structure which covers all risk areas with appropriate reporting regimes.
- Reviewing the Society's capital and liquidity adequacy assessments and reverse stress testing analysis.

Minutes of Committee meetings are submitted to the Board following each meeting. In addition, the Committee Chairman reports verbally to the Board after each meeting of the Committee.

In 2014 the Committee considered reports relating to principal risks and uncertainties faced by the Society, which are set out in the Risk Management Report (pages 16 to 54). At each meeting it considered a detailed consolidated risk report.

Other matters considered by the Committee during the year included:

- Review of the Society's enterprise-wide risk framework.
- Stress testing scenarios and adequacy assessment of capital (ICAAP) and liquidity (ILAA).
- Implementation of the Mortgage Market Review.
- Review of key policies, including the Society's lending and treasury policies.

Board Audit Committee

Details of the Board Audit Committee are contained in the Board Audit Committee Report on pages 65 to 68.

Remuneration Committee

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

Bridget Blow (Chairman of the Committee)
Janet Ashdown
Ian Geden
Ian Pickering

The Remuneration Committee has delegated authority from the Board to:

- Review and approve the Society's Remuneration Policy Statement.
- Approve the remuneration of the executive directors and, in consultation with the Chief Executive, senior management.
- Oversee the remuneration of all other Code Staff.
- Approve all performance related pay schemes together with relevant targets.
- Review the remuneration of the Chairman for recommendation to and approval by the Board.
- Review and approve the Directors' Remuneration Report on pages 69 to 82.

No director takes part in the discussion of his or her own remuneration.

The Committee met eight times during the year to consider matters within its remit. The outcomes of the Committee's work are set out in the Directors' Remuneration Report on pages 69 to 82.

Non-Executive Directors' Remuneration Committee

The members of the Committee are:

Mark Parsons (Chairman of the Committee)
John Lowe
Ian Pickering

The Committee is responsible for reviewing and recommending to the Board for approval the remuneration of the non-executive directors, other than the Chairman.

Non-executive directors do not participate in the Society's performance related bonus schemes.

The Committee met once during the year to conduct the annual remuneration review; the meeting was chaired by Colin Franklin as Interim Chief Executive.

Nominations and Governance Committee

The members of the Committee are:

Ian Pickering (Chairman of the Committee)
Bridget Blow
Peter Ayliffe
Ian Geden

The Committee is responsible for reviewing and making recommendations to the Board on matters relating to the structure, size and composition of the Board (including Board succession planning, the appointment of new directors, the reappointment of retiring directors, and the appointment of non-executive and executive directors to Committees of the Board) and certain aspects of senior management appointments. The recruitment policy relating to the Board is that when vacancies on the Board are being filled, the Committee considers the skills, knowledge, experience and diversity (including gender) of existing members of the Board in order to consider the capabilities needed on each occasion.

It also takes an active role in other matters relating to the governance of the Board, such as reviewing the effectiveness of the Board and its Committees, reviewing the matters reserved to the Board, Board training and considering conflicts of interests.

As part of its terms of reference, the Committee reviews diversity on the Board. It also recommends to the Board a target for female representation on the Board and a policy as to how to reach that target in accordance with Article 88 of the Capital Requirements Directive. The Society's Board has set a target of 25% female directors by December 2017. The current percentage is 18%. In order to reach the target the Society has a development programme that includes a Leadership Academy and mentoring programmes designed to develop a more diverse talent pool from within the Society ready to take on senior positions as they become available. In addition, when working with recruitment agencies to recruit staff, including non-executive directors, the Committee ensures the agencies are experienced and successful in the identification of diverse candidate shortlists which include female executives with the potential to be effective Board members.

The Nominations and Governance Committee considers that the directors currently comply with Article 91 of the Capital Requirements Directive, which became effective in July 2014, 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.

The Committee met 10 times during the year. Among its activities in 2014 were:

- Overseeing the appointment and induction of Mark Parsons as Chief Executive and the interim appointment of Colin Franklin to that role pending Mark Parsons' arrival.
- Recommending that, beginning from the 2015 AGM, all directors should retire voluntarily each year and stand for re-election, in the light of the provisions of the Code relating to the annual re-election of directors.
- Reviewing the Society's succession plan with particular reference to ensuring an appropriate supply and turnover of independent non-executive directors and to improving the percentage of female representation on the Board and in the senior management team.
- Reviewing the matters reserved to the Board and the Board annual planner to ensure that matters were being considered or delegated appropriately.
- Reviewing directors' proposed external appointments to ensure they did not represent a conflict of interest or exceed the number of directorships permitted by the Capital Requirements Directive.
- Reviewing the respective roles of the Chairman and Chief Executive.
- Overseeing actions to improve the effectiveness of the Board and its Committees, following the 2013 effectiveness review, including the Board training programme.

Appointments to the Board

Under Rule 26 of the Society's Rules, directors have to submit themselves for re-election at least once every three years. The Board has considered the provisions of the Code relating to re-election of directors, and has decided that it is in the best interests of members to submit the entire Board for annual re-election by the members. Accordingly all directors who were on the Board at the end of the 2014 AGM have voluntarily submitted themselves for re-election and the Board has unanimously decided to recommend them for re-election by the members at this year's AGM. The exception is Feike Brouwers who announced his decision to resign as an executive director on 31 March 2015.

In accordance with Rule 25 of the Society's Rules, all directors are subject to election by members at the AGM following their appointment or, in certain limited circumstances, at the next following AGM. In addition, all directors must receive approval from the regulators as an approved person in order to fulfil their controlled function as a director. The Board has decided unanimously to recommend Mark Parsons, who joined the Board on 1 July 2014 as Chief Executive, for election as a director by the members at the 2015 AGM.

Ongoing Board development

New directors complete a tailored induction programme that covers all key aspects of the Society's business and regulatory environment, including meetings with senior management and branch visits. Directors update their skills, knowledge and familiarity with the Society through presentations by senior managers and by attending internal and external courses. The Board's ongoing training and development needs are reviewed by the Nominations and Governance Committee.

Board and Board Committee attendance 2014

Name	Title	Number of Board meetings 13	Number of Board Audit Committee meetings 5	Number of Board Risk Committee meetings 10	Number of Remuneration Committee meetings 8	Number of NED Remuneration Committee meetings 1	Number of Nominations and Governance Committee meetings 10
Ian Pickering	Chairman	13			8	1	10
Bridget Blow	Deputy Chairman	13	5		8		10
Janet Ashdown[1]	Non-executive Director	13		8	8		
Peter Ayliffe	Non-executive Director	13	5				10
Feike Brouwers	Chief Risk Officer	13					
Roger Burnell	Non-executive Director	13	5	10			
Colin Franklin[2]	Sales and Marketing Director (until March 2014) Interim Chief Executive (April to June 2014) Deputy Chief Executive (July to September 2014)	10				1	
Peter Frost	Chief Operating Officer	13					
Ian Geden	Non-executive Director	12		10	8		9
John Lowe	Finance Director	13				1	
Mark Parsons[3]	Chief Executive (from July 2014)	5				–	
Glyn Smith	Non-executive Director	13	5	10			
David Stewart[4]	Chief Executive (until March 2014)	3				–	

1. Appointed to the Board Risk Committee in February 2014. Maximum number of meetings is 9.
2. Retired from the Board in September 2014. Maximum number of Board meetings is 10. Chaired the March NED Remuneration Committee meeting in view of the imminent departure of the outgoing Chief Executive.
3. Appointed to the Board and the NED Remuneration Committee in July 2014. Maximum number of meetings are 5 and 0 respectively.
4. Retired from the Board and the NED Remuneration Committee in March 2014. Maximum number of meetings are 3 and 0 respectively.

Review of Board effectiveness

The performance of the directors is appraised by the Chairman. The Chairman's performance review is led by the Senior Independent Director taking into account the views of the rest of the Board.

Each Board Committee reviews its own effectiveness by means of a self-assessment questionnaire and the Committee Chairman reports the outcome of the review to the Board.

The Board also periodically reviews its own performance and that of its Committees. The Board carried out a review of its own and its Committees' effectiveness and concluded that all operated effectively.

In addition, all directors have open and direct access to the Chairman and to the Senior Independent Director in order to raise any issues of concern.

Relations with members

The members' views are communicated through the Members' Council that meets quarterly and through regular online, branch and telephone surveys.

Non-executive directors also engage with the Society's members through attending the AGM. The Chairmen of the Audit, Remuneration and Nominations and Governance Committees are all available to answer questions at the AGM.

All members who are eligible are encouraged to exercise their vote at the AGM either by attending in person or by voting by proxy, for which purpose they are sent a proxy voting form and reply-paid envelope, or they can vote in any branch or online. All proxy votes are counted. All resolutions are taken on a poll and the Chairman 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 Limited to act as independent scrutineers and ensure the votes are properly received and recorded.

Internal controls and risk management

The principal categories of risk inherent in the Society's business are described in greater detail in the Risk Management Report (see pages 16 to 54).

The Board is responsible for the system of internal control which is designed to facilitate effective and efficient operations whilst managing the risk of failure to achieve business objectives. The Board and senior management are committed to maintaining a robust control framework and for reviewing its effectiveness.

The Board reviews the effectiveness of systems of internal control and risk management through a combination of processes including:

- Regular reports to the Board, through the Board Risk Committee, from the Risk function on the principal risks facing the Society and the strength of the controls in place to mitigate such risks. The Chief Risk Officer has direct access to the Board Risk Committee Chairman.
- Regular reports to the Board, through the Board Audit Committee, from the Internal Audit function in respect of its independent audits of risk management processes and the effectiveness of internal controls across the Society (further information can be found in the Board Audit Committee Report on page 67). The Head of Internal Audit reports directly to the Board Audit Committee Chairman.
- An annual Risk Management Framework Effectiveness review by the Chief Risk Officer, verified by the Internal Audit function, to the Board Audit Committee.
- A consolidated risk report presented by the Chief Risk Officer at each Board meeting on each of the principal risks and the efficacy of the controls in place to manage the risks.

The Board is satisfied that during 2014 the Society maintained adequate risk management arrangements taking into account its profile and strategy together with an adequate system of internal control that met the requirements of the Code.

Board Audit Committee Report

Board Audit Committee

The Board Audit Committee consists of four non-executive directors. The members of the Committee are:

Glyn Smith (Chairman of the Committee)
Peter Ayliffe
Bridget Blow
Roger Burnell

Glyn Smith and Roger Burnell have recent and relevant financial experience and are both Chartered Accountants.

The Committee invites the Chief Executive, Finance Director, Chief Risk Officer, General Counsel and Secretary, Head of Internal Audit and the external auditor to attend meetings on a regular basis. Other senior managers are invited to attend meetings as required. Private meetings are held at least twice a year with the external auditor and annually with the Head of Internal Audit in the absence of management to enable issues to be raised directly if necessary. The Committee Chairman also meets regularly with the Head of Internal Audit and the external auditor.

Following each Committee meeting, the minutes of the meeting are distributed to the Board, and the Committee Chairman provides a verbal update to the Society's Board on key matters discussed by the Committee.

The responsibilities of the Committee are in line with the provisions of the Financial Reporting Council (FRC) Guidance on Audit Committees. The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities with specific regard to:

- Monitoring the integrity of the interim and annual financial statements and formal announcements relating to financial performance, focusing particularly on significant financial reporting judgements and ensuring the financial statements overall are fair, balanced and understandable.
- Reviewing the adequacy of systems of internal control and the risk management systems.
- Scrutinising the activities and performance of Internal Audit.
- Monitoring the external auditor's independence and objectivity and the effectiveness of the audit process.
- Recommending the appointment and approving the remuneration and terms of engagement of the external auditor.
- Overseeing the Society's whistleblowing arrangements.

In 2014, the Committee met five times and focused on the following matters:

Preparation of financial statements and key areas of judgement

When assessing both the interim and full year 2014 accounts, the Committee considered in detail areas subject to management judgement and received a report from the Finance Director on each area setting out the approach adopted, methodology, key assumptions and comparison with prior year. Each of the reports presented to the Committee by management was subject to scrutiny by the external auditor. There were no material or significant disagreements between management and the external auditor. Note 2 to the accounts summarises material judgements and critical accounting estimates made in applying accounting policies, and the sensitivity of reported performance to these judgements and estimates is then set out in subsequent relevant notes. The areas reviewed included:

Effective Interest Rate (EIR) methodology

The Society recognises interest income using a rate of return that reflects a constant level of interest over the expected behavioural life of the mortgage loan. This methodology recognises the impact of different interest rates charged over the life of the loan, for example an initial fixed interest rate for a period followed by the Society's Standard Variable Rate, and generally gives rise to an asset in the balance sheet in the early life of a loan that is subsequently amortised. The EIR calculation is most sensitive to future margin assumptions and the level of prepayment that may occur.

The Committee reviewed updated assumptions used for 2014, reflecting the latest experience, together with the impact on the EIR asset of higher levels of redemption than recently experienced and the expectation of future margin compression. The Committee concluded that the basis of calculation and value of the asset was appropriate. Further information can be found in note 3 to the accounts.

Impairment and forbearance

The Committee reviewed in detail the level of provision within the accounts and the range of impairment triggers considered by management. The Committee also considered the basis of calculation of individual and collective provisions, management overlays and details of the forbearance measures utilised by the Society and the approach used to calculate the likelihood and level of any future losses on such accounts. Given the relatively early stage of the economic recovery and the increase in house prices that occurred during 2014, the sensitivity of the provision calculation to various assumptions was considered, including an increase in the propensity of accounts to fall into default, and the impact of a fall in house prices. Noting the limited impact of this sensitivity analysis, the modest use of forbearance, the subsequent performance of assets subject to such measures and the general high quality of the mortgage assets, the Committee was satisfied with the adequacy of the provisions recorded within the balance sheet. The Committee also concurred with management's view that an investment in a related party amounting to £3.5 million should be fully impaired. Further information can be found in the retail credit risk section of the Risk Management Report and note 10 to the accounts.

Fair valuations for acquired assets

The Society acquired mortgage assets and retail savings through the merger with Stroud & Swindon Building Society and mortgage assets as a result of a loan book purchased from Bank of Ireland. These items were initially recognised at fair value with subsequent recognition at amortised cost using EIR methodology. Fair value techniques were used based on observable market data where available, and the Society's internal models used for similar asset classes. The key fair value adjustments recognised were in respect of anticipated credit losses and interest shortfalls, where the yield was lower than corresponding levels in the market. The Committee considered the performance of the assets and the level of fair value adjustments that had been amortised through the Income Statement. Given the consistent performance of the assets, the Committee was satisfied that amortisation in the current period was appropriate. The Committee also considered the impact of the adjustments on the Income Statement and whether year-on-year there was a significant variation that required additional disclosure. It concluded that this was not the case and the Committee was satisfied with the disclosures prepared by management. Further information can be found in note 3 to the accounts.

Hedge accounting

The Committee reviewed the Society's approach to hedge accounting. This included reviewing the different types of hedging adopted by the Society, valuation techniques, sources of accounting ineffectiveness and the key movements during the year. The Committee noted that following the introduction of cash flow hedging in 2013 there had been no significant developments during 2014. Whilst cognisant of the risks that can arise from the current accounting requirements, the Committee was satisfied that the approach adopted was appropriate and that the hedging activity undertaken was effective in mitigating the underlying risk. Further information can be found in note 1 to the accounts.

Calculation of the defined benefit pension scheme position

The Society has a defined benefit pension scheme which was closed to new entrants in December 2001 and was closed to future service accrual on 31 December 2012. The Committee reviewed the methodologies and the acceptable ranges from which assumptions had been selected in calculating the latest estimate of the scheme's assets and liabilities. This review was supported by a benchmarking report provided by the Society's advisors. Noting that the assumptions adopted by management were consistent with this report, a view confirmed by the external auditor, the Committee was satisfied with the position reported within the accounts. Further information can be found in note 19 to the accounts. In addition to the areas of management judgement set out above, the Committee also considered the following in relation to the interim and full year accounts overall.

Going concern

The Committee evaluated whether the going concern basis of accounting was appropriate by considering a report prepared by the Finance Director which covered profitability, the Society's liquidity position, the availability of funding, regulatory capital considerations and forecast capital ratios. The report also referenced the detailed stress testing undertaken as part of the annual liquidity and capital adequacy assessments. Further information can be found in the Directors' Report on page 85.

Fair, balanced and understandable

The Committee considered whether the 2014 Annual Report & Accounts were fair, balanced and understandable. The Committee did this by satisfying itself that there was a robust process of review and challenge at different levels within the Society to ensure balance and consistency which included:

- Issuing guidance to those involved in drafting or reviewing the Annual Report & Accounts.
- A thorough internal verification process of the factual content of the reports.
- Central coordination ensuring a sufficient cycle of review and adequate review time at each level within the Society.
- Comprehensive review by senior management, executives and the Committee Chairman, prior to a meeting of the Audit Committee held to review and consider the Annual Report & Accounts in advance of the Board's approval.

The Committee also considered other information regarding the Society's performance presented to the Board during the year. After consideration of relevant information, the Committee concluded that it could recommend to the Board that the 2014 Annual Report & Accounts are fair, balanced and understandable.

New accounting standards

Regular updates on financial reporting developments were presented to the Committee during the year to enable it to provide effective oversight of the reporting and disclosures within the interim and full year accounts. 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 reviews the adequacy of internal control and risk management arrangements through regular reporting from Internal Audit and the external auditor. To assist the Committee in its assessment of the Society's risk management framework, it requested Internal Audit to undertake a comprehensive review during the year. The review recognised that the Society's low risk appetite and simple business model are important factors in how risk is mitigated. However, the review also noted that the Society's risk management framework could be improved by applying a more formal and cohesive approach to managing risk. As a result management is undertaking a series of actions to enhance the current framework. Based on the work performed and the current low risk profile of the Society, the Committee concluded the overall risk management arrangements to be adequate. The Committee will monitor the progress of the improvements being implemented as part of its continual assessment of the risk management framework and system of internal control.

Further information on the Society's approach to internal control and risk management is included in the Directors' Report on Corporate Governance on page 64.

With respect to the Society's whistleblowing arrangements, the Committee considered an annual report on its operation and a thematic summary of concerns raised and concluded that the arrangements were adequate.

The activities of Internal Audit

The Committee received regular reports from the Head of Internal Audit setting out the results of assurance activity, proposed changes to the audit plan and the level of resources available. Significant findings and thematic issues identified were considered by the Committee, as well as management's response and the tracking and completion of outstanding actions. In addition to approving the annual plan and budget, throughout the year the Committee reviewed and approved amendments to the Internal Audit plan and resources.

The Committee oversaw an independent external review of the effectiveness of the Internal Audit function which considered the quality of Internal Audit's work, the appropriateness of skills and resources within the team and compliance with the Chartered Institute of Internal Auditors' guidance for Effective Internal Audit in the Financial Services Sector. Whilst a number of findings arose from the report, the report confirmed the Internal Audit function to be effective. The Committee is monitoring the implementation of actions required to address the detailed findings from the review.

The external auditor – effectiveness, tendering and feedback on activities

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

Ernst & Young LLP and its predecessor firms have been the Society's auditors since 1930 when first appointed to audit the Coventry Permanent Economic Building Society's accounts. The lead audit partner rotates at least every five years and the current lead audit partner is due for rotation in 2018. In 2013, the Society tendered its external audit relationship in line with best practice including most recent FRC guidance at that time. The UK Corporate Governance Code now requires that the audit contract be put out to tender every 10 years, with transitional provisions for compliance meaning that the contract will be re-tendered no later than 2019 for the 2020 year end audit. Based on these factors, the Committee has recommended to the Board that, subject to implementation of the European Union Directive, a tender of the external audit should commence in 2017 with respect to the 2018 audit. Ernst & Young LLP will not be invited to re-tender based on guidance under the new rules.

The Committee completed a formal assessment of the effectiveness of the external audit process which included consideration of:

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

The review was conducted as part of the 2014 year end process. The views of members of the Committee, the Finance Director and key members of the finance team were sought.

The review also considered the FRC's Audit Quality Inspections Annual Report 2013/14 (May 2014), the Audit Quality Inspections Report on Ernst & Young LLP (May 2014) and the Audit Quality Thematic Review on loan loss provisions and related IT controls (December 2014). In addition, the Committee requested representatives from Ernst & Young LLP to present their response to the FRC's findings. 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.

