Annual Report & Accounts

for the year ended 31 December 2017

COVENTRY Building Society

Contents

The term 'Society' is used in this Annual Report & Accounts pages 1 to 91 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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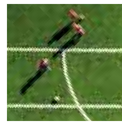
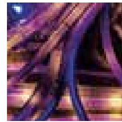
Economic House, PO Box 9, High Street, Coventry CV1 5QN.



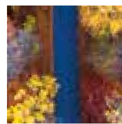
Strategic Report

Our Performance 2017 04
Chairman's Statement 06
Chief Executive's Review 08
Business Review 10
Corporate Responsibility Report 19



Risk Management

Introduction 23
Principal Risks 29
Capital 53

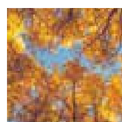


Governance

Board of Directors 60
Directors' Report on Corporate Governance 66
Board Audit Committee Report 74
Directors' Remuneration Report 79
Directors' Report 88

Financial Statements

Independent Auditor's Report 93
Accounts 100
Notes to the Accounts 104



Other Information

Annual Business Statement 144
Glossary 146

Welcome

Putting our members first

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

In 2017, we maintained our long record of growth by continuing to attract and retain members through competitive products and excellent service. At the same time we delivered a strong financial performance, and increased our reserves, whilst supporting investment in infrastructure.

By offering a genuinely member-focused approach, we show that an independent mutual organisation can succeed and prosper in an environment that continues to be challenging.

Strategic Report

This section provides commentary on the Society's 2017 performance, our overall business strategy and approach to corporate responsibility.

Our Performance 2017	04
Chairman's Statement	06
Chief Executive's Review	08
Business Review	10
Corporate Responsibility Report	19

Our Performance 2017

These pages show how we have performed across a range of measures aligned to our strategic goals.

9.3%

Mortgage balance growth

against market growth of 3.4%[1]

our 2016 result: 11.8%

10.6%

Savings balance growth

against market growth of 2.7%[1]

our 2016 result: 10.6%

Awarded

by Fairer Finance

Clear & Simple Mark for our General Terms for savers

4%

Complaints against us were upheld by the Financial Ombudsman[3]

financial services average 36%

8/10

Customers

would recommend us to others

1. Source: Bank of England.
2. The Society's weighted average month end savings rate (Society mix of products) compared to the Bank of England weighted average rate for household interest-bearing deposits (market mix of products).
3. Source: Financial Ombudsman Service – latest published information: 1 January 2017 to 30 June 2017.

91%

of our employees are proud to work for the Society

79%

of our employees engaged in charitable or community activities

our 2016 result: 78%

0.13%

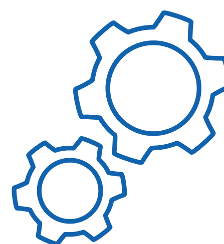
Mortgage balances were 2.5% or more in arrears

against industry average of 0.81%[4]