Taking into consideration the matters noted above the Committee has recommended to the Board and to the members via a Resolution at the 2015 Annual General Meeting that Ernst & Young LLP be reappointed.

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

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 define unacceptable non-audit assignments, pre-approval of certain acceptable non-audit assignments and procedures for approval of other non-audit assignments. At no time does the external auditor audit their own work, make management decisions for the Society, create a conflict of interest or find themselves 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 remain in place. Furthermore, the Society's policy and framework require that the external auditor should only be appointed if the threat to their objectivity is clearly insignificant, unless appropriate safeguards can be applied to eliminate or reduce such threat to an acceptable level.

During 2014 the Society engaged the external audit firm to provide certain non-audit services. These engagements included other assurance services and advice in relation to regulatory and taxation matters; all engagements complied with the policy set out above and the Committee received regular updates on the nature and cost of the engagements.

Details of the fees paid to the external auditor for audit and non-audit services are set out in note 8 to the accounts.

The effectiveness of the Committee

The Committee carried out a review of its effectiveness during 2014, including an assessment of its work against its terms of reference, published guidance and best practice. The review was facilitated by Internal Audit and considered questionnaires which were completed by both Committee members and regular attendees. The review concluded that the Committee had operated effectively during the year.

Directors' Remuneration Report

Statement by the Chairman of the Remuneration Committee

I am pleased to present the Remuneration Committee's report, which sets out the pay, benefits, bonuses and incentive plans for the directors for the year to 31 December 2014 and the remuneration policy for 2015.

The Society is committed to being transparent to members in its remuneration report. New reporting regulations have come into effect for UK listed companies. To the extent they are appropriate to mutuals these have been adopted by the Society; these primarily impact the presentation and disclosure of directors' remuneration. As a result, we have improved our report and have included some additional information to help our members understand what our directors could earn through our annual bonus and longer term incentive plans and how we measure the performance of the Society.

There are two sections to the report – a Remuneration Policy Report, which sets out the Society's remuneration policy for directors; and the Annual Remuneration Report, which outlines how the policy was implemented during 2014.

2014 was a year of change for the Society, with the departure of outgoing Chief Executive David Stewart and the start of new Chief Executive Mark Parsons. The new incumbent was brought in on a higher basic salary, which was benchmarked against similar organisations and reflects his experience at larger financial institutions necessary to support the Society's strategy for growth. His total remuneration package is structured in a similar way to that of the outgoing Chief Executive. The Deputy Chief Executive Colin Franklin resigned as a director of the Society but remained with the Society as an advisor to the new Chief Executive until 16 December when he commenced garden leave.

The Society continued to operate successfully during this period of change, and the Committee considers that the Society's performance compares favourably with that of major banks and other building societies. Performance was strong, with the profit target exceeded for the Long Term Incentive Plan (LTIP) 2012-2014 and strong business performance against targets for the annual bonus for 2014. Measures relating to growth and financial performance, risk and compliance, customer experience, staff engagement and community activity were exceeded. In determining the annual bonus for staff and executive directors, the Committee considered the appropriateness of the level of annual bonus awards given members' savings rates, among other factors, and an award for the performance year 2014 of 12% of salary was made to all eligible staff.

An award was also made from the LTIP for executive directors and other senior managers; the Society exceeded the scheme maximum of £136.5 million profit (before Financial Services Compensation Scheme (FSCS) charges) in the final year of the scheme, resulting, after consideration of other modifiers, in an award under the scheme of 40% of salary for eligible executive directors and 20% for other senior managers. This comprised awards to the Chief Risk Officer and Chief Operating Officer on a pro rata basis; to the former Deputy Chief Executive and outgoing Chief Executive as good leavers of the scheme; and to the Finance Director.

In 2014, the average base salary increase was 4.4% for remaining executive directors; 2015 pay increases will be revised from 1 April 2015. The pay award is determined with respect to Society performance, individual performance, the prevailing rate of inflation and both the current salaries and expected pay awards in other similar organisations.

In 2015, the Society will continue to ensure that remuneration arrangements focus on aligning executive director rewards with the delivery of long-term strategic objectives. The approach will be reviewed by the Committee in line with any changes to regulation such as new clawback and deferral rules, which will be applied as required.

The Committee retains discretion to make arrangements outside of the terms of the Remuneration Policy in exceptional circumstances; should this be deemed absolutely necessary the Committee will take into account members' interests and the Society's ability to pay. During 2014 the Committee granted a pro rata award to the Chief Operating Officer in respect of the 2012-2014 LTIP. This was in order to more closely align his total remuneration with market levels. The Committee also exercised its discretion in considering the outgoing Chief Executive and Deputy Chief Executive as good leavers.

The Society has regard to the Prudential Regulation Authority (PRA) Remuneration Code, disclosures required by Capital Requirements Regulation, the UK Corporate Governance Code and market best practice.

An advisory vote in respect of the resolution to approve the Annual Remuneration Report for 2014 will be retained as in previous years.

On behalf of the Board

Bridget Blow
Chairman of the Remuneration Committee
26 February 2015

Remuneration Policy Report

This report informs members of the policy for the remuneration of both executive and non-executive directors, who are equally responsible for directing the Society's affairs.

The Society's remuneration policy is based on the following principles:

- Remuneration of directors and other Code Staff (staff who have a material impact on the Society's risk profile), including material risk takers and key staff in control functions, is in line with the PRA's Remuneration Code; the Committee believes the remuneration arrangements for staff in control functions do not affect their independence; and no director, senior manager or member of staff is involved in the setting of his or her own remuneration.
- Remuneration policy is in line with the business strategy, objectives, values and long-term interests of the Society and does not result in conflicts of interests.
- Remuneration is consistent with the overall financial stability of the Society and does not present material risk to this stability; remuneration promotes sound and effective risk management and does not encourage excessive risk taking.
- Remuneration policy focuses on rewarding directors and other staff within a market competitive range, subject to satisfactory performance; remuneration packages aim to aid the recruitment and retention of quality staff at all levels and to reflect their responsibilities, performance and experience.
- Incentive plans, performance measures and targets are stretching and aligned with members' interests; no member of staff is incentivised on the basis of an individual or team sales target. Bonus awards will be limited or withdrawn where individual or business performance does not merit award of a bonus.
- The performance of staff is reviewed each year against agreed individual and business objectives and the outcome of this review is taken into account when considering pay decisions.

The main elements of remuneration for executive directors are:

	Element	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics
Fixed remuneration	Base salary	Core element of fixed remuneration with the aim of recruiting, retaining and motivating high calibre executives at the level of responsibilities, experience and performance required.	Salaries are reviewed annually (more frequently where required) with regard to a number of factors, including role, experience and individual performance; the economic environment and the Society's financial performance; and within market competitive ranges.	Salary increases are assessed in line with other staff but higher increases may be awarded where there is a rationale to do so, for example an increase in scope or responsibility, or a new director being benchmarked against the external market.	Not applicable.
Fixed remuneration	Benefits	Element of fixed remuneration with the aim of recruiting and retaining executive directors.	Each executive director receives benefits broadly in line with the market, such as a company car or a cash alternative, private fuel, membership of a private medical insurance scheme and life insurance. Other benefits may be provided on an individual basis, such as relocation allowances.	Benefits are set at a level to be appropriate and sufficient according to individual circumstances.	Not applicable.

	Element	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics
Fixed remuneration continued	Pension	Provides post-retirement benefits for participating executive directors.	Executive directors are eligible to participate in the defined contribution pension plan. In some circumstances, such as where contributions exceed the annual or lifetime allowance, executive directors may be permitted to take a cash alternative in place of contributions. The defined benefit pension scheme closed to future service accrual in 2013.	A pension contribution or cash supplement of up to 20% of salary is made to executive directors. For the Chief Executive this is currently 20%, and for other executive directors this is currently 10% of salary.	Not applicable.
Variable remuneration	Annual bonus	Rewards the achievement of corporate targets for a single financial year.	Executive directors are eligible to participate in the same annual bonus scheme as provided to all Society staff. Awards to executive directors are made in cash, half of which is currently paid in the March following the financial year under review after approval of the accounts, and the remainder of which is retained in an equivalent share-like instrument for a further six months. During the retention period the retained element can move both up and down in value. For the upward movement, the retained element of variable remuneration will be indexed and increase in line with the Retail Prices Index to preserve the real terms value of the award. It can move down based on the performance of the Society post vesting. The retained award will reduce in the event that capital strength or profit declines significantly, as would be the case for a decline in the share price of a listed firm. The scheme is reviewed each year in light of business plans and changes in regulation.	Maximum award for executive directors, as for all staff, is 20% of base salary as at 31 December of the performance year. If profit plans are achieved, the scheme allows for an award of 10% of salary to be made; if profit plans are not met, there is no award. The Committee has absolute discretion to adjust awards if necessary, including withholding vested awards under 'malus' arrangements.	Performance is measured against a challenging financial target, and is linked to profit. The Committee also assesses the Society's non-financial performance in a number of areas, economic conditions and individual performance, and modifies the award as appropriate.

	Element	Purpose and link to strategy	Operation	Maximum potential value	Performance metrics
Variable remuneration continued	Long Term Incentive Plan (LTIP)	Rewards sustained strong performance over a three year performance cycle. Aims to ensure a strong link between remuneration and the interests of members through the long-term performance of the Society; and to recruit and retain high calibre individuals at the level required.	Executive directors are eligible to participate in the LTIP. The three year cycle meets the deferral requirements of the PRA's Remuneration Code. Awards are made in cash, half of which is currently paid in the March following the end of the three year cycle and the approval of the accounts for the final year, and the remainder of which is retained in an equivalent share-like instrument for a further six months, when the award may be subject to adjustment as for the annual bonus scheme, outlined above. The scheme is reviewed each year in light of business plans and changes in regulation.	Maximum award for executive directors is 40% of base salary at the time the LTIP is granted. If the threshold is achieved, the scheme allows for an award of 10% to be made; no award will be made if the threshold is not met. The Committee has absolute discretion to adjust awards if necessary, including withholding vested awards under 'malus' arrangements.	Performance is measured against challenging financial targets. The Committee also assesses the Society's non-financial performance in a number of areas, economic conditions and individual performance, and modifies the award as appropriate.

The Committee is clear that it is essential that variable remuneration awards are not excessive, and variable pay awarded in respect of a financial year is currently limited to a maximum of 60% of fixed pay, which is under the fixed to variable pay cap of 100% set out in the Capital Requirements Regulation and Capital Requirements Directive (CRD IV). The minimum variable remuneration is nil.

Explanation of performance metrics chosen for executive directors' variable remuneration

The Society operates two variable pay schemes for executive directors:

- The annual bonus scheme, which rewards performance over a single financial year.
- The LTIP, which is the deferred element of variable pay and rewards performance over the longer term.

When reviewing variable pay schemes, the Committee considers target ranges taking into account budget expectations, growth forecasts and long-term stability. Performance modifiers are set to discourage excessive risk taking and to take into consideration customer and member outcomes.

To protect the interests of members, the Committee may amend any award if it considers it appropriate in light of either the Society's overall performance or economic conditions or any other factors the Committee feels are relevant.

The following table shows the different levels of potential variable pay as a percentage of basic salary, benefits and pension:

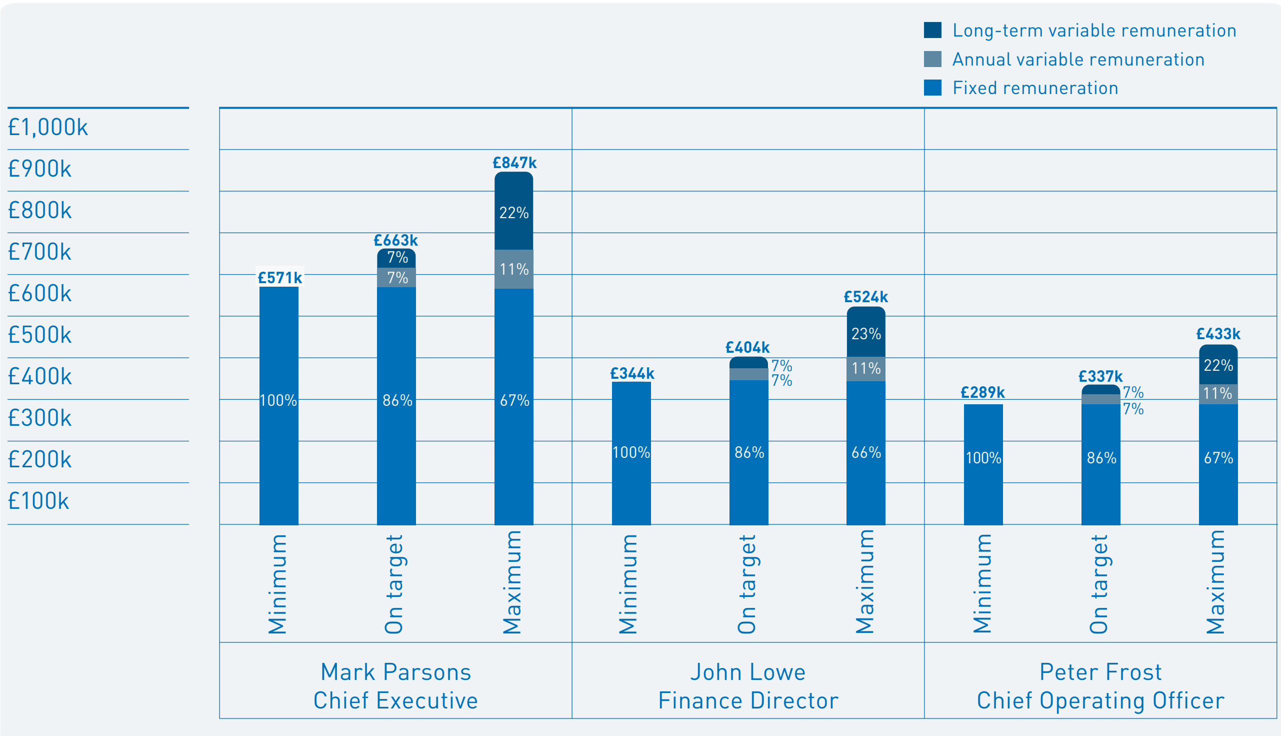
Performance scenarios	Annual bonus %	LTIP %	Total variable remuneration %
	As a percentage of basic salary		
Minimum	0	0	0
On target	10	10	20
Maximum	20	40	60

Illustration of the application of the remuneration policy

The graph below illustrates what the executive directors could earn based on the remuneration policy based on 2014 levels and three potential performance scenarios – minimum, on target and maximum variable remuneration. Under the variable remuneration schemes, thresholds need to be achieved to generate a 'target' award and considerably exceeded to generate a maximum award. The long-term variable element would not be paid until after the end of the performance period.

In applying the scenarios, the following assumptions have been made:

- Fixed remuneration refers to current basic salary, pension as a percentage of basic salary, and benefits paid over the course of the calendar year. Benefits figures are taken from those disclosed in the single figure table on page 76.
- The element of the annual bonus and LTIP retained in an equivalent share-like instrument (50%) is shown before any adjustment has been applied.



Feike Brouwers has not been included in the above illustration due to his decision to resign as an executive director on 31 March 2015.

Approach to recruitment remuneration

When agreeing the elements of a remuneration package for the appointment of executive directors, the Committee will consider the following:

- Sufficiency of package to enable the recruitment of high calibre executives for the level of responsibilities, experience and performance required without being excessive.
- Comparison with similar positions within the Society's close peer group of building societies and other organisations of a similar size and complexity.
- Alignment with the existing packages offered within the Society's remuneration policy, including maximum variable pay limits.

The Committee may also make awards on hiring an external candidate to compensate them for forfeiting any awards foregone from a previous employer. In determining any such 'buyout', the Committee will consider all relevant factors, including the likelihood of the awards vesting had the candidate remained in their previous employment, the form in which they were awarded and the time over which they would have vested, and seek to implement any 'buyout' or recruitment awards 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.

Service contracts

Executive directors' terms and conditions of employment are detailed in their individual service contracts, which are available at the head office. Contracts are terminable by the director on six months' notice and by the Society on one year's notice. The dates individuals were appointed as executive directors to the Society are shown in the table below.

Executive director	Date of appointment as a director of the Society
Chief Executive – Mark Parsons	1.7.2014
Finance Director – John Lowe	14.10.2010
Chief Operating Officer – Peter Frost	1.11.2012
Chief Risk Officer – Feike Brouwers	24.4.2013

All directors are subject to election by members, generally at the Annual General Meeting (AGM) following their appointment by the Board, and with effect from the 2015 AGM will stand voluntarily for re-election each year, with the exception of Feike Brouwers who announced his decision to resign as an executive director on 31 March 2015.

Policy on payment for loss of office

The Society's approach to determining payments for the loss of office of executive directors is summarised as follows.

Termination payments will include payment of any base salary or other contractual benefits due for the notice period, although this may be reduced if alternative employment is found during any period of garden leave.

The annual bonus and LTIP will be paid according to the leaver provisions within the scheme rules and is dependent on whether the executive director is deemed a good leaver. A good leaver is an individual who ceases to be a director either due to death, ill-health, injury or disability, or any other reason as determined by the Remuneration Committee.

Under good leaver circumstances, the rules state that any annual bonus or LTIP award will be pro rata to the time served during the performance period. Any deferral and retention requirements will be applicable and amounts will be subject to any necessary adjustment and payable at the same time as it would be for executive directors remaining in employment. If an individual is deemed not to have left under good leaver circumstances, no annual bonus payments will be made and unvested LTIP awards will lapse.

Other considerations when setting executive director remuneration

When approving executive director pay, the Committee will take into account remuneration paid to other staff across the Society, including the salary increases awarded and consideration of the remuneration policy as applied to the wider staff group.

All eligible members of staff participate in the discretionary annual bonus scheme. Eligibility is dependent upon satisfactory individual performance, although the amount paid is determined by the performance of the Society as a whole. It applies to all staff on the same terms, including executive directors. It does not apply to non-executive directors. Members of senior management other than executive directors are eligible to participate in the LTIP, with the maximum award capped at 20% of salary.

Non-executive directors

The basis of non-executive directors' remuneration is set out below:

Element	Purpose and link to strategy	Operation
Non-executive director fees	Only element of remuneration, set at a level that reflects the market and is sufficient to attract individuals with appropriate knowledge and experience.	Non-executive directors receive a basic fee and an additional fee for chairmanship of a committee and/or holding the position of Senior Independent Director or Deputy Chairman and are reimbursed for reasonable expenses, paid in accordance with the Society's Rules. The non-executive directors do not participate in any Society pension or bonus arrangements. Fees are reviewed annually with regard to the Society's financial performance; annual pay increases awarded to executive directors and other staff; and within market competitive ranges.

Letters of appointment

Non-executive directors are appointed by letter of appointment for an initial term of three years, which is terminable at the discretion of the Board or of the director concerned. All directors are subject to election by members, generally at the AGM following their appointment by the Board, and with effect from the 2015 AGM will stand voluntarily for re-election each year.

Consideration of member views

The Society has dialogue with members and welcomes feedback on executive and non-executive directors' remuneration. At the 2014 Annual General Meeting, 91.6% of members voted in favour of the approval of the 2013 Directors' Remuneration Report.

Annual Remuneration Report

Taking into account pension and other benefits, the total pay package awarded to current executive directors is shown below:

Audited information: Single total figure of remuneration for each executive director:

	Salary £000	Taxable benefit[1] £000	Annual bonus £000	LTIP £000	Pension contributions[1] £000	Increase in accrued pension £000	Loss of office £000	Total £000
2014								
Mark Parsons (appointed 01.07.2014)	230	10	28	–	46	–	–	314
David Stewart (resigned 31.03.2014)	107	5	13	102	27	1	278[2]	533
John Lowe	296	14	36	88	30	–	–	464
Colin Franklin[3]	229	17	31	56	34	–[4]	148	515
Remuneration as a director (resigned as a director on 30.9.2014)	181	12	23	56	27	–	–	299
Remuneration as an employee (including garden leave period to 15.6.2015)	48	5	8	–	7	–	148	216
Peter Frost	236	25	29	64	24	–	–	378
Feike Brouwers[5]	255	9	15	67	25	–	–	371
Total	1,353	80	152	377	186	1	426	2,575
2013								
David Stewart	420	19	60	128	105	1	–	733
John Lowe	279	13	40	74	28	–	–	434
Colin Franklin	156	16	22	55	51	12	–	312
Peter Frost	224	24	32	–	22	–	–	302
Feike Brouwers (appointed 24.04.2013)	171	36	26	33	17	–	–	283
Total	1,250	108	180	290	223	13	–	2,064

No director has received payments in excess of €1,000,000 during 2014 or 2013.

1. Amounts in 2013 relating to payments to David Stewart in respect of the value of pension benefits foregone have been reclassified from taxable benefits to pension contributions.
2. Further information on loss of office payments for David Stewart is disclosed on page 79.
3. Colin Franklin stood down from the Board on 30 September 2014 and the table reflects his remuneration as an executive director, including an additional allowance while he undertook the role of Interim Chief Executive, as well as his ongoing advisory role as an employee. Loss of office includes remuneration due to the end of his garden leave (15 June 2015). He is not entitled to take part in the 2015 annual bonus scheme but retains eligibility to the 2013-2015 and 2014-2016 LTIPs on a pro rata basis. Maximum amounts payable under the LTIP are shown on page 79.
4. Colin Franklin was in receipt of pension payments from 1 April 2014 and an early retirement adjustment was applied which reduced the accrued pension figure. No increase in accrued pension is therefore shown in the table above. The accrued pension figures are disclosed on page 78.
5. On 9 February 2015 Feike Brouwers announced his decision to resign as an executive director on 31 March 2015. He will receive half of the 2014 annual bonus, and the full amount due to him awarded under the 2012-2014 LTIP.

Further information on individual remuneration elements: executive directors

Base salary

The average increase for eligible executive directors was 4.4% in 2014, higher than the basic award of 2.5% for other staff. The higher amount reflected alignment with the market.

The Remuneration Committee considered the results of the Society's annual benchmarking exercise, together with the financial performance of the Society and individual executive director performance and experience.

For 2015, the base salaries for executive directors will be revised from April 2015 and are anticipated to be set in line with the approach outlined in the remuneration policy report, with the exception of the incoming Chief Executive whose salary from April 2015 was agreed in his service contract which amounts to an increase of 4.35%.

In addition to base salary, the former Deputy Chief Executive was also paid a temporary acting up allowance during 2014 to reflect his responsibilities as Interim Chief Executive and his key role in the transition to the new Chief Executive.

Annual bonus

The Society has performed strongly in 2014, meeting key corporate strategic objectives for the period. The threshold profit of £213.2 million, before the FSCS levy and after provision for the cost of the annual bonus scheme, was achieved for the annual bonus for 2014. Details of performance against the financial and non-financial modifiers, such as performance and growth, risk and compliance, customer experience, human resources and community, are set out in the Strategic Report section of the Annual Report & Accounts (pages 1 to 56).

In determining the annual bonus award to staff and executive directors, the Committee also considered the appropriateness of the level of annual bonus awards given, among other factors, members' savings rates. This gave rise to a calculated bonus for all 2,113 eligible members of staff equivalent to 12% of base salary from a potential maximum of 20%. The bonus percentage payable to each of the executive directors is the same as for all other eligible staff.

For executive directors and other senior managers 50% of the annual bonus will be retained in an equivalent share-like instrument for a further six months. This will be paid at the end of the retention period, subject to adjustment, as outlined on page 71 and Committee discretion. The Chief Risk Officer, who announced his decision to resign as an executive director from 31 March 2015, will not receive the deferred amount of the annual bonus due in September 2015.

The 2015 annual bonus scheme has been reviewed in line with business strategy and changes to relevant regulation. There is no change to the maximum award achievable.

Long Term Incentive Plan (2012-2014)

The Society has achieved strong results throughout the period of assessment, and achieved the targets set in its plans for the period. The Society significantly exceeded the scheme maximum of £136.5 million profit in the final year of the scheme (before FSCS charges) and has seen strong performance against the measures for financial performance and growth, risk and compliance, customer experience, human resources and community. Further information in respect of this performance is provided in the Strategic Report section of the Annual Report & Accounts (pages 1 to 56).

This resulted in a maximum award under the scheme to each participant of 40% of base salary for eligible executive directors and 20% of base salary for senior management. Base salary is set as the salary for each participant at the date of the original 2012 grant. No award was made to the incoming Chief Executive. No targets were adjusted from those originally set when the grant was made in 2012.

Awards included those to the Chief Risk Officer on a pro rata basis to meet the value of existing incentives foregone when he left his previous employment and to the outgoing Chief Executive and Deputy Chief Executive as good leavers of the scheme.

At the discretion of the Remuneration Committee the Chief Operating Officer was granted a late award in relation to the 2012-2014 LTIP on a pro rata basis in order to bring his remuneration in line with market levels. The award was granted on the same basis as for other executive directors in the scheme.

For executive directors and other senior managers 50% of the payments made under the LTIP will be retained in an equivalent share-like instrument for a further six months. This will be paid at the end of the retention period, subject to an adjustment as defined on page 71 and Committee discretion.

A new LTIP was granted to executive directors (on a pro rata basis for the incoming Chief Executive) and other senior managers in 2014 for the performance period 2014-2016. The maximum award for participants is 40% of base salary for executive directors and 20% of base salary for senior managers. If the threshold is achieved, the scheme allows for an award of 10% to be made; no award will be made if the threshold is not met. The performance conditions are based on achieving final year Strategic Plan profit before tax and the FSCS levy, less charitable donation and including an adjustment relating to the impact of new capital instruments. When determining awards, additional financial and non-financial measures will be assessed, as outlined in the Remuneration Policy Report.

The maximum award levels under the variable award schemes are shown below:

	Maximum award levels (% of salary)			
	Annual bonus 2014 %	Annual bonus 2013 %	LTIP 2014-2016 %	LTIP 2013-2015 %
Executive directors	20	20	40	40

The 2015-2017 LTIP will be reviewed in light of regulation, in particular with regard to clawback rules and revised deferral arrangements, which may result in a longer deferral period for executive directors. No change is anticipated to current maximum awards under the scheme.

Benefits and pension

Executive directors received benefits including a fully expensed car, including private fuel, or a cash alternative, personal membership of a private medical insurance scheme and life insurance.

Executive directors were eligible to participate in the defined contribution pension plan (Group Personal Pension (GPP) scheme) which is offered to all staff and is pensions auto-enrolment compliant.

Defined contribution scheme

The Finance Director and the Chief Risk Officer are active members of the Group's defined contribution pension scheme and received contributions of 10% of base salary.

The incoming Chief Executive's pension contributions are cash payments equivalent to 20% of base salary in respect of the value of pension benefits foregone.

The Chief Operating Officer ceased to be a member of the Society's pension scheme on 1 April 2014; therefore amounts included in pension contributions are contributions up to this date and cash payments in lieu equivalent to 10% of base salary in respect of the value of benefits foregone.

The former Deputy Chief Executive became a deferred member of the defined benefit pension scheme on 31 December 2013, following the scheme closure to future service accrual. Since this time he received a cash alternative of 15% in lieu of pension contributions and will continue do so until the end of his employment on 15 June 2015. The contribution of 15% was agreed for all other staff who were previously members of the defined benefit pension scheme, and transferred to the Society's defined contribution scheme.

The outgoing Chief Executive left the Society's defined benefit pension scheme in 2006. Pension contributions include cash payments equivalent to 25% of base salary in respect of the value of benefits foregone up to 31 March 2014.

Defined benefit pension scheme (Audited information)

David Stewart made no contributions to the defined benefit pension scheme during 2014 (2013: nil). Accrued pension per annum as at 31 December 2014 was £44,000 (31 December 2013: £43,000). The normal retirement age is 60. If early retirement is taken, the accrued pension will be adjusted accordingly. There is no entitlement to any additional benefits.

Colin Franklin made no contributions to the defined benefit pension scheme during 2014 (2013: £12,000). Accrued pension per annum as at retirement (31 March 2014) was £67,000 (31 December 2013: £71,000). The decrease in accrued pension relates to an early retirement adjustment. The value of the accrued pension includes an adjustment for the settlement of a tax charge. There is no entitlement to any additional benefits.

No changes are anticipated to the Society's approach to pension and benefit provision in 2015.

Payments to past directors (Audited information)

The Deputy Chief Executive stepped down from his role as a director on 30 September 2014 but remained as an employee of the Society in an advisory role until 15 December 2014. He has now commenced garden leave and will continue to be remunerated on his current salary until 15 June 2015. He has been in receipt of regular pension payments since April 2014.

The Committee has determined the former Deputy Chief Executive a good leaver due to his retirement after a long period of employment with the Society and he is therefore eligible to receive payments under the 2014 annual bonus scheme, the 2014-2016 LTIP (included in the table on page 76) and future LTIP awards not yet vested included in the following table, pro rata to his period of employment with the Society and subject to the rules of the schemes. He is not eligible to participate in the 2015 schemes. Any awards due will vest in line with those for executive directors remaining in employment with the Society, including any retention and discretion adjustments.

The following table shows the amounts payable to the former Deputy Chief Executive under the relevant schemes not yet vested before any adjustment:

	Potential award levels – LTIP	
	2014-2016 £000	2013-2015 £000
LTIP awards not yet vested	Nil to 46	Nil to 47

David Stewart the outgoing Chief Executive agreed to extend his notice period to 30 September 2014, when he tendered his resignation in 2013, to allow the Society a longer period to recruit his successor. In 2014 as the recruitment process was proceeding satisfactorily it was agreed he would leave the Society on 31 March 2014.

A final payment of £278,000 was made in six monthly instalments of £46,333 to the outgoing Chief Executive in 2014 and reflects the fixed remuneration the outgoing Chief Executive would otherwise have been entitled to during his extended notice period. Payments would have been subject to reduction in the event of the outgoing Chief Executive obtaining full time employment elsewhere, among other factors.

The Committee determined the outgoing Chief Executive to be a good leaver in recognition of his significant contribution to the successful performance and growth of the Society during a challenging period for the financial services sector and wider economy. He is therefore eligible to receive payments under the 2014 annual bonus scheme, 2014-2016 LTIP (included in the table on page 76), and future LTIP awards not yet vested included in the following table, pro rata to his period of employment with the Society and subject to the rules of the schemes. Any awards due will vest in line with those for executive directors remaining in employment with the Society, including any retention and discretion adjustments.

The following table shows the amounts payable to the outgoing Chief Executive under the relevant schemes not yet vested before any adjustment:

	Potential award levels – LTIP	
	2014-2016 £000	2013-2015 £000
LTIP awards not yet vested	Nil to14	Nil to 65

On 9 February 2015 Feike Brouwers, the Chief Risk Officer, announced his decision to resign as an executive director on 31 March 2015. He was awarded the 2014 annual bonus; however he will not receive the deferred element due in September 2015. He will receive the full amount due to him under the 2012-2014 LTIP. All amounts relating to future LTIPs were forfeited. Feike Brouwers will continue to accrue normal contractual pay and benefits up to the end of his notice period (9 August 2015).

There were no other payments made to previous directors in relation to past service during the financial year ending 31 December 2014.

Recruitment remuneration

The remuneration package of the new Chief Executive was set in accordance with the Society's policy to attract a candidate with the right skills, qualifications and experience for the role and following a benchmarking exercise performed by the Society's remuneration advisors. The form of the package is consistent with that of the outgoing Chief Executive and the other executive directors.

Change in remuneration of director undertaking the role of Chief Executive

The historic levels of the Chief Executive's annual bonus and LTIP awards as a percentage of the maximum payable are shown in the table below:

	2014 %	2013 %	2012 %	2011 %	2010 %
Incoming Chief Executive					
Annual bonus as a percentage of maximum	60	–	–	–	–
LTIP as a percentage of maximum	–	–	–	–	–
Outgoing Chief Executive					
Annual bonus as a percentage of maximum	60	70	60	65	55
LTIP as a percentage of maximum	100	100	97	38	38

Relative importance of spend on pay

The following table sets out the percentage change in profit and overall spend on remuneration in the year ended 31 December 2014, compared with the year ended 31 December 2013:

	2014 £m	2013 £m	Percentage change %
Profit after tax	158.5	101.3	56
Staff remuneration costs	57.8	51.7	12
Headcount (number)	2,065	1,925	7

Audited information: Non-executive directors' emoluments

	Basic fees		Committee Chair fees		Taxable benefits		Total fees and taxable benefits	
	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000	2014 £000	2013 £000
Non-executive directors:								
Ian Pickering (Chairman)	133	130	–	–	4	4	137	134
Janet Ashdown (appointed 18.09.2013)	45	13	–	–	2	–	47	13
Peter Ayliffe (appointed 01.05.2013)	45	29	–	–	1	–	46	29
Bridget Blow (Deputy Chairman, Senior Independent Director and Chairman of the Remuneration Committee)	45	44	16	16	–	–	61	60
Roger Burnell (Chairman of the Board Risk Committee)	45	44	12	12	–	–	57	56
Ian Geden	45	44	–	–	1	1	46	45
Fiona Smith (retired 25.04.2013)	–	14	–	–	–	–	–	14
Glyn Smith (Chairman of the Board Audit Committee and Models and Ratings Committee)	45	44	23	18	3	4	71	66
Total	403	362	51	46	11	9	465	417

Further information on individual remuneration elements: Non-executive directors

Fees

A Non-Executive Directors' Remuneration Committee, comprising the Chairman, Chief Executive and Finance Director, reviews the fees of the non-executive directors annually in light of their responsibilities and within market competitive ranges and recommends to the Board for approval the remuneration of the non-executive directors, other than the Chairman. Recommendations for the remuneration of the Chairman are made by the Remuneration Committee and approved by the full Board without the participation of the Chairman. No director takes part in the discussion of his or her own remuneration.

The fees for non-executive directors were last increased in January 2014. The table below sets out the fee levels for non-executive director roles which were in effect during the year compared with the previous year. Non-executive director fees are made up of a basic fee, plus a Committee Chair fee as appropriate. The Chairman does not receive additional fees for roles carried out other than that of Chairman.

Role	2014 £000	2013 £000
Chairman	133	130
Basic fee	45	44
Deputy Chairman	6	6
Remuneration Committee Chairman	10	10
Board Audit Committee Chairman	12	12
Board Risk Committee Chairman	12	12
Models and Ratings Committee Chairman	10	6
Senior Independent Director (if different from Deputy Chairman)	6	6

For 2015, the fees for non-executive directors will be reviewed in 2015 and any increase backdated to 1 January 2015.

Taxable benefits

Taxable benefits are amounts relating to the reimbursement of travel and accommodation expenses in relation to attendance at meetings held in the Coventry head office.

Non-executive directors do not participate in any performance related pay or bonus schemes, pension arrangements or other benefits.

Aggregate remuneration data disclosure under CRD IV

These additional disclosures focus on the remuneration policies and practices for staff who have a material impact on the Society's risk profile (Code Staff). Code Staff consist of executive directors, non-executive directors, certain senior managers in control functions (for example, Audit, Risk and Compliance) and other material risk takers.

The Capital Requirements Regulation (CRR) as part of CRD IV requires the Society to disclose aggregate remuneration data for all Code Staff. The number of Code Staff increased in 2014 due to new European Union regulatory technical standards on the definition of material risk takers, which specify certain categories of employees whose professional activities are thought to have a material impact on the Society's risk profile. The remuneration relevant to Code Staff, comprising senior management and other material risk takers, was as follows for 2014 and 2013:

	Aggregate remuneration data for Jan-Dec 2014			Aggregate remuneration data for Jan-Dec 2013		
Code Staff	Number of staff	Fixed pay £m	Variable pay[1] £m	Number of staff	Fixed pay £m	Variable pay[1] £m
Senior manager Code Staff[2,3]	18	2.9	0.9	20	2.7	0.8
Other Code Staff[2]	32	2.7	0.3	14	1.2	0.1
Total	50	5.6	1.2	34	3.9	0.9

1. Variable pay includes the annual performance related bonus (£0.5 million) for 2014 (paid March 2015) (2013: £0.3 million paid March 2014), the LTIP 2014-2016 payment granted (not paid) in 2014 (£0.7million) (LTIP 2013-2015 payment granted (not paid) in 2013 (£0.6 million)) and the late LTIP 2012-2014 payment granted in 2014 for the Chief Operating Officer (£0.1million). The LTIP payment included above is the maximum possible under the scheme (40% executive directors and 20% senior managers of salary as at the grant date); the actual payment will be subject to the performance criteria outlined on page 72.
2. Senior manager Code Staff comprises of non-executive directors, executive directors and certain senior managers. All other relevant staff are classified as other Code Staff.
3. Severance payments were made to two senior managers during 2014, totalling £0.4 million.

Details of the Remuneration Committee

The Committee consists of non-executive directors and the Board Chairman. Non-executive directors are independent of the Society's management and are not required to devote the whole of their time to its affairs. The remit and the composition of the Remuneration Committee are detailed on page 61 of the Directors' Report on Corporate Governance.

Further information on the dates of appointments of the non-executive directors is included in the Annual Business Statement (pages 136 and 137), and on the Society's committees is included in the Directors' Report on Corporate Governance (pages 60 to 63).

Remuneration Committee advisors and fees

The Remuneration Committee considers external data from independent national surveys of the financial services sector, FTSE 250 companies and a comparator group of financial institutions to ensure remuneration remains competitive. The Committee also considers regulatory compliance, best practice for remuneration (for example, deferral) and market practice.

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. As well as advising the Remuneration Committee, Deloitte also provided tax, internal audit, risk, liquidity and pension audit services to the Society during the year. The Committee is satisfied that the advice received is objective and independent and services provided by Deloitte are reviewed annually to ensure this continues to be the case. Deloitte's fees for providing advice to the Committee amounted to £47,000 (including VAT) for the year ended 31 December 2014.

On behalf of the Board

Bridget Blow
Chairman of the Remuneration Committee
26 February 2015

Directors' Report

The directors have pleasure in presenting their Annual Report & Accounts for the year ended 31 December 2014.

Business objectives

The Society exists solely for the benefit of its current and future members, meeting their needs for savings and residential property mortgages. In delivering its strategic objectives, the Society is committed to Putting Members First in everything it does and fully embraces the mutual ethos on which the Society was founded.

Business review, future developments and key performance indicators

The Group's business and future plans are reviewed in the Strategic Report section of the Annual Report & Accounts (pages 1 to 56). The Group's principal key performance indicators are detailed in the Business Review.

Profit and capital

Profit before tax for the year ended 31 December 2014 was £201.8 million (2013: £132.1 million). The profit after tax transferred to the general reserve was £158.5 million (2013: £101.3 million).

Total Group reserves and equity at 31 December 2014 were £1,490.9 million (2013: £895.0 million). Further details on the movements on reserves and equity are given in the Group Statement of Changes in Members' Interests and Equity (page 92).

Gross capital at 31 December 2014 was £1,710.7 million (2013: £1,114.7 million) including £58.2 million (2013: £58.2 million) of subordinated debt, £161.6 million (2013: £161.5 million) of subscribed capital and £396.9 million of Perpetual Capital Securities. The ratio of gross capital as a percentage of savings and borrowings at 31 December 2014 was 5.90% (2013: 4.17%) and the free capital ratio was 5.78% (2013: 4.05%). The Annual Business Statement gives an explanation of these ratios (see page 135).

In June 2014 the Society issued £400.0 million (£396.9 million net of issuance costs) of Perpetual Capital Securities, a form of Additional Tier 1 capital to strengthen its leverage ratio. For further information, see note 27 to the accounts.

Mortgage arrears

At 31 December 2014, there were 235 mortgage accounts 12 months or more in arrears (including those in possession) (2013: 332). The balance on these accounts totalled £32.9 million (2013: £44.1 million) and the value of these arrears was £2.9 million (2013: £4.1 million) or 0.01% (2013: 0.02%) of total mortgage balances. The mortgage arrears methodology is based on the Council of Mortgage Lenders' 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 £1.8 million (2013: £1.9 million) to charitable organisations during the year. This included an amount of £1.7 million (2013: £1.6 million) to The Royal British Legion's Poppy Appeal and £60,000 (2013: £102,000) to the Coventry Building Society Charitable Foundation. In 2013 £200,000 was donated to Cancer Research UK following the launch of the Society's inaugural Race for Life Bond.