our 2016 result: 0.17%

0.42%

Costs as a percentage of average assets



our 2016 result: 0.41%

34.9%

Capital strength

Common Equity Tier 1 ratio

our 2016 result: 32.2%

208%

Liquidity strength

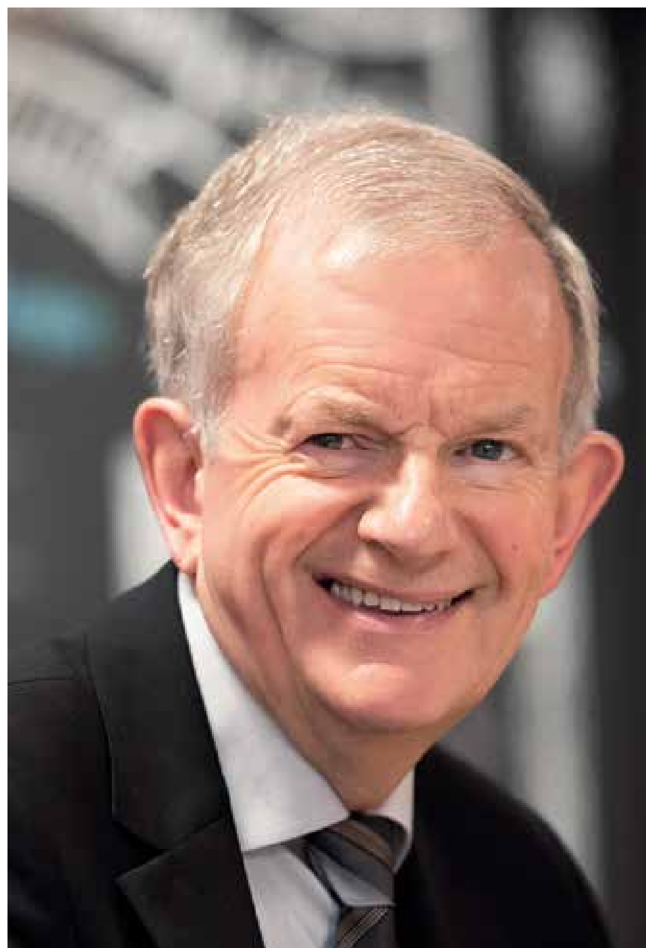
Liquidity coverage ratio

our 2016 result: 151%

4. Prudential Regulation Authority latest available information at 30 September 2017.

Strategic Report

Chairman's Statement



I would like to begin by paying tribute to Ian Pickering, who passed away suddenly and unexpectedly in September 2017 whilst Chairman of the Society.

Ian was a Board member for 12 years, becoming Chairman in 2013, and helped the Society deliver sustained growth through a period of market volatility. He maintained, at all times, a steadfast conviction that the Society's mission of Putting Members First was paramount, providing both the source of our strength and the measure of our progress.

The Society's performance during Ian's time as Chairman is testament to this conviction. It has been one of financial strength and consistent growth, with an increasing membership as well as a growing reputation for being a simple, transparent and trusted organisation.

Of great importance to Ian, and I believe to our members, are the Society's Values which define the way in which we do things and are the cornerstone of our service promise.

We call these Values 'Coventry CARES', which stands for being Caring, Attentive, Reliable, Ethical and Straightforward. Collectively the Values describe how we strive to meet the needs of our saving and borrowing members – doing the right things in the right way.

We are a simple organisation. Our business model is to attract and retain savers by offering long-term value and to use these savings to fund responsible lending in the residential housing market. We support our competitive position and protect the interests of our members by being a low cost and low risk organisation. To be successful we must execute this model very well and I am pleased to report that the Society continues to grow and perform strongly.

Dominating the economic and political agenda is the UK's withdrawal from the European Union. As a national business with no operations outside the UK we are not impacted directly by this change. However, we are alive to the fact that there may be some indirect impact if the decision to leave the European Union affects confidence in the wider economy, not least in extending the low interest rate environment. This said, our low risk business model and UK-only focus mean we remain unperturbed by possible Brexit impacts.

As an organisation which relies on, and supports, hundreds of thousands of individual savers I am particularly proud that we have maintained our track record of paying savings rates well above the market average. This reflects our financial strength, as well as our commitment to doing the right thing for savers. In this context, we welcomed the decision by the Monetary Policy Committee to raise the base rate to its pre-Brexit vote level of 0.50%.

We are equally supportive of our mortgage members and understand that the November rate rise would have been the first interest rate rise that many would have experienced. Accordingly, we were quick to provide certainty to those borrowing members affected by the rate change. The Society has a track record of lending responsibly, believing it is in the interest of individual members and the Society that people should not over-borrow. We remain confident that we and our members are well positioned to manage this and any further increase in interest rates.

Mortgages and savings are fundamental financial requirements for many households and building societies, as member-owned businesses, have a particularly important role to play in the financial services market. The Board remains convinced that the Society's success is due to the focus we have on Putting Members First and that the interests of our members and our local communities are best served by remaining an independent mutual building society.

To stay relevant and meet the future needs and expectations of our members in a rapidly changing marketplace, it is important that we continue to invest in our business. As I look forward to 2018 and beyond, I am excited by our plans to invest in our technology and infrastructure to improve business resilience and enhance our core offerings whilst developing our digital capabilities. We will also be investing in refurbishing our branch network, a cornerstone of our business model, to make it even more relevant to the communities it serves.

In addition to this investment we will continue to focus on and support our people. We have long recognised that skills and knowledge can be taught but attitude and behaviours are deeply ingrained. For this reason we aim to recruit the right people and invest in their career with the Society. I believe this is fundamental to the service we provide and the high level of satisfaction of our members.

This is equally true at Board level and I am very pleased to welcome new executive and non-executive directors who were appointed in 2017.