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

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 11 days at 31 December 2014 (2013: 11 days).

Country-by-country reporting

The Capital Requirements (Country-by-Country Reporting) Regulations 2013 came into effect on 1 January 2014 and place certain reporting obligations on financial institutions within the scope of the Capital Requirements Directive (CRD IV).

The nature of activities of the Society are set out under Business objectives earlier in this report and for each of the Society's subsidiaries in note 16 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 9 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 and business risk. The Group seeks to manage all the risks that arise from its activities and has established a number of committees and policies to do so. Details of these are set out in the Risk Management Report (pages 16 to 54), and the Directors' Report on Corporate Governance (pages 57 to 64).

Employees

The Society recognises that its goal of 'Putting Members First' is best achieved through a knowledgeable and motivated workforce.

This underpins all aspects of the Society's approach to its staff. People are recruited on the basis of their behaviours as well as skills and knowledge, and the values of 'Putting Members First' are built in to the way the Society recruits, develops, communicates with and manages its staff.

The Society has invested significantly in developing its staff, and has a framework of training initiatives that provide career advancement and personal development opportunities at all levels of the organisation. It is committed to equal opportunities and encouraging diversity and fostering inclusion and has policies in place to support the aspirations of applicants and members of staff, whatever their personal characteristics. Additional support is given to those who need it; for example, should employees become disabled, the Society's policy is to continue their employment where possible with appropriate training and redeployment.

The Society recognises the importance of effective internal communications and operates a number of channels to inform and engage with staff. A well-used intranet and established briefing channels are supported by events and focus groups whilst regular surveys provide additional opportunities to voice opinions and identify areas for improvement. The Society has positive relations with its union, and has worked closely with it on key projects affecting staff.

In 2012 the Society was one of the first financial services organisations to be awarded Gold status by Investors in People, a status that has been retained in successive years. This independent assessment highlighted the importance the Society attaches to positive employee relations and the success that it is achieving in this regard. This is reinforced by the results of the Society's 2014 employee opinion survey which, on a response rate of 90%, showed a level of staff engagement of 84% – a figure that is 10% higher than the financial services organisations surveyed by the same research company.

For further information see the Staff section of the Corporate Responsibility Report on page 55.

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 89, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' Remuneration Report, the Annual Business Statement and this Directors' Report.

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

The Group and Society Annual Accounts are required by law and IFRS as adopted by the EU to present fairly the financial position and the performance of the Group and the Society; the Building Societies Act 1986 provides in relation to such Annual Accounts that references in the relevant part of that Act to Annual Accounts giving a true and fair view are references to their achieving a fair presentation. The Act also requires the Annual Accounts to provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made thereunder.

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

- Select suitable accounting policies and apply them consistently.
- Make judgements and estimates that are reasonable and prudent.
- State whether they have been prepared in accordance with IFRS as adopted by the EU.
- Prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Group and Society will continue to trade.

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, in accordance with the Act.
- Takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business (in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000).

The directors have general 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 auditors are 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 auditors are 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 section of the Annual Report & Accounts (pages 1 to 56).

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 Business Review and Risk Management Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Directors' statement pursuant to the UK Corporate Governance Code

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

Details of the governance procedures which have been implemented to support this can be found in the Audit Committee report (page 66).

Directors' responsibilities in respect of going concern

In preparing the financial statements the directors must satisfy themselves that it is reasonable to adopt the going concern basis.

The Society meets its day-to-day liquidity requirements through managing both its retail and wholesale funding sources and is required to maintain a sufficient buffer over minimum regulatory capital requirements in order to continue to be authorised to carry on its business.

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 section of the Annual Report & Accounts (pages 1 to 56). 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 and business risk, along with details of its financial instruments and hedging activities.

The directors believe that the Society is well placed to manage its business risks, despite the current uncertain economic outlook. After considering factors including default rates on loans, house price movements and the Society's capital and liquidity position, including the use of stress testing, the directors are confident that the Society has adequate resources for the foreseeable future. Accordingly, the going concern basis continues to be adopted in preparing the Annual Report & Accounts.

Directors

The directors who served during the year are set out in the Directors' Report on Corporate Governance (pages 58 and 59).

The auditors

A resolution to reappoint Ernst & Young LLP as auditors of the Society will be proposed at the Annual General Meeting.

Approved by the Board of directors and signed on its behalf by

Ian Pickering
Chairman
26 February 2015

Independent Auditors' Report to the Members of Coventry Building Society

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, of the state of the Group's and the Society's affairs as at 31 December 2014 and of the Group's and the Society's income and expenditure for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the consolidated financial statements, Article 4 of the IAS Regulation.

What we have audited

We have audited the Group and Society financial statements of Coventry Building Society for the year ended 31 December 2014 which comprise the Group and Society Income Statements, the Group and Society Statements of Comprehensive Income, the Group and Society Statements of Financial Position, the Group and Society Statements of Changes in Members' Interests and Equity, the Group and Society Statements of Cash Flows and the related notes 1 to 34. The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

This report is made solely to the Society's members, as a body, in accordance with Section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Our assessment of risks of material misstatement and our primary responses

We identified the following risks of material misstatement that have had the greatest effect on the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the engagement team:

Description of risk	Primary audit responses
Revenue recognition including the risk of management override of internal control	
Interest income on mortgage loans is recognised using the Effective Interest Rate (EIR) method. This requires significant judgement about future events such as the expected life of each loan type and future interest rates. Fair value adjustments, which arose on merger with Stroud & Swindon Building Society and on acquisition of a mortgage portfolio from Bank of Ireland, include assumptions on interest rate yields and expected credit losses. The unwind of these adjustments involves management's judgement about the expected lives of the portfolios and the extent to which actual impairments differ from expected impairment loss assumptions.	We tested the completeness and accuracy of data on a sample basis from source systems to models, and agreed the model output to the general ledger. We challenged assumptions about the expected lives of loans by comparing them to recent actual redemption behaviour and compared assumptions about future changes in interest rates to market data and historical experience of mortgage yields. We recalculated the EIR asset for a sample of loans and agreed the total EIR balance to the general ledger. We challenged assumptions about the expected lives of loans by comparing them to recent actual performance. We compared the expected loss impairment component of fair value adjustments to actual losses incurred. In respect of both EIR and fair value adjustments we challenged assumptions and obtained supporting evidence for adjustments made by management to test the risk of fraud arising from management override of internal controls.

Description of risk	Primary audit responses
Hedge accounting and related fair value of financial instruments	
The Group uses fair value and cash flow hedge accounting to manage its interest rate and foreign currency risk. Hedge accounting is complex and therefore inherently more susceptible to error. The valuation of derivatives and any associated hedged items involves subjectivity in terms of valuation methodologies and data inputs used. IAS 39 *Financial Instruments* has specific requirements for the application of hedge accounting and correct identification of sources of ineffectiveness.	We assessed the compliance of hedge accounting documentation with accounting standards. We tested controls over the valuation of hedging instruments, and engaged our in-house derivative valuation specialists to perform independent valuations for a sample of hedge instruments, and we tested valuations of hedged items on a sample basis. We tested that sources of ineffectiveness were appropriately identified. We checked the accuracy of the resulting adjustments, including hedge accounting ineffectiveness, and agreed them to the general ledger accounts.
Impairment of retail mortgage loans	
The measurement of loan impairments requires judgement about the probability of default, and the likely loss in the event of default. The loss in event of default depends on the value of the secured property, assumptions on forced sale discounts and the costs to sell.	We tested the accuracy and completeness of data used within impairment models described in note 1 to the financial statements through reconciliation to source systems and independent testing of internal controls. We recalculated the probability of default derived by roll rates on a sample basis. We challenged management's judgements in key assumptions such as house price movements and compared forced sale discounts and costs to sell to recent actual experience.

The Board Audit Committee's consideration of these risks is set out on pages 65 and 66.

Our application of materiality

We apply the concept of materiality both in planning and performing the audit and in evaluating the effect of identified and unadjusted misstatements on the financial statements and in forming our opinion.

When establishing our overall audit strategy, we determined materiality for the Group to be £10.7 million (2013: £8.4 million), which is approximately 1% of members' interests and equity (excluding other equity instruments). Members' interests and equity is an important overall indicator of the financial strength of the Group and we consider members' interests and equity to be an appropriate basis for materiality given the Group focuses on its mutual status above maximisation of profit generation.

This provided a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that overall performance materiality (i.e. our tolerance for misstatement in an individual account or balance) should be 50% of materiality, namely £5.4 million (2013: £4.2 million). We used a proportion of this value for performing the audit work on the subsidiaries based on their individual contribution to the Group as a whole. Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in the financial statements did not exceed our materiality level. We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in the light of other relevant qualitative considerations.

We have reported to the Board Audit Committee all identified audit differences in excess of £0.5 million, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the accounting records and the financial statements; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or
- is otherwise misleading.

In particular, we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the directors' statement that they consider the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Board Audit Committee which we consider should have been disclosed.

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- proper accounting records have not been kept by the Society; or
- the Society financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 84, the directors are responsible for the preparation of the financial statements which give a true and fair view. Our responsibility is to audit and express an opinion on the Group and Society financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group and Society's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Steven Robb (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
Leeds
26 February 2015

Income Statements

For the year ended 31 December 2014

	Notes	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Interest receivable and similar income	3	885.3	854.5	764.3	790.2
Interest payable and similar charges	4	(544.0)	(601.4)	(527.5)	(624.5)
Net interest income		341.3	253.1	236.8	165.7
Fees and commissions receivable	5	11.1	12.1	9.5	10.7
Fees and commissions payable	6	(3.3)	(3.3)	(3.2)	(3.2)
Other operating income		0.4	0.5	0.2	0.3
Net (losses)/gains from derivative financial instruments	7	(0.7)	2.8	(3.6)	3.5
Total income		348.8	265.2	239.7	177.0
Administrative expenses	8	(112.3)	(98.2)	(105.2)	(91.8)
Amortisation of intangible assets	17	(6.3)	(4.7)	(6.3)	(4.7)
Depreciation of property, plant and equipment	18	(6.0)	(6.0)	(5.9)	(5.9)
Impairment losses on loans and advances to customers	10,16	(5.4)	(6.3)	(6.1)	(2.9)
Provisions for liabilities and charges	24	(15.3)	(16.3)	(15.3)	(16.3)
Charitable donation to Poppy Appeal		(1.7)	(1.6)	(1.7)	(1.6)
Profit before tax		201.8	132.1	99.2	53.8
Taxation	11	(43.3)	(30.8)	(21.3)	(12.2)
Profit for the financial year		158.5	101.3	77.9	41.6

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 2014

	Notes	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Profit for the financial year		158.5	101.3	77.9	41.6
Other comprehensive income					
Items that will not be transferred to the Income Statement:					
Remeasurement of defined benefit pension plan	19	(5.1)	(10.8)	(5.1)	(10.8)
Taxation	11	1.0	2.0	1.0	2.0
Effect of change in corporation tax rate	11	(0.1)	–	(0.1)	–
Items that may be transferred to the Income Statement:					
Available-for-sale investments:					
Fair value movements taken to reserves		81.7	(138.0)	81.7	(138.0)
Amount transferred to Income Statement	28	(66.8)	134.8	(66.8)	134.8
Taxation	11	(3.5)	0.7	(3.5)	0.7
Cash flow hedges:					
Fair value movements taken to reserves		(44.0)	(33.9)	(16.0)	(17.3)
Amount transferred to Income Statement		94.4	24.4	61.0	9.1
Taxation	11	(10.8)	2.0	(9.7)	1.7
Effect of change in corporation tax rate	11	0.7	–	0.6	–
Other comprehensive income for the year, net of tax		47.5	(18.8)	43.1	(17.8)
Total comprehensive income for the year, net of tax		206.0	82.5	121.0	23.8

The notes on pages 94 to 134 form part of these accounts.

Statement of Financial Position

As at 31 December 2014

	Notes	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Assets					
Cash and balances with the Bank of England	12	2,114.5	2,042.1	1,909.0	1,883.7
Loans and advances to credit institutions	13	180.5	179.3	184.1	86.7
Debt securities	14	1,655.2	1,666.0	1,608.2	1,646.0
Loans and advances to customers	15	26,959.6	24,117.1	18,016.0	16,195.2
Hedge accounting adjustment		98.1	(8.4)	98.1	(8.4)
Derivative financial instruments	23	208.3	191.2	135.9	129.5
Investments in subsidiary undertakings	16	–	–	8,884.1	7,852.3
Intangible assets	17	15.9	12.2	15.9	12.2
Property, plant and equipment	18	28.4	29.4	28.4	29.4
Investment properties	18	5.2	5.3	0.3	0.3
Pension benefit surplus	19	1.6	5.1	1.6	5.1
Deferred tax assets	20	5.0	8.3	2.7	5.6
Prepayments and accrued income		6.0	5.7	5.6	5.0
Total assets		31,278.3	28,253.3	30,889.9	27,842.6
Liabilities					
Shares		23,395.6	21,311.7	23,395.6	21,311.7
Deposits from banks	21	1,479.0	1,032.6	1,479.0	1,032.6
Other deposits		7.5	4.0	7.5	4.0
Amounts owed to other customers		452.3	337.1	452.3	337.1
Debt securities in issue	22	3,665.5	4,064.8	3,351.2	3,593.9
Hedge accounting adjustment		162.0	89.5	114.3	51.3
Derivative financial instruments	23	323.3	213.6	321.2	185.4
Current tax liabilities		21.6	16.1	10.7	7.9
Deferred tax liabilities	20	9.1	2.0	8.3	2.0
Accruals and deferred income		26.9	35.6	17.0	14.3
Other liabilities		16.3	21.7	193.4	272.6
Provisions for liabilities and charges	24	8.5	9.9	8.5	9.9
Subordinated liabilities	25	58.2	58.2	58.2	58.2
Subscribed capital	26	161.6	161.5	161.6	161.5
Total liabilities		29,787.4	27,358.3	29,578.8	27,042.4
Members' interests and equity					
General reserve		1,061.9	914.6	885.5	818.8
Other equity instruments	27	396.9	–	396.9	–
Available-for-sale reserve	28	(0.7)	(12.1)	(0.7)	(12.1)
Cash flow hedge reserve		32.8	(7.5)	29.4	(6.5)
Total members' interests and equity		1,490.9	895.0	1,311.1	800.2
Total members' interests, liabilities and equity		31,278.3	28,253.3	30,889.9	27,842.6

The notes on pages 94 to 134 form part of these accounts.

Approved by the Board of directors on 26 February 2015 and signed on its behalf by

Ian Pickering
Chairman

Mark Parsons
Chief Executive

John Lowe
Finance Director

Statement of Changes in Members' Interests and Equity

For the year ended 31 December 2014

Group	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2014	914.6	–	(12.1)	(7.5)	895.0
Profit for the financial year	158.5	–	–	–	158.5
Net remeasurement of defined benefit plan	(4.2)	–	–	–	(4.2)
Net movement in Available-for-sale reserve	–	–	11.4	–	11.4
Net movement in cash flow hedge reserve	–	–	–	40.3	40.3
Total comprehensive income	154.3	–	11.4	40.3	206.0
Issue of Additional Tier 1 capital*	–	396.9	–	–	396.9
Distribution to Additional Tier 1 capital holders**	(7.0)	–	–	–	(7.0)
As at 31 December 2014	1,061.9	396.9	(0.7)	32.8	1,490.9
As at 1 January 2013	822.1	–	(9.6)	–	812.5
Profit for the financial year	101.3	–	–	–	101.3
Net remeasurement of defined benefit plan	(8.8)	–	–	–	(8.8)
Net movement in Available-for-sale reserve	–	–	(2.5)	–	(2.5)
Net movement in cash flow hedge reserve	–	–	–	(7.5)	(7.5)
As at 31 December 2013	914.6	–	(12.1)	(7.5)	895.0

Society	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2014	818.8	–	(12.1)	(6.5)	800.2
Profit for the financial year	77.9	–	–	–	77.9
Net remeasurement of defined benefit plan	(4.2)	–	–	–	(4.2)
Net movement in Available-for-sale reserve	–	–	11.4	–	11.4
Net movement in cash flow hedge reserve	–	–	–	35.9	35.9
Total comprehensive income	73.7	–	11.4	35.9	121.0
Issue of Additional Tier 1 capital*	–	396.9	–	–	396.9
Distribution to Additional Tier 1 capital holders**	(7.0)	–	–	–	(7.0)
As at 31 December 2014	885.5	396.9	(0.7)	29.4	1,311.1
As at 1 January 2013	786.0	–	(9.6)	–	776.4
Profit for the financial year	41.6	–	–	–	41.6
Net remeasurement of defined benefit plan	(8.8)	–	–	–	(8.8)
Net movement in Available-for-sale reserve	–	–	(2.5)	–	(2.5)
Net movement in cash flow hedge reserve	–	–	–	(6.5)	(6.5)
As at 31 December 2013	818.8	–	(12.1)	(6.5)	800.2

* The issue of Additional Tier 1 capital is shown net of an associated tax credit of £0.8 million.
** The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £1.9 million.

The notes on pages 94 to 134 form part of these accounts.

Statements of Cash Flows

For the year ended 31 December 2014

	Notes	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Cash flows from operating activities					
Profit before tax		201.8	132.1	99.2	53.8
Adjustments for:					
Impairment provisions and other provisions	10,24	20.7	22.6	20.7	19.2
Depreciation and amortisation		12.3	10.7	12.2	10.6
Interest on subordinated liabilities and subscribed capital		16.4	16.4	16.4	16.4
Changes to fair value adjustment of hedged risk		42.2	(39.6)	64.1	(28.2)
Other non-cash movements		33.5	(9.9)	34.6	(10.9)
Non-cash items included in profit before tax		125.1	0.2	148.0	7.1
Loans to credit institutions		(72.0)	111.5	(98.1)	98.7
Loans and advances to customers		(2,847.3)	(2,106.1)	(1,826.2)	(1,261.0)
Prepayments, accrued income and other assets		(6.8)	(14.6)	(7.1)	(14.9)
Changes in operating assets		(2,926.1)	(2,009.2)	(1,931.4)	(1,177.2)
Shares		2,053.3	1,222.9	2,053.3	1,222.9
Deposits and other borrowings		565.2	197.4	565.2	197.4
Debt securities in issue		(55.9)	(90.3)	(56.5)	(90.5)
Accruals and deferred income and other liabilities		(30.8)	(28.0)	(0.3)	(4.1)
Changes in operating liabilities		2,531.8	1,302.0	2,561.7	1,325.7
Interest paid on subordinated liabilities and subscribed capital		(16.4)	(16.4)	(16.4)	(16.4)
Taxation		(37.2)	(17.9)	(37.2)	(18.1)
Net cash flows from operating activities		(121.0)	(609.2)	823.9	174.9
Cash flows from investing activities					
Purchase of investment securities		(313.2)	(573.3)	(73.0)	(553.3)
Sale and maturity of investment securities		405.8	1,110.5	192.6	1,085.5
Purchase of property, plant and equipment and intangible assets		(16.7)	(12.8)	(16.7)	(12.8)
Net cash flows from investing activities		75.9	524.4	102.9	519.4
Cash flows from financing activities					
Loans to connected undertakings		–	–	(1,105.8)	(1,119.5)
Issuance of Additional Tier 1 capital		396.1	–	396.1	–
Distributions paid to Additional Tier 1 capital holders		(8.9)	–	(8.9)	–
Repurchase and repayment of debt securities		(726.9)	(263.9)	(570.1)	–
Issue of debt securities		386.5	543.7	386.5	543.7
Net cash flows from financing activities		46.8	279.8	(902.2)	(575.8)
Net increase in cash		1.7	195.0	24.6	118.5
Cash and cash equivalents at start of year		2,071.6	1,876.6	1,843.2	1,724.7
Cash and cash equivalents at end of year		2,073.3	2,071.6	1,867.8	1,843.2
Cash and cash equivalents:					
Cash and balances with central banks	12	2,073.3	2,001.6	1,867.8	1,843.2
Loans and advances to credit institutions		–	70.0	–	–
		2,073.3	2,071.6	1,867.8	1,843.2

The notes on pages 94 to 134 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 have been prepared on an historical cost basis, as modified by the revaluation of Available-for-sale 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 below.

Basis of consolidation

The Group accounts consolidate the assets, liabilities and results of the Society and all its subsidiary companies.

Subsidiaries are all entities, including special purpose entities (SPE), controlled by the Society. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the subsidiary and has the ability to affect those returns, through its power over the entity, voting rights, or in the case of an SPE, by establishing the form of the securitisation agreements.

The Society's investment in its subsidiaries is recognised on the Statement of Financial Position at cost. Intra-Group transactions and balances and unrealised gains on transactions between intra-Group companies are eliminated in the consolidated accounts.

Changes in accounting policy

The following standards and interpretations, relevant to the Group, have been adopted with effect from 1 January 2014.

Pronouncement	Nature of change
IFRS 10,11,12 and amendments to IAS 27 and 28	A package of five new and revised standards addressing the accounting for consolidation, involvements in joint ventures and disclosure of involvements with other entities. The Society has determined that the new and revised standards have had no impact on which entities are consolidated within the Group. Some additional disclosures have been included in note 15.

Future accounting developments

The following standards, relevant to the Group's future reporting, were not effective as at 31 December 2014 and have not been applied in preparing these financial statements.

Pronouncement	Nature of change	Periods beginning on or after
IFRS 15 *Revenue from contracts with customers*	IFRS 15 replaces IAS 18 *Revenue* and provides a new model for revenue recognition. Financial instruments are outside the scope of IFRS 15. The Group is currently assessing the impact IFRS 15 will have on its financial statements. However, given the nature of Group's activities it is not currently anticipated that IFRS 15 will have a significant impact for the Group.	1 January 2017 (subject to EU endorsement)
IFRS 9 *Financial Instruments*	A final version of IFRS 9 was issued in July 2014 to replace IAS 39. IFRS 9 will lead to changes to the classification and measurement of the Group's financial assets and liabilities, in the recognition of impairment and in relation to hedge accounting. The Group is currently assessing the impact that IFRS 9 will have on its financial statements. Due to the complexity of the new requirements, it is not possible at this stage to quantify the potential effects of implementing IFRS 9 although it is expected to have a significant impact for the Group in line with the wider industry.	1 January 2018 (subject to EU endorsement)

Securitisation and covered bond transactions

The Group has securitised certain mortgage loans by the transfer of the loans to SPEs controlled by the Group. The securitisations enable subsequent issuance of debt to investors, who gain the security of the underlying assets as collateral. The SPEs are fully consolidated into the Group accounts.

The transfers of the mortgage loans to the SPEs are not treated as sales by the transferring entity and are not derecognised. The continued recognition of the mortgage loans on the transferor's own Statement of Financial Position is because it retains the risks and rewards of the mortgage loans through the receipt of substantially all of the profits of the SPEs. For securitisations, in the accounts of the Society, the proceeds received from the transfer of mortgage loans are accounted for as a deemed loan repayable to the SPEs disclosed within other liabilities on the Statement of Financial Position.

For covered bonds the position is different, as the Society itself and not the SPE issues the covered bonds and then lends the proceeds on back to back terms to the covered bond SPE. Therefore, in the accounts of the Society, the loan to the SPE and the consideration for the transfer of mortgage loans are not recognised separately as an additional asset and liability. This avoids the 'grossing up' of the financial statements that would otherwise arise.

1. Accounting policies continued

Securitisation and covered bond transactions continued

The Group has also entered into issuances of debt to be used as collateral for central government schemes or sale and repurchase agreements and similar transactions. Some or all of the issuances of debt may be retained by the Society (self-issued debt). Investments in self-issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Society's financial statements. This avoids the 'grossing up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the SPEs, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, 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. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations are treated as explained in the derivatives and hedging accounting policy (see page 100).

Funding for Lending Scheme

The Society participates in the Funding for Lending Scheme (FLS), which provides Treasury bills in return for eligible collateral including approved mortgage portfolios, self-issued covered bonds and self-issued Residential Mortgage Backed Securities (RMBS). The first phase of the FLS ended on 31 January 2014 with all transactions maturing within four years of that date. An extension to the scheme was granted up to 31 January 2015, and then subsequently to 31 January 2016, with all transactions under the extension period maturing within four years. The Society was active in both phases of the scheme. FLS transactions do not involve the transfer of risk on the collateral and hence fail the derecognition criteria under IAS 39. Therefore, for accounting purposes, the underlying collateral is retained on balance sheet and the Treasury bills are not.

Interest receivable and interest payable

For instruments measured at amortised cost the Effective Interest Rate (EIR) method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The EIR is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

In calculating the EIR, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees received and paid and costs borne that are an integral part of the EIR and all other premiums above or below market rates.

Interest income on Available-for-sale debt securities is included in interest receivable and similar income.

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 services are provided, or on the completion of an act to which the fee relates.

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 Statement of Financial Position 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 the deductible temporary differences, carried forward tax credits or tax losses 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 settled based on the tax rates and laws enacted or substantively enacted at the Statement of Financial Position date.

Corporation tax is charged or credited directly to other comprehensive income if it relates to items that are credited or charged to other comprehensive income and to the Statements of Changes in Members' Interests and Equity if it relates to other equity instruments. Otherwise corporation tax is recognised in the Income Statement.

Segmental reporting

The Group operates solely within the retail financial services sector and within the United Kingdom. As such, no segmental analysis is required.

Financial assets

The Group classifies its financial assets at inception into the following categories:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's residential mortgage loans, unsecured lending and loans to credit institutions are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the EIR method less provisions for impairment.

Loans and receivables 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 loans and receivables. Fair value adjustments are made to reflect both credit risk and interest yield associated with the acquired loan assets. Any discount between book value and the fair value is recognised in interest receivable and similar income using the EIR method, except for any specific credit impairment provisions which are either utilised against non-performing assets or released to interest receivable and similar income if assumptions around the future asset performance are revised.

For a portfolio acquisition the fair value is normally assumed to be the transaction price (i.e. the consideration paid). However, the fair value may differ from the transaction price in certain circumstances. Where the valuation technique is based on observable market data only, the gain or loss arising from the difference between the fair value and the transaction price is recognised immediately. In circumstances where other inputs are required in the valuation of the portfolio, any gain or loss arising from the difference between the fair value and the transaction price is recognised over an appropriate period of time.

1. Accounting policies continued

Financial assets continued

Fair value through profit or loss

All derivatives are carried at fair value and are initially recognised at the trade date.

For those derivatives in fair value hedge accounting relationships and for any derivatives not in a hedge accounting relationship, gains and losses arising from changes in the fair values 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 note (page 100).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in other comprehensive income as set out in the hedge accounting policy note for cash flow hedges (page 100).

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are designated as such or not classified into either of the two categories above. Available-for-sale assets comprise debt securities, such as certificates of deposit and gilts.

Available-for-sale assets are measured at fair value. The fair values, in the majority of cases, are based on quoted market prices or prices obtained from market intermediaries. In cases where quoted market prices are not available, discounted cash flow valuations are used. Unrealised gains and losses arising from changes in fair value are recognised directly in the Available-for-sale reserve, 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 Available-for-sale assets, including any cumulative gains or losses previously recognised in the Available-for-sale reserve, are recognised in the Income Statement.

When a decline in the fair value of an Available-for-sale financial asset has been recognised directly in Available-for-sale reserve and there is objective evidence that the asset is impaired, the cumulative loss recognised in Available-for-sale reserve is removed and recognised in the Income Statement.

Financial assets are derecognised when the rights to receive cash flows have expired or where substantially all the risks and rewards of ownership have been transferred.

Impairment of loans and advances to customers

The Group assesses its loans and advances to customers for objective evidence of impairment at each Statement of Financial Position date. An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the Statement of Financial Position date and has a reliably measurable impact on the estimated future cash flows.

Impairment is categorised as either individual impairment (where individual assets have been assessed for loss) or collective impairment (where losses are assessed as being present in a portfolio of loans, but they cannot be attributed to individual accounts). As well as loans that are individually or collectively identified as being impaired, recognition is also made of accounts where forbearance has been exercised and agreement has been reached with customers in financial difficulty to temporarily forgo some element of the payment due or where other impairment indicators are present.

If there is objective evidence that an impairment loss on loans and advances to customers has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred).

Estimating future cash flows
Future cash flows are based upon prudent assumptions about the value of the property representing the underlying security for the mortgage, workout costs that might be incurred in realising the value of the property (i.e. following repossession and sale), the likelihood of repossession and the time it takes to repossess and sell properties.

- All properties being used as security are valued at the outset of the loan and, if a further advance is made during the lifetime of the loan, at the time of the further advance.
- Once the value of the property has been established, the Nationwide regional House Price Index is used to provide an updated estimate of the property's value, on a quarterly basis.
- Assumptions are continuously updated to reflect the time taken to sell a repossessed property and the likely discount to the latest property valuation. Typically, the forced sale discount averages 27% of the property value.
- No assumptions are made as to the future value of properties beyond the estimation of a discount for the forced sale that results from a repossession of a mortgaged property.

Individual assessment of impairment
The identification of loans for individual assessment of impairment is via a set days-past-due trigger being met or if, in the opinion of management, there is evidence that individually identifiable loans are impaired even if a set days-past-due trigger has not yet been met. For example, a small number of customers have been declared bankrupt but continue to make their mortgage repayments as scheduled. These customers can be individually identified and therefore an individual assessment can be made as to the level of potential impairment.

The Group employs various models to assess the level of impairment. These include models to predict roll rates to default, the likelihood of possession given default, and shortfalls in property values over loan balances after accounting for expected costs, the effects of forced sale, and updated valuations including via house price indexation. The assumptions in these models capture the differing experience of different mortgage types, and are updated regularly to reflect ongoing experience, with overlays to ensure appropriate judgement is reflected in the final assessment of impairment.

Collective assessment of impairment
A variety of collective impairment assessments have been made against segments of the mortgage book where there is objective evidence of an impairment event impacting that segment, but which cannot be individually attributed, or more generally where there is evidence of an increased risk of credit losses being present but, again, where the risks cannot be individually attributed. Examples of segments where collective assessments of impairment have been conducted include provisions held to collectively address the risk that in a downturn, issues will emerge that will adversely affect the value and saleability of properties, something that would otherwise be masked in a growing housing market.

Forbearance impairment assessment
Assessment has also been made of customers who are undergoing some measure of forbearance. Evidence-based results are used to identify potential forbearance indicators, measure the performance of accounts with these indicators and determine the level of impairment provision required.

Use of overlays
Management applies overlays to assumptions to ensure that an appropriate level of conservatism in cash flow forecasts is employed. For instance, current point-in-time experience may be for an improvement in a particular roll rate, but if the longer-term view is that the risk remains higher than the short-term backwards looking experience used in the model, an overlay may be applied to reflect forward looking judgement of cash flows. An example is in values applied in the 'probability of possession from default' assumption. The applied probabilities of possession are generally more conservative than the current short-term experience to accommodate the fact that the likelihood of possession may increase in the event of a further economic downturn.

1. Accounting policies continued

Impairment of loans and advances to customers continued

Recognition of post-impairment improvement

Impairment provisions are raised as the risk is recognised and measured. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the impairment provision. The amount of the reversal is recognised in the Income Statement.

Write-off policy and recognition of post-loss recoveries

When a loan is not collectable, it is written off against the related provision for loan impairment (see note 10). Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the Income Statement.

Sale and repurchase agreements

Securities sold subject to a commitment to repurchase them are retained on the Statement of Financial Position when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately on the Statement of Financial Position, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the EIR method.

Derivative financial instruments

The Group holds derivative financial instruments to manage the risks associated with its various fixed and capped rate assets, its fixed rate liabilities and its foreign currency transactions. In accordance with legislation and its treasury policy, the Group holds derivative financial instruments only for risk management and not for speculative or trading purposes.

All 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. For collateralised positions the Group uses discount curves based on overnight indexed swap (OIS) rates and for non-collateralised positions the Group uses discount curves based on term LIBOR rates. In measuring fair value, separate adjustments are made for credit risk to the extent not already included in the valuation.

Hedge accounting

All derivatives entered into by the Group are for the purpose of providing an economic hedge. Where the criteria set out in IAS 39 are met, the Group uses hedge accounting and designates the hedging derivative as either hedging fair value or cash flow risks.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement under net (losses)/gains from derivative financial instruments 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 Available-for-sale financial asset.

Cash flow hedges

Changes in the effective part of any gain or loss on the derivative financial instrument hedging the variability in cash flows of a recognised asset or liability are recognised directly through other comprehensive income in the cash flow hedge reserve. In the periods in which the hedged item affects profit or loss, these changes in value are reclassified to the Income Statement in the line item affected by the hedged item. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. The hedged risks for cash flow hedges are interest rate risk and currency risk (euro to sterling).

Leases and contract purchase agreements

Where the Group enters into a lease that entails taking substantially all the risks and rewards of ownership of an asset, the agreement is treated as a finance lease. The asset is recorded on the Statement of Financial Position within property, plant and equipment and is depreciated over its estimated useful life. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life. Future instalments under such leases, net of finance charges, are included within other liabilities. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the capital element, which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and payments are charged to administrative expenses on a straight line basis over the period of the lease. Rents receivable are credited to other operating income on a straight line basis over the period of the lease.

Intangible assets

Software development costs and purchased software that is not an integral part of a related hardware purchase are recognised as an intangible asset. Amortisation of such assets is charged to the Income Statement on a straight line basis over the useful life of the asset. The useful life of computer software is between three and eight years.

Investment properties and property, plant and equipment

Investment property is property held to earn rentals or for capital appreciation or for both, rather than for sale or use in the business. The Group recognises investment properties at cost less accumulated depreciation and any accumulated impairment. The carrying values of investment properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

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 for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

An asset's carrying value is written down immediately to its recoverable amount if the asset's carrying value is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying value of the asset and are included within the Income Statement.

Depreciation is provided on a straight line basis over the anticipated useful life of the asset as follows:

Freehold buildings (including investment properties)	Over a period of 50 years
Leasehold buildings	Shorter of remaining term of the lease and useful life
Equipment, fixtures, fittings and vehicles	Three to eight years

1. Accounting policies continued

Employee benefits

Pensions

The Group operates a defined benefit pension scheme and a defined contribution scheme for members of staff.

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 the current and prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds. This calculation allows the net obligation of the scheme to be expressed as either a surplus or deficit, which is recognised as either an asset or liability respectively in the Group's accounts at the Statement of Financial Position date.

Pension costs for service in the period are assessed in accordance with advice from a qualified actuary and are recognised in the Income Statement. 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 year in which they are earned is recognised in the year in which the employees render the related service and when there is an obligation to pay a bonus under the terms of the scheme.

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 incorporates shares, bank and other deposits, amounts owed to other customers, debt securities in issue, derivative financial liabilities, subordinated liabilities and subscribed capital. The Group classifies its financial liabilities into the following categories:

Amortised cost

Financial liabilities (other than derivatives) are measured on an amortised cost basis. This represents the face value adjusted for any unamortised premiums, discounts and transaction costs directly attributable to the acquisition or issue. The amortisation is recognised in interest payable and similar charges using the EIR method.

Financial liabilities are derecognised when the obligation is discharged, cancelled or has expired.

Fair value through profit or loss

All derivatives are carried at fair value.

For those derivatives in fair value hedge accounting relationships and for any derivatives not in a hedge accounting relationship, gains and losses arising from changes in the fair values 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 note (see page 100).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in other comprehensive income as set out in the hedge accounting policy note for cash flow hedges (see page 100).

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.

Contingent liabilities are potential obligations from past events which shall be confirmed by future events. Contingent liabilities are not recognised within the Statement of Financial Position unless arising from a business combination.

Equity instruments

Issued 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. Costs incurred that are incremental and directly attributable to the issuance are deducted from the proceeds (net of applicable tax) and are not amortised.

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, from the general reserve.

During the year the Group issued its first Capital Requirement Directive IV (CRD IV) compliant Additional Tier 1 (AT 1) capital instruments. It has classified these as equity as they pay a fully discretionary, non-cumulative coupon; have no fixed maturity date; are repayable at the option of the Society only (subject to regulatory permission) but with no step up in interest or any other incentive to redeem. Should the Society's capital levels breach a pre-defined limit, these instruments permanently convert into Common Equity Tier 1 capital (core capital deferred shares – CCDS). As such the Group does not have a present obligation as set out in the first paragraph above. Further information on AT 1 capital is included in note 27.

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 Statement of Financial Position date. Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the Income Statement.

Cash and cash equivalents

For the purposes of the statements of cash flows, cash and cash equivalents 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 are included within the Risk Management Report as follows:

- Credit risk (pages 24 to 34).
- Market risk (pages 34 to 37).
- Liquidity and funding risk (pages 37 to 44).

A maturity analysis for all assets and liabilities is presented in a table, on page 40.
Audited information is also included within the Directors' Remuneration Report on pages 76 to 82.

These disclosures, where marked as 'audited', are covered by the Independent Auditors' Report on pages 86 to 89.

2. Judgement in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgement and estimates are disclosed are in the following notes:

Area of significant judgement and estimate	Note
Mortgage EIR	3
Fair value adjustments in respect of acquired assets	3
Impairment provisions on loans and advances to customers	10
Pension scheme	19
Valuation of Level 3 derivatives	31

3. Interest receivable and similar income

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
On loans fully secured on residential property	909.0	865.0	543.5	525.3
On other loans				
Connected undertakings	–	–	246.4	277.9
Other	2.7	3.3	1.9	2.1
	911.7	868.3	791.8	805.3
Interest and other income on debt securities	40.5	56.5	39.7	56.0
Interest and other income on other liquid assets	10.9	8.7	10.6	7.9
Net expense on financial instruments hedging assets	(77.8)	(79.0)	(77.8)	(79.0)
Total	885.3	854.5	764.3	790.2

Included within interest receivable and similar income is interest accrued of £5.3 million (2013: £7.1 million) for the Group and £3.3 million (2013: £4.6 million) for the Society on impaired loans and advances to customers.

Critical accounting estimates and judgements

The Group recognises interest on loans and advances to customers on the basis of their EIR. This is a constant rate that averages out the effect of incentives and fees across the expected life of the loan account. A critical assumption in the calculation is the expected life, as this determines the assumed period over which customers may be paying various differentiated interest 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 balance arising from actual product life experience, differing from the assumed life, are periodically calculated and an adjustment made to the loan balance, with a corresponding adjustment to interest receivable and similar income. A decrease in the average expected life of one month would result in a decrease in loans and advances to customers of £6.3 million, with a corresponding reduction to income in the Income Statement. Assumptions as to future market interest rates also affect the calculation. A relative increase in market rates of five basis points per annum over five years would result in a decrease in loans and advances to customers of £12.2 million with a corresponding reduction to income in the Income Statement.

Where assets are acquired as a result of merger or via the purchase of mortgage portfolios, management is required to estimate the expected life and associated cash flows of the assets and amortise the fair value adjustments over this period. Similarly management is required to estimate a suitable period to amortise the impact of any transactions where the transaction price differed from fair value. If different assumptions were made then the impact of these adjustments would be recognised over longer or shorter periods. The impact of increasing the length of these assumptions by one year would have reduced profits by £4.9 million.