Michele Faull joined the Society in April as Chief Financial Officer. Michele has extensive experience at director level roles in financial services, most recently at Nationwide Building Society where she worked as Group Risk Director and Director for Financial Reporting & Tax.

Andy Deeks was also appointed to the Board in April. Andy is the Society's Product, Marketing and Strategy Director and is an excellent example of the Society developing and promoting from within, having originally joined the Society in 2004.

I would also like to welcome Jo Kenrick as a non-executive director. Jo has a strong commercial and marketing background gained within the retail, consumer goods and home improvement sectors as well as building society and payments experience.

I must thank John Lowe, who left the Board during 2017. John served as Finance Director with great skill and insight and combined his professional expertise with commercial acumen and a deep seated commitment to the Society's Values. I would also like to thank non-executive directors, Janet Ashdown, who served on the Board for four years with great integrity and dedication, and Alasdair Lenman, who joined us in 2016 and has taken an executive position at Yorkshire Building Society. Both brought valuable knowledge and experience to Board discussions and made an excellent contribution to the Society.

And of course I must thank our wonderful employees for their contribution to another successful year. It is a privilege of my position to meet so many of our committed, professional and enthusiastic people and I know from these meetings that the Society is in very good hands.

I will finish where I started in recognising the contribution, both professional and personal, of Ian Pickering. In his integrity, commitment, warmth and enthusiasm he embodied much of what the Society stands for and our success over the last 12 years very much reflects the application of these values.

Peter Ayliffe
Chairman

22 February 2018

Chief Executive's Review

Coventry Building Society delivered a strong and balanced performance in 2017, maintaining our record of savings and mortgage growth, excellent member service and a robust financial position. This was driven by our clear and consistent focus on Putting Members First.

We have grown our membership, attracted record savings deposits and increased mortgage balances nearly three times faster than the market[1], sustaining our position as a top 10 UK mortgage and savings provider[2]. We are well capitalised and efficient, retaining enough profit to support our capital strength, and we are using our financial strength to invest in meeting the expectations of current and future members.

Critically our performance has members at its heart. To be successful we must provide clear benefits to our members, not only in terms of the long-term value of savings and mortgages, but also in the quality of service and support we provide.

1. Source: Bank of England.
2. Source: eBenchmarkers Spring 2017 (savings), CML Economics, 2016 top mortgage lenders (balance outstanding) as at 22 February 2018 (mortgages).

Central to our performance is our commitment to savers. Despite the UK's 10 year record of low savings rates we firmly believe in the importance of cash savings to individual savers and the wider UK economy. We are proud of our track record of paying significantly higher than average savings rates and in 2017 have maintained this record. The average rate of interest we paid on savings in 2017 was 1.49% which was 0.86% higher than the market average[3].

Our simple and open approach to savings is becoming an increasing point of differentiation for the Society. We were the first UK savings provider to enable individuals to compare our own savings products with those of competitors through our website. We think this transparency is how savings should be and that it reflects confidence in our strong rates.

This unique approach has been endorsed by Fairer Finance, which placed us first in its rankings of savings providers for the third year running, as well as presenting us with its Clear & Simple Mark for our savings terms and conditions – the first UK savings provider to receive this accolade. We have also become one of only four UK savings providers to become a Which? Recommended Provider for Savings accounts[4].

This approach to savings means we have attracted more savers and more deposits in 2017, with balances growing by 11%, almost four times faster than the market as a whole[1]. These deposits supported our mortgage performance in 2017, with mortgage balances growing by 9%.

This was a strong performance in an environment that has shown some softening of house purchase demand and strengthening of mortgage rate competition. Our performance was underpinned by well-priced products in the lower loan to value and remortgage segments of the market. Just as importantly it reflects the service we provide to our borrowers and mortgage intermediary partners; we were pleased to be awarded the highest accolade for mortgage servicing, the Financial Adviser Five Stars award, for the second year running.

Our focus on lower loan to value lending is reflected in an average loan to value of our mortgage book of 47%. Together with the low interest rate environment this has resulted in continued very low loan impairments.

Our simple, focused business model means we have a low cost base. Notwithstanding a continued investment in technology and people, our management expense ratio[5] was broadly maintained at 0.42% (2016: 0.41%). This is

3. The Society's weighted average month end savings rate (Society mix of products) compared to Bank of England weighted average rate for household interest-bearing deposits (market mix of products).
4. As at August 2017.
5. Administrative expenses, depreciation and amortisation/Average total assets.

significantly lower than that of our building society competitors[6], an advantage which allows us to provide long-term value to our savers and borrowers by operating at a relatively low net interest margin[7] of 1.02% as we return value to our members through favourable interest rates.