4. Interest payable and similar charges

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Bank and customer				
Subordinated liabilities	4.2	4.2	4.2	4.2
Other	14.7	11.5	14.7	11.5
Debt securities in issue	136.8	138.1	97.6	134.8
Other borrowed funds				
On shares held by individuals	437.8	497.8	437.8	497.8
On other shares	0.1	0.1	0.1	0.1
On subscribed capital	12.2	12.2	12.2	12.2
On loans from connected undertakings	–	–	5.4	7.0
Net income on financial instruments hedging liabilities	(61.8)	(62.5)	(44.5)	(43.1)
Total	544.0	601.4	527.5	624.5

5. Fees and commissions receivable

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Mortgage related fees	4.7	4.1	3.1	2.7
General insurance commissions	4.6	5.8	4.6	5.8
Other fees and commissions	1.8	2.2	1.8	2.2
Total	11.1	12.1	9.5	10.7

6. Fees and commissions payable

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Banking fees	2.2	2.3	2.1	2.2
Other fees and commissions	1.1	1.0	1.1	1.0
Total	3.3	3.3	3.2	3.2

7. Net (losses)/gains from derivative financial instruments

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
(Losses)/gains on derivatives designated as fair value hedges	(101.6)	86.9	(112.4)	129.2
Movement in fair value of hedged items attributable to hedged risk	100.1	(82.8)	109.6	(124.3)
	(1.5)	4.1	(2.8)	4.9
Derivatives designated as cash flow hedges*	0.8	(1.2)	0.6	0.1
Losses on other derivatives	–	(0.1)	(1.4)	(1.5)
Total	(0.7)	2.8	(3.6)	3.5

* Represents ineffectiveness on cash flow hedge relationships which will mature in one to five years.

8. Administrative expenses

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Employee costs				
Wages and salaries	57.8	51.7	57.8	51.7
Social security costs	5.6	5.2	5.6	5.2
Pension costs				
Defined benefit plan (note 19)	(0.2)	0.4	(0.2)	0.4
Defined contribution plan	4.0	2.8	4.0	2.8
	67.2	60.1	67.2	60.1
Other expenses				
Loss on disposal of property, plant and equipment	1.6	–	1.6	–
Premises and facilities	10.5	9.8	10.5	9.8
Other	33.0	28.3	25.9	21.9
Total	112.3	98.2	105.2	91.8

The remuneration of the auditors, Ernst & Young LLP, is set out below:

Group and Society	2014 £m	2013 £m
Audit of the annual accounts	0.2	0.2
Audit related assurance services – subsidiary audits	0.1	0.1
Other assurance services	0.1	–
Total	0.4	0.3

The Group's policy in relation to the use of its auditors on non-audit engagements sets out the nature of services they are generally precluded from performing. Further details on the Society's policy is included within the Board Audit Committee Report on page 68. All non-audit engagements provided by the Group's auditors, are subject to pre-approval by either the Board Audit Committee or the Finance Director (on a limited delegated basis from the Board Audit Committee), depending upon the nature of the non-audit engagement.

9. Staff numbers

Group and Society	2014 Full time	2014 Part time	2013 Full time	2013 Part time
The average number of persons employed during the year (including executive directors) was:				
Head office and administrative centres	1,131	302	1,019	287
Branches	371	261	377	242
Total	1,502	563	1,396	529

The average number of employees on a full time equivalent basis was 1,850 (2013: 1,708) and all of these are employed within the United Kingdom.

10. Impairment provisions on loans and advances to customers

Impairment provisions have been deducted from the appropriate asset values on the Statement of Financial Position. The incurred loss element of the fair value adjustments arising from the merger with Stroud & Swindon Building Society in 2010 of £5.2 million (2013: £6.0 million) has been included within the opening and closing provisions in the tables below.

Group	Loans fully secured on residential property 2014 £m	Other loans 2014 £m	Total 2014 £m	Loans fully secured on residential property 2013 £m	Other loans 2013 £m	Total 2013 £m
At 1 January						
Individual impairment	16.2	1.3	17.5	18.8	1.4	20.2
Collective impairment	9.1	0.8	9.9	7.0	0.4	7.4
	25.3	2.1	27.4	25.8	1.8	27.6
Charge for the year						
Individual impairment	1.7	3.6	5.3	4.4	0.4	4.8
Collective impairment	0.1	–	0.1	1.6	(0.1)	1.5
	1.8	3.6	5.4	6.0	0.3	6.3
(Credit)/Charge set against fair value adjustment	(0.4)	(0.2)	(0.6)	0.8	0.8	1.6
Amounts written off	(5.8)	(0.3)	(6.1)	(7.3)	(0.8)	(8.1)
At 31 December						
Individual impairment	11.7	4.4	16.1	16.2	1.3	17.5
Collective impairment	9.2	0.8	10.0	9.1	0.8	9.9
Total	20.9	5.2	26.1	25.3	2.1	27.4

Society	Loans fully secured on residential property 2014 £m	Other loans 2014 £m	Total 2014 £m	Loans fully secured on residential property 2013 £m	Other loans 2013 £m	Total 2013 £m
At 1 January						
Individual impairment	9.2	0.5	9.7	10.5	1.0	11.5
Collective impairment	3.4	0.2	3.6	3.5	0.3	3.8
	12.6	0.7	13.3	14.0	1.3	15.3
Charge for the year						
Individual impairment	1.4	3.5	4.9	2.8	0.2	3.0
Collective impairment	0.5	–	0.5	–	(0.1)	(0.1)
	1.9	3.5	5.4	2.8	0.1	2.9
Charge set against fair value adjustment	0.1	–	0.1	–	–	–
Amounts written off	(4.1)	(0.1)	(4.2)	(4.2)	(0.7)	(4.9)
At 31 December						
Individual impairment	6.6	3.9	10.5	9.2	0.5	9.7
Collective impairment	3.9	0.2	4.1	3.4	0.2	3.6
Total	10.5	4.1	14.6	12.6	0.7	13.3

10. Impairment provisions on loans and advances to customers continued

Of the 2014 impairment charge, £3.5 million (2013: nil) relates to a holding in Arkose Funding Limited, a related party to the Group.

When arriving at the impairment provision, the Group has considered accounts with forbearance and other potential impairment indicators. See pages 30 and 31 for further details.

Critical accounting estimates and judgements

In accordance with the accounting policy described in note 1, impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of discounted future cash flows. Key assumptions include the probability of any account going into default, the probability of defaulting accounts progressing to possession and the eventual loss incurred in the event of forced sale or write-off. These assumptions are based on observable historical data and updated as management considers appropriate to reflect current conditions.

If average regional house prices were to fall by 10%, the impact on the impairment provision would be an increase of £2.3 million. If the probability of defaulting accounts progressing to possession decreased by 5% the impact on the impairment provision would be a decrease of £0.8 million.

11. Taxation

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Current tax				
UK corporation tax at 21.5% (2013: 23.25%)	42.6	32.5	20.8	14.9
UK corporation tax – adjustment in respect of prior years	(0.2)	(0.3)	(0.2)	(0.3)
Total current tax	42.4	32.2	20.6	14.6
Deferred tax				
Current year	0.9	1.6	0.7	0.6
Adjustment in respect of prior years	–	0.2	–	0.2
Change in accounting policy – Financial Services Compensation Scheme (FSCS)	–	(3.2)	–	(3.2)
Total deferred tax	0.9	(1.4)	0.7	(2.4)
Total	43.3	30.8	21.3	12.2

The effective tax rate for the year is 21.5% (2013: 23.3%) for the Group and 21.5% (2013: 22.7%) for the Society. A reconciliation between tax expense and the accounting profit multiplied by the UK standard corporation tax rate of 21.5% (2013: 23.25%) is as follows:

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Profit before tax (PBT)	201.8	132.1	99.2	53.8
Tax at UK standard rate of corporation tax on PBT of 21.5% (2013: 23.25%)	43.4	30.7	21.3	12.5
Adjustments in respect of prior years	(0.2)	(0.1)	(0.2)	(0.1)
Effect of rate change	–	0.1	–	(0.4)
Expenses not deductible for tax purposes	0.1	0.1	0.2	0.2
Total	43.3	30.8	21.3	12.2

The tax on items reported through other comprehensive income is as follows:

Statement of Comprehensive Income	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Tax credit on remeasurement of defined benefit pension plan	(1.0)	(2.0)	(1.0)	(2.0)
Tax charge/(credit) on Available-for-sale movements	3.5	(0.7)	3.5	(0.7)
Tax charge/(credit) on cash flow hedges	10.8	(2.0)	9.7	(1.7)
Effect of change in corporation tax rate	(0.6)	–	(0.5)	–
Total	12.7	(4.7)	11.7	(4.4)

The tax on other items reported through the Statements of Changes in Members' Interests and Equity is as follows:

Statement of Changes in Members' Interests and Equity	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Tax credit on issuance costs of Additional Tier 1 capital	(0.8)	–	(0.8)	–
Tax credit on Additional Tier 1 capital distribution	(1.9)	–	(1.9)	–
Total	(2.7)	–	(2.7)	–

Further information relating to deferred tax is presented in note 20.

12. Cash and balances with the Bank of England

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Cash and balances with the Bank of England other than mandatory reserve deposits	2,073.3	2,001.6	1,867.8	1,843.2
Mandatory reserve with the Bank of England	41.2	40.5	41.2	40.5
Total	2,114.5	2,042.1	1,909.0	1,883.7

The £1,871.2 million (2013: £1,848.4 million) cash and balances with the Bank of England included in the Group liquidity resources table on page 38 excludes the £41.2 million (2013: £40.5 million) mandatory reserve with the Bank of England and £202.1 million (2013: £153.2 million) of cash held in the Group's covered bond and RMBS programmes as neither of these is available for use in the Group's day-to-day operations.

13. Loans and advances to credit institutions

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Loans and advances to credit institutions have remaining maturities as follows:				
Accrued interest	–	0.1	–	–
Repayable on demand	180.5	84.2	184.1	86.7
Other loans and advances by residual maturity repayable:				
In not more than three months	–	70.0	–	–
In more than three months but not more than one year	–	25.0	–	–
Total	180.5	179.3	184.1	86.7

The Group liquidity resources table on page 38 excludes the above £180.5 million (2013: £84.2 million) held in collateral accounts with counterparties relating to interest rate swap agreements and sale and repurchase transactions and £nil (2013: £95.1 million) held in the Group's covered bond and RMBS programmes as neither of these is available for use in the Group's day-to-day activities.

14. Debt securities

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Available-for-sale:				
UK Government investment securities	1,433.5	1,333.8	1,386.5	1,313.8
Other listed transferable debt securities	221.7	332.2	221.7	332.2
Total	1,655.2	1,666.0	1,608.2	1,646.0
Movements during the year are analysed below:				
At 1 January	1,666.0	2,338.2	1,646.0	2,313.2
Additions	313.2	573.3	73.0	553.3
Maturities and disposals	(405.8)	(1,110.5)	(192.6)	(1,085.5)
Changes in fair value	81.8	(135.0)	81.8	(135.0)
At 31 December	1,655.2	1,666.0	1,608.2	1,646.0

A maturity analysis of the Group debt securities is included in a table, on page 40. The Society's debt securities are not materially different.

Pledged assets ('Encumbrance') – Sale and repurchase transactions of debt securities

As part of its liquidity management, the Group enters into sale and repurchase agreements, whereby the Group sells but agrees to repurchase assets at a future date, typically up to three months away. UK Government investment securities have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership. The Group is unable to use, sell or pledge the transferred assets for the duration of the transaction and remains exposed to any associated interest rate risk and credit risk of the assets. Proceeds of these sale and repurchase agreements are included within deposits from banks (see note 21).

	Pledged 2014 £m	Proceeds 2014 £m	Pledged 2013 £m	Proceeds 2013 £m
Available-for-sale:				
UK Government investment securities	712.7	708.3	244.4	248.6

The £895.5 million (2013: £1,401.6 million) of on-balance sheet debt securities included in the Group liquidity resources table on page 38 excludes £712.7 million (2013: £244.4 million) of pledged assets and £47.0 million (2013: £20.0 million) in the Group's covered bond and RMBS programmes as neither of these is available for use in the Group's day-to-day activities.

Although not included on the Statement of Financial Position, the Group has received FLS Treasury bills with a market value of £1,322.6 million (2013: £1,348.2 million). Subsequently, Treasury bills with a market value of £706.3 million (2013: £705.4 million) were pledged as part of sale and repurchase agreements for proceeds of £700.4 million (2013: £700.1 million) included in deposits from banks (see note 21).

Again, although not included on the Statement of Financial Position, the Group has received UK Government investment securities with a market value of £38.9 million (2013: £34.0 million) pledged by counterparties under interest rate swap agreements (see note 32).

15. Loans and advances to customers

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Residential				
Owner-occupier mortgages	16,826.2	15,149.2	16,065.0	14,230.8
Buy to let mortgages	9,647.9	8,410.4	1,745.4	1,733.0
Near-prime mortgages	104.1	114.1	6.6	7.3
Self-certification mortgages	330.3	380.5	167.6	184.5
Other				
Commercial mortgages	5.5	7.3	1.1	1.3
Unsecured personal loans	45.6	55.6	30.3	38.3
Total	26,959.6	24,117.1	18,016.0	16,195.2

Maturity analysis

The remaining maturity of loans and advances to customers at the Statement of Financial Position date is as follows:

	Note	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
In not more than one year		2,122.8	1,941.9	1,398.6	1,300.7
In more than one year		24,862.9	22,202.6	16,632.0	14,907.8
		26,985.7	24,144.5	18,030.6	16,208.5
Impairment provision	10	(26.1)	(27.4)	(14.6)	(13.3)
Total		26,959.6	24,117.1	18,016.0	16,195.2

The maturity analysis is based on contractual maturity not actual redemption levels experienced by the Group or Society.

15. 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. The programmes have enabled the Group to obtain secured funding.

Loans and advances to customers pledged to support the programmes and the FLS, and the notes in issue are as follows:

		Notes in issue			
2014	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	4,359.7	1,660.6	1,400.0	–	3,060.6
Securitisation programme – Leofric No.1 plc	527.1	314.3	–	52.5	366.8
Securitisation programme – Mercia No.1 plc	1,539.1	–	308.1	1,128.3	1,436.4
Whole mortgage loan pools	3,142.5	–	–	3,142.5	3,142.5
Total	9,568.4	1,974.9	1,708.1	4,323.3	8,006.3

		Notes in issue			
2013	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	4,320.1	1,817.3	1,400.0	–	3,217.3
Securitisation programme – Leofric No.1 plc	694.1	470.9	–	78.7	549.6
Securitisation programme – Mercia No.1 plc	1,535.0	–	–	1,436.4	1,436.4
Whole mortgage loan pools	3,852.7	–	408.6	3,444.1	3,852.7
Total	10,401.9	2,288.2	1,808.6	4,959.2	9,056.0

Mortgages pledged are not derecognised from the Group or Society Statements of Financial Position as the Group has retained substantially all the risk and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

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 the FLS, subject to a 'haircut' as defined by the Bank of England. Therefore, balances shown in the table above under notes in issue are the outstanding balances of the mortgages.

Notes in issue and held by third parties are included within debt securities in issue (note 22).

Notes in issue, held by the Group and drawn include debt securities issued by the covered bond programme to the Society and those issued by the Mercia securitisation programme, 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 Statements of Financial Position, thus preventing inappropriate grossing up of the Group and Society Statements of Financial Position.

Covered bonds

The Group established Coventry Building Society Covered Bonds LLP (LLP) in July 2008, initially in order to provide security for issues of self-issued covered bonds and subsequently for external issuances. As at 31 December 2014, the Society had in issue £2,650.0 million (2013: £2,650.0 million) and €500.0 million (2013: €650.0 million) of covered bonds; of which £1,400.0 million (2013: £1,400.0 million) was retained by the Group.

At the reporting date, the Society has overcollateralised the LLP as set out in the table above to secure the ratings of the covered bonds and to provide operational flexibility. From time to time, the obligation of the Society to provide collateral may increase due to the formal requirements of the 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.

During the period, the Society provided non-contractual capital contributions totalling £271.0 million to the LLP as a result of a regulatory requirement to pre-fund upcoming contractual covered bond redemptions. It will continue to provide such support in 2015. During the period, the Society also voluntarily repurchased £643.2 million of mortgages from the LLP to maintain the quality of the pool and minimise the overcollateralisation requirement.

Securitisation – Leofric No.1 plc

Leofric No.1 plc (Leofric) was incorporated in November 2011. In May 2012, Leofric issued £933.5 million of listed debt securities secured against certain loans of the Society and its subsidiary Godiva Mortgages Limited, of which £133.5 million was retained by the Group. 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. As at 31 December 2014, the nominal value of listed debt securities in issue had fallen to £367.1 million, of which £52.5 million was held by the Group. The Group's obligations in respect of the Leofric securitisation vehicle are limited to cash flows from the underlying assets.

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. As at 31 December 2014, listed debt securities totalled £1,436.4 million. The Group's obligations in respect of the Mercia securitisation vehicle are limited to cash flows from the underlying assets.

The fair value of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset are presented in the table below:

	Fair value assets pledged 2014 £m	Fair value liabilities 2014 £m	Fair value net position 2014 £m	Fair value assets pledged 2013 £m	Fair value liabilities 2013 £m	Fair value net position 2013 £m
Securitisation programme – Leofric No.1 plc	527.1	371.4	155.7	694.1	560.3	133.8

The above table excludes the Mercia securitisation programme as all the notes issued were retained by the Society.

16. Investments in subsidiary undertakings

Society	Shares £m	Loans £m	Total 2014 £m
At 1 January	8.0	7,844.3	7,852.3
Additions	–	1,032.5	1,032.5
Impairment	–	(0.7)	(0.7)
At 31 December	8.0	8,876.1	8,884.1

The Society has the following subsidiary undertakings, all of which are consolidated:

Subsidiary undertakings	Principal activity
Godiva Mortgages Limited	Mortgage lending
ITL Mortgages Limited	Mortgage lending and mortgage acquisition vehicle
Five Valleys Property Company Limited	Investment properties holding company
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
Coventry Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Leofric No.1 plc	Funding vehicle
Mercia No.1 plc	Funding vehicle

All the companies are registered in England and operate in the United Kingdom.

All the entities are wholly owned by Coventry Building Society, except for Coventry Building Society Covered Bonds LLP, Leofric No.1 plc and Mercia No.1 plc. The Society's interests in these entities are, in substance, no different than if they were wholly owned subsidiary undertakings and consequently are consolidated in the Group accounts. The nature and risks associated with the Society's investments in these entities (including obligations of financial support) are disclosed in note 15.

17. Intangible assets

Group and Society	2014 £m	2013 £m
Cost		
At 1 January	18.1	13.4
Additions	11.3	7.7
Retirements	(1.4)	(3.0)
At 31 December	28.0	18.1
Amortisation		
At 1 January	5.9	4.2
Charge for the year	6.3	4.7
Amortisation on retirements	(0.1)	(3.0)
At 31 December	12.1	5.9
Net book value at 31 December	15.9	12.2

Intangible assets consist entirely of software development costs and purchased software that is not an integral part of a related hardware purchase.

18. Property, plant and equipment

Group and Society	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost					
At 1 January 2014	9.3	3.9	3.4	50.5	67.1
Additions	–	0.1	–	5.3	5.4
Disposals	–	(0.2)	–	(19.3)	(19.5)
At 31 December 2014	9.3	3.8	3.4	36.5	53.0
Depreciation					
At 1 January 2014	1.5	0.7	2.3	33.2	37.7
Charge for the year	0.2	0.1	–	5.6	5.9
Depreciation on disposals	–	(0.2)	–	(18.8)	(19.0)
At 31 December 2014	1.7	0.6	2.3	20.0	24.6
Net book value at 31 December 2014	7.6	3.2	1.1	16.5	28.4

Disposals relate to assets that were retired during the year.

Group and Society	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost					
At 1 January 2013	9.3	3.9	3.4	48.1	64.7
Additions	–	–	–	5.1	5.1
Disposals	–	–	–	(2.7)	(2.7)
At 31 December 2013	9.3	3.9	3.4	50.5	67.1
Depreciation					
At 1 January 2013	1.4	0.7	2.3	29.8	34.2
Charge for the year	0.1	–	–	5.8	5.9
Depreciation on disposals	–	–	–	(2.4)	(2.4)
At 31 December 2013	1.5	0.7	2.3	33.2	37.7
Net book value at 31 December 2013	7.8	3.2	1.1	17.3	29.4

18. Property, plant and equipment continued

Equipment, fixtures, fittings and vehicles includes assets held under finance leases as follows:

Group and Society	2014 £m	2013 £m
Net book value	1.7	1.5
Accumulated depreciation	0.9	0.8

The net book value of land and buildings occupied by the Group for its own activities is as follows:

Group and Society	2014 £m	2013 £m
At 31 December	11.8	11.6

Investment properties

As at 31 December 2014 the Group held investment properties with a cost of £5.6 million and accumulated depreciation of £0.4 million after depreciation charged during the year of £0.1 million (2013: cost £5.6 million, accumulated depreciation £0.3 million, depreciation charge £0.1 million). The Society held investment properties with a cost of £0.4 million and accumulated depreciation of £0.1 million, after depreciation charged during the year of £nil (2013: cost £0.4 million, accumulated depreciation £0.1 million, depreciation charged of £nil). The fair value of the properties held by the Group as at 31 December 2014 was £6.3 million (2013: £6.1 million).

19. Pension scheme

The Society operates a funded defined benefit and a defined contribution pension scheme.

The Coventry defined benefit pension scheme (the Fund) is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are required to act in the best interest of the plan's beneficiaries. The appointment of the trustees is determined by the plan's trust documentation. It is policy that one third of all trustees should be nominated by the members of the pension fund. As at 31 December 2011, the date of the last full actuarial valuation, 1,867 employees, ex-employees and executive directors were members of the Fund.

The Fund is subject to the funding legislation outlined in 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 Statement of Financial Position 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. Additionally, caps on inflationary increases are in place to protect the plan against extreme inflation.

The pension scheme assets are invested in Liability Matching Funds (LMFs). These are leveraged pooled funds that are used to help manage interest rate and inflation risk. The investment policy of the LMFs can be summarised as follows:

- Each LMF relates to a single named benchmark gilt – the Fund holds units in the 2022, 2027, 2032, 2040, 2050 and 2062 index-linked gilt LMFs.
- The LMFs will principally hold a combination of gilt sale and repurchase agreements (repos), 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 LMF reaches a heightened level and follow a re-leveraging process if the leverage in any individual LMF decreases to a depressed level.

- The Fund Manager aims to limit the exposure to each counterparty to 30% of each LMF's overall exposure.
- The Fund will retain the coupon payments and will use them for leverage management rather than being re-invested in the benchmark gilt. Full proceeds will be distributed upon maturity of the benchmark gilt.

For the purposes of IAS 19 *Employee Benefits (Revised)* the actuarial valuation as at 31 December 2011, which was carried out by a qualified independent actuary, has been updated on an approximate basis to 31 December 2014. There have been no changes in the valuation methodology adopted for this period's disclosures compared with the previous period's disclosures.

IAS 19 allows the Society to recognise a surplus as an asset, reflecting 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.

The cost of the Fund was assessed in accordance with the advice of a qualified actuary on the basis of valuations using the projected unit method. The main assumptions used in the valuations were:

I. An investment return pre-retirement of 1.6% (2013: 2.15%) per annum in excess of projected pre-retirement benefit increase.
II. An investment return post-retirement of 0.7% (2013: 1.15%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 1.3% (2013: 2.05%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

A full actuarial valuation was carried out as at 31 December 2011 in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of the scheme is agreed between the Society and the trustees in line with those requirements. This actuarial valuation showed a deficit of £21.9 million. The Society agreed with the trustees that it would aim to eliminate the deficit over a period of 5 years and 4 months from 1 April 2013 by the payment of annual contributions of £1.4 million in respect of the deficit plus a one-off contribution of £4.4 million which was paid in March 2013.

During 2012 the decision was taken to close the pension scheme to future service accrual. In accordance with the actuarial valuation, in 2013 the Society paid 36.6% of pensionable earnings for the notice period of the members and met the expenses of the plan and levies to the Pension Protection Fund. Consequently there were no contributions in respect of members' pensionable salaries during 2014; however the Society contributed £1.4 million in line with the deficit recovery plan. The best estimate of contributions to be paid by the Society to the plan in 2015 is £1.4 million.

The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is then deducted from the fair value of plan assets and the net surplus is presented in the Statement of Financial Position as shown below:

Group and Society	2014 £m	2013 £m
Present value of funded obligation	(184.5)	(157.7)
Fair value of plan assets	186.1	162.8
Funded status/Pension benefit surplus	1.6	5.1

19. Pension scheme continued

	2014			2013		
	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	(157.7)	162.8	5.1	(147.9)	158.0	10.1
Included within administrative expenses:						
Current service cost	–	–	–	(0.8)	–	(0.8)
Interest (expense)/income	(7.1)	7.3	0.2	(6.5)	6.9	0.4
	(7.1)	7.3	0.2	(7.3)	6.9	(0.4)
Included within other comprehensive income:						
Remeasurements:						
Return on plan assets (excluding amounts in the Income Statement)	–	19.5	19.5	–	(3.5)	(3.5)
Losses from changes in financial assumptions	(24.6)	–	(24.6)	(7.3)	–	(7.3)
	(24.6)	19.5	(5.1)	(7.3)	(3.5)	(10.8)
Other contributions and payments:						
Employer contributions	–	1.4	1.4	–	6.2	6.2
Employee contributions	–	–	–	(0.2)	0.2	–
Benefit payments	4.9	(4.9)	–	5.0	(5.0)	–
	4.9	(3.5)	1.4	4.8	1.4	6.2
As at 31 December	(184.5)	186.1	1.6	(157.7)	162.8	5.1

The major categories of plan assets are:

	Plan assets at 31.12.2014 £m	Plan assets at 31.12.2013 £m
Quoted		
Corporate bonds and liability matching	118.0	99.1
Diversified growth funds	28.1	27.4
Cash	1.9	0.9
Unquoted		
Corporate bonds and liability matching	23.0	20.9
Property	15.1	14.5
Total	186.1	162.8

At 31 December 2013, the Coventry Building Society Superannuation Fund held assets totalling £0.7 million invested in Coventry Building Society Permanent Interest Bearing Shares (PIBS). The Fund sold these assets during the year.

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligation at	31.12.2014 %	31.12.2013 %
Discount rate	3.60	4.55
Rate of pensionable salary increase	2.00	2.40
Rates of inflation (Retail Prices Index)	3.00	3.40
Rates of inflation (Consumer Price Index)	2.00	2.40

Weighted average assumptions used to determine net pension cost for the year ended	31.12.2014 %	31.12.2013 %
Discount rate	4.55	4.40
Rate of pensionable salary increase	2.40	3.90
Rates of inflation (Retail Prices Index)	3.40	2.90
Rates of inflation (Consumer Price Index)	2.40	2.15

Weighted average life expectancy for mortality tables used to determine benefit obligation at	31.12.2014		31.12.2013	
	Male	Female	Male	Female
Member age 60 (current life expectancy)	26.9	29.3	26.8	29.2
Member age 45 (life expectancy at age 60)	28.9	31.3	28.3	30.7

The assumptions on mortality are determined by the actuarial tables known as S1PXA with CMI 2013 projections with a 1.25% p.a. long-term improvement rate (2013: S1PXA with CMI 2013 projections with a 1.25% 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:

Impact on present value of obligation:	Change in assumption	Increase in assumption %	Decrease in assumption %
Discount rate	0.25%	(4.7)	5.0
Rates of inflation (Retail Prices Index and Consumer Price Index)	0.25%	4.2	(3.9)
Life expectancy	1 year	2.5	(2.5)

The average duration of the defined benefit obligation at the period ending 31 December 2014 is 22 years.

20. Deferred tax

Deferred tax assets and liabilities are attributable to the following items:

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Deferred tax assets				
Provisions	0.3	0.4	0.3	0.4
IFRS transitional fair value adjustments	0.3	0.6	0.2	0.5
Excess of depreciation over capital allowances	2.0	1.3	2.0	1.2
Transfer of engagements – fair value adjustments	2.4	4.0	0.2	1.8
Cash flow hedges	–	2.0	–	1.7
Total	5.0	8.3	2.7	5.6
Deferred tax liabilities				
IFRS transitional fair value adjustments	0.3	0.7	0.3	0.7
Defined benefit pension plan surplus	0.3	1.0	0.3	1.0
Transfer of engagements – fair value adjustments	0.3	0.3	0.3	0.3
Cash flow hedges	8.2	–	7.4	–
Total	9.1	2.0	8.3	2.0

The Group recognises deferred tax 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 to utilise the asset. The Group considers that sufficient future taxable profit will, in fact, be available to utilise all the Group's deferred tax assets and the Group has therefore recognised deferred tax assets where they have arisen.

The headline rate of UK corporation tax reduced from 23% to 21% on 1 April 2014, and through the enactment of the Finance Act 2013 will reduce further to 20% from 1 April 2015.

Under IAS 12 deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the Statement of Financial Position date.

Accordingly, with the reduction of the corporation tax rate to 21% and 20% (enacted on 17 July 2013), the deferred tax balances at 31 December 2014 have been reflected at the tax rates at which they are expected to be realised or settled.

21. Deposits from banks

A maturity analysis for the Group's deposits from banks is included in a table, on page 40. The Group and Society balances are identical.

As at 31 December 2014, deposits from banks include £1,408.7 million (2013: £948.7 million) in respect of sale and repurchase agreements, of which £700.4 million (2013: £700.1 million) relates to off-balance sheet Treasury bills. The carrying value of assets of £712.7 million (2013: £244.4 million) sold under sale and repurchase agreements is included within debt securities (see note 14). The Group held £1.9 million (2013: £nil) of collateral deposited by counterparties under sale and repurchase agreements.

As at 31 December 2014, £1.1 million (2013: £16.6 million) was held by the Group as amounts deposited by counterparties under interest rate swap collateralisation agreements.

22. Debt securities in issue

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Certificates of deposit	3.0	13.8	3.0	13.8
Medium term notes	1,687.6	1,762.8	1,687.6	1,762.8
Covered bonds	1,660.6	1,817.3	1,660.6	1,817.3
Residential Mortgage Backed Securities (Leofric)	314.3	470.9	–	–
Total	3,665.5	4,064.8	3,351.2	3,593.9

Debt securities in issue are repayable from the Statement of Financial Position date in the ordinary course of business as follows:

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Accrued interest	39.7	42.7	39.0	41.6
Other debt securities in issue with residual maturity repayable:				
In not more than one year	522.9	554.9	522.9	554.9
In more than one year	3,102.9	3,467.2	2,789.3	2,997.4
Total	3,665.5	4,064.8	3,351.2	3,593.9

In November 2014 the Society raised €500 million of seven year funding paying a fixed rate of 0.625% issued from the covered bonds programme, replacing €650 million of covered bonds which matured at the end of October 2014.

23. Derivative financial instruments

Derivative financial instruments are held for risk mitigation purposes and are designated as hedging derivatives under the terms of IAS 39. The tables below analyse derivatives between those designated as hedging instruments and those which, whilst in economic hedging relationships, are not designated as hedging instruments. Contractual/notional amounts indicate the amount on which payments flows are derived at the Statement of Financial Position date and do not represent amounts at risk. Foreign exchange gains of £92.4 million have been recognised in the Income Statement relating to financial instruments held at amortised cost. This is offset by £92.2 million of foreign exchange losses on financial instruments held at fair value.

	2014			2013		
Group	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate swaps	16,144.8	208.3	302.1	12,859.2	184.9	176.1
Interest rate caps	–	–	–	140.0	–	–
Derivatives designated as cash flow hedges:						
Cross currency swaps*	1,340.4	–	21.2	1,516.2	6.3	37.5
Total derivatives	17,485.2	208.3	323.3	14,515.4	191.2	213.6
Derivatives have remaining maturities as follows:						
In not more than one year	4,359.0	2.6	2.2	4,245.1	1.6	35.7
In more than one year	13,126.2	205.7	321.1	10,270.3	189.6	177.9
Total derivatives	17,485.2	208.3	323.3	14,515.4	191.2	213.6

	2014			2013		
Society	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/ notional amount £m	Fair value assets £m	Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate swaps	15,394.8	135.9	302.1	12,109.2	122.9	176.1
Interest rate caps	–	–	–	140.0	–	–
Derivatives designated as cash flow hedges:						
Cross currency swaps*	946.1	–	18.0	946.1	6.3	9.3
Other derivatives:						
Interest rate basis swaps	500.0	–	1.1	500.0	0.3	–
Total derivatives	16,840.9	135.9	321.2	13,695.3	129.5	185.4
Derivatives have remaining maturities as follows:						
In not more than one year	4,859.0	2.6	3.3	3,675.0	1.6	7.5
In more than one year	11,981.9	133.3	317.9	10,020.3	127.9	177.9
Total derivatives	16,840.9	135.9	321.2	13,695.3	129.5	185.4

* Cash flows are expected to occur over a seven year period in respect of both Group and Society cross currency swaps.

For valuing collateralised derivatives the Group uses discount curves based on OIS rates, whilst for non-collateralised derivatives discount curves based on term LIBOR rates are used.

In addition to the above, the Society also has intra-Group interest rate swaps with the subsidiaries that operate the Group's covered bond and RMBS programmes. 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 £4,984.8 million (2013: £5,074.5 million) and are accounted for on an accruals basis in accordance with IAS 39; see note 1 for further details.

24. Provisions for liabilities and charges

Group and Society	FSCS 2014 £m	Other provisions 2014 £m	Total 2014 £m	FSCS 2013 £m	Other provisions 2013 £m	Total 2013 £m
At 1 January	8.7	1.2	9.9	8.2	1.0	9.2
Charge for the year	15.3	–	15.3	15.4	0.9	16.3
Provisions utilised	(16.2)	(0.5)	(16.7)	(14.9)	(0.7)	(15.6)
At 31 December	7.8	0.7	8.5	8.7	1.2	9.9

FSCS levy provision

All deposit-taking institutions that are members of the UK Financial Services Compensation Scheme (FSCS) are required to contribute to the costs of the FSCS in safeguarding the deposits of savers in financial institutions. The Society is, and continues to be, a member of the FSCS. Contributions to the FSCS are calculated according to a prescribed formula using the retail savings balances of all deposit-taking institutions who are members of the FSCS. As at 31 December 2014, the Group held a provision of £7.8 million with respect to the estimated FSCS levy for the period 2014/15. The FSCS provision is expected to be utilised in September 2015.

Other provisions

Other provisions have also been recognised in respect of circumstances that may give rise to various customer claims including Payment Protection Insurance (PPI) redress.

The Group has no contingent liabilities to report.

25. Subordinated liabilities

Group and Society	2014 £m	2013 £m
Subordinated liabilities owed to note holders are as follows:		
Fixed rate subordinated notes 2016 – 12.25%	7.1	7.1
Fixed rate subordinated notes 2021 – 6.12%	10.1	10.1
Fixed rate subordinated notes 2022 – 6.469%	15.5	15.5
Fixed rate subordinated notes 2026 – 6.327%	10.2	10.1
Fixed rate subordinated notes 2032 – 7.54%	15.3	15.4
Total	58.2	58.2

All the subordinated liabilities are denominated in sterling. The notes are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, with the 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 PIBS and Perpetual Capital Securities (other equity instruments) (PCS)) as to principal and interest.

26. Subscribed capital

Group and Society	Call date	2014 £m	2013 £m
Subscribed capital owed to permanent interest holding members is as follows:			
Permanent Interest Bearing Shares 1992 – 12 1/8%	n/a	41.5	41.4
Permanent Interest Bearing Shares 2006 – 6.092%	June 2016	120.1	120.1
Total		161.6	161.5

Interest is paid in arrears on £40 million PIBS at the rate of 12 1/8% per annum in half yearly instalments, and on £120 million PIBS at the rate of 6.092% per annum in half yearly instalments. The shares are repayable only in the event of a winding up of the Society or otherwise with the prior consent of the PRA. 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) as to 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.

27. Other equity instruments

	Total £m
At 1 January 2014	–
Issuance proceeds	400.0
Issuance costs	(3.9)
Tax credit on issuance costs	0.8
At 31 December 2014	396.9

In June 2014, the Society issued £400 million of new PCS capital. These instruments rank equally with each other and PIBS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS) as to principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.375% per annum. The rate will reset on 1 November 2019 and every five years thereafter to the five year mid swap rate plus 4.113%. Coupons are paid semi-annually in May and November. The first coupon payment of £8.9 million, covering the period from issuance to 31 October 2014, was approved by the Board, paid in November 2014 and is recognised in the statement of changes in members' interests and equity in the financial year ended 31 December 2014.

The instruments have no maturity date. They are repayable at the option of the Society in 2019 and on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an individual consolidated or a consolidated basis, falls below 7% they convert to CCDS at the rate of one CCDS for every £67 held.

The returns paid to investors on these securities are treated as an appropriation of profit after tax, reflecting their categorisation as equity instruments, and hence are not reflected within the Income Statement, but instead are distributed directly from the general reserve.

28. Available-for-sale reserve

Amounts within the Available-for-sale reserve are transferred to the Income Statement upon the disposal of debt securities, and where a fair value hedging relationship exists between the debt securities and a derivative instrument.

During the year a £66.9 million gain (2013: £137.6 million loss) was transferred to net losses/gains from derivative financial instruments in the Income Statement with respect to hedge accounting adjustments relating to Available-for-sale debt securities in fair value hedge accounting relationships. Amounts transferred to interest receivable and similar income totalled a £0.1 million loss (2013: £2.8 million gain) in respect of the disposal of Available-for-sale debt securities.

29. Financial commitments

Subject to the satisfaction of previously agreed loan to value ratios, the Group and Society are committed to the following undrawn mortgage loan facilities relating to equity release and flexible mortgage products:

	Group 2014 £m	Group 2013 £m	Society 2014 £m	Society 2013 £m
Undrawn mortgage loan facilities	86.7	97.7	68.1	75.0

In addition, the Society has also agreed but not contractually committed to advance £1,353.1 million (2013: £934.9 million) in respect of loans and advances to customers.

30. Capital and leasing commitments

Capital commitments

Group and Society	2014 £m	2013 £m
Capital expenditure contracted for but not provided for in the accounts	0.2	1.0

Leasing commitments

Future minimum lease payments under non-cancellable operating leases relating to land and buildings were as follows:

Group and Society	2014 £m	2013 £m
Amounts falling due:		
Within one year	2.8	3.1
Between one and five years	7.7	9.0
After five years	5.7	7.3
Total	16.2	19.4
Lease payments recognised as an expense in the period	3.7	3.7

30. Capital and leading commitments continued

Leasing payments due as lessor

Future minimum sub-leasing payments receivable under non-cancellable subleases were as follows:

Group and Society	2014 £m	2013 £m
Within one year	0.1	0.1
Between one and five years	0.1	0.3
Total	0.2	0.4

Future minimum lease payments receivable under non-cancellable leases were as follows:

Group and Society	2014 £m	2013 £m
Within one year	0.1	–
Total	0.1	–

31. Financial instruments – classification and fair value measurement

Fair value is 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.

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: quoted prices (unadjusted) 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 the fair value of an instrument 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. For all other financial instruments 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 on the face of the Group's Statement of Financial Position and the disaggregation by the fair value hierarchy.

The Society position is not materially different to that of the Group except for £8,943.6 million (2013: £7,921.9 million) of loans and advances to customers with a fair value of £8,937.4 million (2013: £7,904.2 million) which are held in subsidiaries of the Society.

2014 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	180.5	–	180.5	–	180.5
Loans and advances to customers	26,959.6	–	–	26,884.6	26,884.6
Financial liabilities					
Shares	23,395.6	–	–	23,673.1	23,673.1
Deposits from banks	1,479.0	–	1,477.5	–	1,477.5
Other deposits	7.5	–	7.5	–	7.5
Amounts owed to other customers	452.3	–	452.3	–	452.3
Debt securities in issue	3,665.5	3,957.5	19.1	–	3,976.6
Subordinated liabilities	58.2	–	63.5	–	63.5
Subscribed capital	161.6	201.0	–	–	201.0

2013 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	179.3	–	179.3	–	179.3
Loans and advances to customers	24,117.1	–	–	23,997.0	23,997.0
Financial liabilities					
Shares	21,311.7	–	–	21,395.5	21,395.5
Deposits from banks	1,032.6	–	1,023.6	–	1,023.6
Other deposits	4.0	–	4.0	–	4.0
Amounts owed to other customers	337.1	–	337.3	–	337.3
Debt securities in issue	4,064.8	4,273.2	13.8	–	4,287.0
Subordinated liabilities	58.2	–	62.8	–	62.8
Subscribed capital	161.5	192.4	–	–	192.4

31. Financial instruments – classification and fair value measurement continued

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. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Prudent assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting estimated future cash flows are discounted at current market rates to determine a fair value. These fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

Customer shares and deposits

Shares and deposits from customers are valued in accordance with the cash flows projected from the contractual terms of the deposits. The fair value of shares and deposits that are 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 from those deposits discounted at the current market rates for those types of deposit.

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer-dated liabilities are calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of significant 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 Statements of Financial Position and the disaggregation by fair value hierarchy and product type.

The Society position is not materially different to that of the Group except for £72.5 million (2013: £62.0 million) of interest rate swap assets which are held in subsidiaries of the Society and a £1.1 million fair value liability (2013: £0.3 million fair value asset) relating to intercompany interest rate basis swaps that would only be disclosed in the Society.

2014 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	208.3	–	208.3
Total	–	208.3	–	208.3
Debt securities				
UK Government investment securities	1,433.5	–	–	1,433.5
Other listed transferable debt securities	169.2	45.2	7.3	221.7
Total	1,602.7	45.2	7.3	1,655.2
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	241.9	60.2	302.1
Cross currency swaps	–	21.2	–	21.2
Total	–	263.1	60.2	323.3

2013 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	184.9	–	184.9
Cross currency swaps	–	6.3	–	6.3
Total	–	191.2	–	191.2
Debt securities				
UK Government investment securities	1,333.8	–	–	1,333.8
Other listed transferable debt securities	332.2	–	–	332.2
Total	1,666.0	–	–	1,666.0
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	141.5	34.6	176.1
Cross currency swaps	–	37.5	–	37.5
Total	–	179.0	34.6	213.6

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Level 1: Debt securities – Available-for-sale – Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2: Derivatives

Derivative products valued using a valuation technique with observable market inputs are interest rate swaps and cross currency swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various assumptions including interest rate curves and foreign exchange spot and forward rates.

31. Financial instruments – classification and fair value measurement continued

Financial instruments recorded at fair value continued

Level 2: Debt securities – Available-for-sale – Listed

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 price for valuation purposes. Otherwise, a security is priced based on its relative value to comparable bonds.

Level 3: Derivatives

Critical accounting estimates and judgements

The items included within Level 3 are balance tracking swaps, which have remained in place during the year. These are valued using the same valuation technique as Level 2 derivatives, namely 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 £0.6 million change in the value of the swaps. As changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact the swap and hedged item equally, the net Income Statement and balance sheet impact would be negligible.

Level 3: Debt securities – Available-for-sale – Listed

The item included within Level 3 is a mortgage backed security. This is valued using the same valuation technique as Level 2 listed securities, namely by establishing a price based on its relative value to comparable bonds. The unobservable inputs relate to estimates of the likely timing of repayments and, hence, the weighted average life of the security. A change in price of 1%, which can be taken to represent the impact of repayment commencing (if positive) or being set back further (if negative), would change the value of the security by £0.1 million.

The following table analyses movements in the Level 3 portfolio for both the Group and the Society.

Group and Society	Debt securities 2014 £m	Derivative financial instruments 2014 £m	Debt securities 2013 £m	Derivative financial instruments 2013 £m
As at 1 January	–	(34.6)	–	(46.3)
Losses/gains recognised in the Income Statement				
Interest payable and similar expense	–	(6.4)	–	(6.5)
Net unrealised (losses)/gains from derivative financial instruments	–	(25.7)	–	11.8
Settlements	–	6.5	–	6.4
Transfers into Level 3 portfolio	7.3	–	–	–
Transfers out of Level 3 portfolio	–	–	–	–
As at 31 December	7.3	(60.2)	–	(34.6)

Transfers between fair value hierarchies

Transfers between fair value hierarchies occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. Transfers are considered to occur at the end of the reporting period for the purposes of this disclosure. During the period, five listed debt securities with a value of £52.5 million were transferred from Level 1 due to changes in the availability of observable market prices or executable bids. Of these, four securities, totalling £45.2 million were transferred into Level 2 and one security with a value of £7.3 million was transferred to Level 3.

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 Statements of Financial Position as IAS 32 *Financial Instruments – Presentation* conditions state 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. Neither of these conditions is met by the Group or the Society.

However, 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 on a weekly basis 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 transaction but a CSA has been entered into which provides for full collateralisation when the counterparty bank credit rating falls below a certain threshold.

The table below shows the net exposure for derivative contracts after netting benefits and collateral and also for sale and repurchase agreements after collateral. The Group does not enter into securities lending or reverse sale and repurchase agreements.

2014 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	208.3	(125.8)	(39.5)	43.0
Total financial assets	208.3	(125.8)	(39.5)	43.0
Financial liabilities				
Derivative financial instruments	323.3	(125.8)	(178.8)	18.7
Sale and repurchase agreements	708.3	–	(708.3)	–
Total financial liabilities	1,031.6	(125.8)	(887.1)	18.7

2013 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	191.2	(102.8)	(46.4)	42.0
Total financial assets	191.2	(102.8)	(46.4)	42.0
Financial liabilities				
Derivative financial instruments	213.6	(102.8)	(77.2)	33.6
Sale and repurchase agreements	248.6	–	(248.6)	–
Total financial liabilities	462.2	(102.8)	(325.8)	33.6

* As reported in the Statements of Financial Position.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

32. Offsetting financial assets and liabilities continued

2014 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	135.9	(125.8)	(0.6)	9.5
Total financial assets	135.9	(125.8)	(0.6)	9.5
Financial liabilities				
Derivative financial instruments	321.2	(125.8)	(178.8)	16.6
Sale and repurchase agreements	708.3	–	(708.3)	–
Total financial liabilities	1,029.5	(125.8)	(887.1)	16.6

2013 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	129.5	(102.8)	(15.5)	11.2
Total financial assets	129.5	(102.8)	(15.5)	11.2
Financial liabilities				
Derivative financial instruments	185.4	(102.8)	(77.2)	5.4
Sale and repurchase agreements	248.6	–	(248.6)	–
Total financial liabilities	434.0	(102.8)	(325.8)	5.4

* As reported on the Statement of Financial Position.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

For derivative financial assets, collateral received is in the form of both cash and UK Government investment securities. Where cash is received it is included as a liability within deposits from banks (see note 21). Where UK Government investment securities are received, these are not recognised on the Statement of Financial Position, as the Group does not obtain the risks and rewards of ownership (see note 14).

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 (see note 13).

For sale and repurchase agreements, 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 (see note 13). UK Government investment securities are not derecognised as the Group has retained substantially all the risks and rewards of ownership (see note 14).

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 2014, 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 on page 15 and pages 48 to 54.

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	
	2014 £m	2013 £m	2014 £m	2013 £m
Loans payable to the Society				
Loans outstanding as at 1 January	7,844.3	6,830.5	0.3	1.1
Loans issued during the year	1,032.5	1,013.8	0.3	–
Impairment	(0.7)	–	–	–
Repayments during the year*	–	–	(0.6)	(0.8)
Loans outstanding as at 31 December	8,876.1	7,844.3	–	0.3
Deposits payable by the Society				
Deposits outstanding at 1 January	250.9	356.6	2.4	2.1
Deposits received during the year**	–	–	1.3	1.6
Repayments during the year*	(74.0)	(105.7)	(0.8)	(1.3)
Deposits outstanding at 31 December	176.9	250.9	2.9	2.4
Net interest income/(expense)				
Interest receivable	246.4	277.9	–	–
Interest payable	(5.4)	(7.0)	–	(0.1)
Total	241.0	270.9	–	(0.1)
Other income and expenses				
Fees and expenses paid to the Society	6.7	6.0	–	–

* Includes loans and deposits for key management on retirement.
** Includes existing deposits for key management on appointment.

Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiaries.

Deposits payable by the Society to Group undertakings relate to amounts owing to the Society's SPEs, in accordance with the accounting policy set out in note 1 to the accounts. These intercompany balances have been presented within other liabilities on the Statement of Financial Position.

34. Related party transactions continued

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 directors are considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24. Key management personnel also incorporate non-executive directors. No director has any interest in the shares or debentures of any connected undertaking of the Society.

During the year, David Stewart entered into an agreement in relation to his decision to resign his position as Chief Executive. Colin Franklin accepted the role of Interim Chief Executive following David Stewart's departure and then also stepped down as an executive director during the year. Furthermore, in February 2015 Feike Brouwers also entered into an agreement in relation to his decision to resign as an executive director. Further details are provided in the Directors' Remuneration Report (pages 78 and 79). 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 Registered 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. During the year, the Society fully provided against an investment of £3.5 million in loan notes issued by Arkose Funding Limited.

Annual Business Statement

For the year ended 31 December 2014

1. Statutory percentages

	2014 %	Statutory limits %
Lending limit	1.6	25.0
Funding limit	19.4	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 2014.

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 2014.

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.

The value of X used is the value at 31 December 2014.

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. The value of Y used is the value at 31 December 2014.

2. Other percentages

	2014 %	2013 %
As a percentage of shares and borrowings:		
Gross capital	5.90	4.17
Free capital	5.78	4.05
Liquid assets	13.6	14.5
As a percentage of mean total assets:		
Profit for the financial year	0.53	0.37
Management expenses	0.42	0.39
Net profit as a percentage of total balance sheet	0.51	0.36

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. Information relating to directors

Directors

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Ian Pickering, MA (Cantab), FCA (16.10.1955)	Company Director	Electrocab Limited	01.09.2005
Janet Ashdown, BSc (Hons) (05.07.1959)	Company Director	SIG plc	18.09.2013
Peter Ayliffe BA (Hons), FCIBS, CMgr (05.03.1953)	Company Director	Chartered Management Institute The Pennies Foundation Monitise Plc truRating Limited	01.05.2013
Bridget Blow CBE (02.06.1949)	Company Director	Birmingham Hippodrome Limited Birmingham Hippodrome Theatre Trust Limited Bridget Blow Consulting Limited City of Birmingham Symphony Orchestra Kensington Green (Management) Limited The Move Factory Holdings Limited	01.02.2007
Feike Brouwers MSc, MBA (12.10.1967)	Building Society Chief Risk Officer	None	24.04.2013
Roger Burnell, BSc, FCA (08.04.1950)	Company Director	Clarence Mansions Management Company Limited	01.09.2008
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer	Five Valleys Property Company Limited (appointed 21.01.15)	01.11.2012
Ian Geden, BSc (Hons), FCII (08.07.1953)	Company Director	The Police Mutual Assurance Society Limited Faraday Underwriting Limited Faraday Reinsurance Limited	01.09.2008
John Lowe, BA (Oxon), ACA (26.10.1972)	Building Society Finance Director	Godiva Mortgages Limited Coventry Financial Services Limited Coventry Property Services Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Savings Limited Godiva Securities and Investments Limited Five Valleys Property Company Limited Coventry Building Society Covered Bonds LLP ITL Mortgages Limited Arkose Funding Limited	14.10.2010

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Mark Parsons BA (Hons), FCMA (24.10.1961)	Building Society Chief Executive	Godiva Mortgages Limited ITL Mortgages Limited The Royal Latin School	01.07.2014
Glyn Smith, MA (Cantab), FCA (15.09.1952)	Company Director	Covent Garden Market Authority Reclaim Fund Limited (appointed 04.02.15) FCO Services	22.09.2010

Documents may be served on the above named directors at:

Coventry Building Society, c/o Ernst & Young LLP, 1 Bridgewater Place, Leeds LS11 5QR.

In 2010 the Society appointed John Lowe (Finance Director) to the Board. A service contract has been entered into which is terminable by John Lowe on six months' notice and by the Society on one year's notice.

In 2012 the Society appointed Peter Frost (Chief Operating Officer) to the Board. A service contract has been entered into which is terminable by Peter Frost on six months' notice and by the Society on one year's notice.

In 2013 the Society appointed Feike Brouwers (Chief Risk Officer) to the Board. A service contract has been entered into which is terminable by Feike Brouwers on six months' notice and by the Society on one year's notice. Feike Brouwers gave notice under the service contract on 9 February 2015.

In 2014 the Society appointed Mark Parsons (Chief Executive) to the Board. A service contract has been entered into which is terminable by Mark Parsons on six months' notice and by the Society on one year's notice.

4. 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.

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 Common Equity Tier 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Available-for-sale reserve (AFS)	The Available-for-sale reserve contains unrealised gains and losses arising from changes in the fair value of non-derivative financial assets that are categorised as Available-for-sale.
Average loan to value (LTV)	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 II	The Basel Committee on Banking Supervision's statement of best practice that defined the methods by which firms should calculate their regulatory capital requirements to retain sufficient capital to protect the financial system against unexpected losses, prior to 1 January 2014.
Basel III	The Basel Committee on Banking Supervision issued strengthened proposals in response to the recent financial crisis, which are referred to as Basel III. These standards were implemented in the European Union via CRD IV, which came into force on 1 January 2014.
Basis point	One hundredth of a percent (0.01 percent). Used when quoting movements in interest rates and yields on securities.
BIPRU	The Prudential sourcebook for Banks, Building Societies and Investment Firms, which sets out detailed prudential requirements applicable to the Society. This has largely been superseded by CRD IV.
Business risk	Business risk is the risk arising from changes to the business model and/or where the business model or strategy proves inappropriate due to macroeconomic, geopolitical, regulatory or other factors.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital requirements	Amount 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 resources	Capital comprising the general reserve, Available-for-sale reserve, eligible Additional Tier 1 capital, subordinated debt and collectively assessed impairment allowances, less all required regulatory adjustments.
Certificates of deposit	Bearer-negotiable instruments issued on the receipt of a fixed term deposit at a specified interest rate.
Code Staff	A group of employees to which the PRA's Remuneration Code applies. Code Staff consists of executive directors, non-executive directors, certain senior managers in control functions (e.g. Audit, Risk and Compliance) and other material risk takers, who could have a material impact on the firm's risk profile.
Collateral	Security pledged by the borrower to the lender in case of default.
Common Equity Tier 1 capital (CET 1)	Common Equity Tier 1 capital comprises general reserves and the negative balance on the Available-for-sale 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	Conduct risk is the risk that the Society's behaviours fail to deliver good customer outcomes.
Contractual maturity	The date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.
Council of Mortgage Lenders (CML)	A trade association for the residential mortgage lending industry.
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	Credit risk is the risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due.
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	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods resulting from temporary or timing differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit pension plan resulting from past employee service.
Defined benefit pension scheme	A pension or other post-retirement benefit plan offering guaranteed benefits, usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
Effective interest rate (EIR)	The effective interest rate is the rate of interest income or expense that produces a level yield, either to maturity or to the next re-pricing date, equivalent to the projected cash flows on an instrument.
Effective tax rate	The tax charge in the Income Statement as a percentage of profit before tax.
Encumbered assets	Assets used to secure third party 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 CRD IV with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A framework that seeks to provide the context and guidance 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 prudential regulation and supervision across the European banking sector.
Eurozone	An economic and monetary union (EMU) of European Union member states that have adopted the euro (€) as their common currency and sole legal tender.

Expected loss	A calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a one year time period.
Exposure	The maximum loss that a financial institution might suffer if a borrower or wholesale counterparty fails to meet their obligations.
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.
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 Ratings	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 or obligations in foreign currencies.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers, less: property, plant and equipment; non-current assets held for sale; and intangible assets.
Funding for Lending Scheme (FLS)	An initiative by the Bank of England and HM Treasury to incentivise banks and building societies to boost their lending to UK households and small and medium sized enterprises, by providing funding to banks and building societies for an extended period.
General reserve	The general reserve is the accumulation of historic and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Gilts	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
Gross capital	The aggregate of equity, subscribed capital and subordinated liabilities.
Gross mortgage lending	The total of mortgage lending advanced during the year.
IFRIC	International Financial Reporting Interpretations Committee. IFRIC interprets the application of IAS and IFRS and provide 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 more than three months in arrears or in possession. However, other indicators of impairment may result in provisioning for losses.

Impairment losses	The reduction in value that arises following an impairment review of an asset that determines that the recoverable amount is less than its carrying value.
Impairment provision	Provisions held against assets on the Statement of Financial Position. The provisions represent management's best estimate of losses incurred in the loan portfolio at the Statement of Financial Position date.
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/collective assessment of impairment	Impairment is measured specifically for assets that are individually identified as being impaired at the Statement of Financial Position date, and collectively for homogenous asset classes where there is evidence of impairment event(s) but these have not yet manifested themselves as individually identified impaired accounts.
Individual Liquidity Adequacy Assessment (ILAA)	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.
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 or value because of different interest rates charged for the mortgages and paid for the funding that comprises the bulk of the balance sheet.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Ratings Based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1. The IRB approach may only be used with permission from the PRA.
ISDA	International Swaps and Derivatives Association is the global trade association for over-the-counter (OTC) derivatives and providers of the industry-standard documentation for derivative transactions.
Leverage ratio	A calculation brought in as part of CRD IV which measures the relationship between eligible Tier 1 capital and exposures to on and off-balance sheet items.
LIBOR	London Inter-Bank Offer Rate. A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquid assets	An amount as defined by The Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including gilts), loans to credit institutions and other liquid assets.
Liquid Assets Buffer (LAB)	The liquid assets that the PRA currently allows in its liquidity measures, which shall be replaced by LCR liquid assets from 1 October 2015.
Liquidity and funding risk	Liquidity risk is the risk 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 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. A binding minimum LCR of 80% will apply to the Society from 1 October 2015.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprises cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and self-issued covered bonds, RMBS and Bank of England approved mortgage portfolios.

Loan to value	The amount of mortgage loan as a percentage of the value of the property.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	The risk that the value of income derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign exchange rates.
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.
Moody's Investor Services	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.
Mortgage Market Review	New mortgage conduct of business rules implemented by the FCA, which required all mortgage lenders to enhance responsible lending controls for mortgages and implement robust mortgage advice services by 26 April 2014, to ensure that all mortgages are affordable and to minimise the risk of detrimental outcomes for customers.
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 Stable Funding Ratio (NSFR)	A ratio which assesses the amount of stable, long-term funding sources (customer deposits and long-term wholesale funding) as a proportion of the Society's less liquid funding requirements. A minimum requirement for the NSFR is due to be set by 1 January 2018.
Operational risk	Operational risk is the risk of loss arising from inadequate internal processes, systems or people, or from external events.
Overnight indexed swap (OIS) rate	A rate reflecting the overnight interest earned or paid in respect of overnight interbank loans, being typically SONIA for sterling loans. OIS is used to value collateralised interest rate derivatives.
Over-the-counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
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. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. PIBS are also known as subscribed capital. These are a form of Tier 1 capital under Basel II, however under Basel III are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Post vesting	Period after which the director may receive payments under the terms of a variable pay award.
PRA Remuneration Code	Requirements provided by the PRA on directors' and Code Staff remuneration.

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.
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 interest rates.
Redenomination risk	The risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent).
Residential Mortgage Backed Securities (RMBS)	Asset backed securities that 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.
Retail deposits	See Shares.
Risk appetite	The articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.
Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a special purpose entity (SPE) which then issues securities (RMBS) backed by the assets. The Society has used residential mortgages as the loan pool for securitisation purposes.
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 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.
SONIA	A rate reflecting the interest earned or paid in respect of sterling overnight interbank loans.
Sovereign exposure	Exposures to governments and on account of cash balances and deposits with central banks.
Special purpose entities (SPEs)	Entities that are created to accomplish a narrow and well defined objective. The Group uses SPEs to facilitate securitisation and covered bond programmes. Where the Group has control of these entities or retains risks and rewards relating to them they are consolidated within the Group results.
Standardised approach	The basic method used to calculate capital requirements for credit risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
Stress testing	Testing undertaken to provide an understanding of the Society's resilience to internal and external shocks.
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.
Subscribed capital	See Permanent Interest Bearing Shares.
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.

Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with intention to trade. The Society does not have a trading book.
UK Corporate Governance Code (the Code)	The code (formerly known as the Combined Code), issued by the Financial Reporting Council, that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.
Underlying profit	The purpose of this measure is to reflect management's view of the Group's underlying performance with like for like comparisons of performance across years without distortion of one-off volatility and items that are not reflective of the Group's ongoing business activities.
Unencumbered assets	Assets readily available as collateral to secure funding. This includes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes and are therefore readily available as collateral to secure funding.
Wholesale funding	Funding received from large businesses, financial institutions and sovereign entities.

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

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