Looking forward, we expect price competition in the mortgage market to remain and margins to tighten further. However, our low cost operating model means that we will be able to continue to offer attractive long-term value to savings and mortgage members.

The combination of growth, low risks and low costs is the foundation of our financial strength and in 2017 we continued to deliver sufficient profits to support our capital position. As a mutual organisation dedicated to Putting Members First, we do not aim to maximise profits. Instead we aim to balance the long-term value we provide through consistently competitive pricing with being a secure and trusted home for our members' savings. In 2017 profit before tax was £243 million and our risk based capital measure[8] increased to 34.9%, the highest reported by any top 20 lender[9], demonstrating that we are strong and secure.

The service we provide to our members is an important part of our balanced performance and in 2017 our members continue to rate our core services highly, with more than 8 out of 10 members happy to recommend us to others[10]. Of the few complaints referred to the Financial Ombudsman Service only 4% were upheld, the lowest reported rate of all UK banks and building societies[11].

Despite a strong service record we are not complacent and understand that in a changing technological age our members will continue to expect more of us. To address this, we are investing to deliver further improved service functionality and customer experience, for example the new customer website that showcases our simplicity and transparency. Behind the scenes we are also investing to enhance our core technology systems and infrastructure to improve business resilience and service flexibility. This commitment to investing for the future will increase further in 2018, and includes investment in making our branches even more welcoming within their communities.

Above all we continue to invest in our people, who make the Society what it is. Our growth is a positive factor in this regard, providing opportunities for internal career progression as well as giving us greater relevance in the external job market. In 2017 the Society was rated one of the 100 Best Companies to Work For in the UK, an accolade which reflects our ambition in supporting and engaging our people. The Society was also named one of the Best Employers for Race[12], recognising our commitment to encouraging diversity. I know that our very high level of employee engagement has its foundation in the Society's commitment to do the right things for members.

Alongside Putting Members First, we also seek to do the right thing for the communities we serve. In 2017, over three quarters of our employees were actively engaged in a wide variety of fundraising and community volunteering activities. This year we celebrate the 10 year anniversary of our partnership with The Royal British Legion during which time we have become its largest corporate partner, donating over £15 million since October 2008. This work is mirrored by the contribution of our employees at a local level, supporting over 250 charities and schools. We are delighted that the city of Coventry has won the bid to become the 2021 UK City of Culture. We supported the bid and have committed to support this transformational opportunity for Coventry.

At its heart, Coventry Building Society is a people business, with a set of values that guide all of its decision making. I would like to echo the Chairman's tribute to Ian Pickering, who exemplified these values and worked tirelessly to ensure we stayed true to our mission of Putting Members First. This will continue to be our focus going forward.

Mark Parsons
Chief Executive

22 February 2018

6. As at 22 February 2018.
7. Net interest income as a percentage of average total assets.
8. Common Equity Tier 1 ratio.
9. Source: CML Economics, 2016 top mortgage lenders (balance outstanding) latest published CET 1 data as at 22 February 2018.
10. Source: Average from 6 surveys in 2017: 12,065 branch visitors scoring 9 or 10/10; 13,642 savings contact centre callers scoring 4 or 5/5; 3,761 online services users scoring 9 or 10/10; 1,749 brokers scoring 9 or 10/10; 1,943 mortgage contact centre callers scoring 9 or 10/10; 1,913 customers who have opened an account scoring 9 or 10/10.
11. Source: Financial Ombudsman Service – latest published information: 1 January 2017 to 30 June 2017.
12. Source: Business in the Community Best Employers for Race list 2017.

Business Review

Our strategy focuses on delivering sustainable growth through providing simple, good value savings products and low risk residential mortgages underpinned by a cost-efficient operating model.

Strategic Review

Objectives

The Society exists solely for the benefit of our current and future members, meeting their needs for savings and residential mortgages. In delivering on our strategic objectives, we are committed to Putting Members First in everything we do and fully embrace the mutual ethos on which we were founded. The Board continues to believe that members' interests are best served by remaining an independent mutual building society, with a clear purpose and a simple business model.

Business model

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

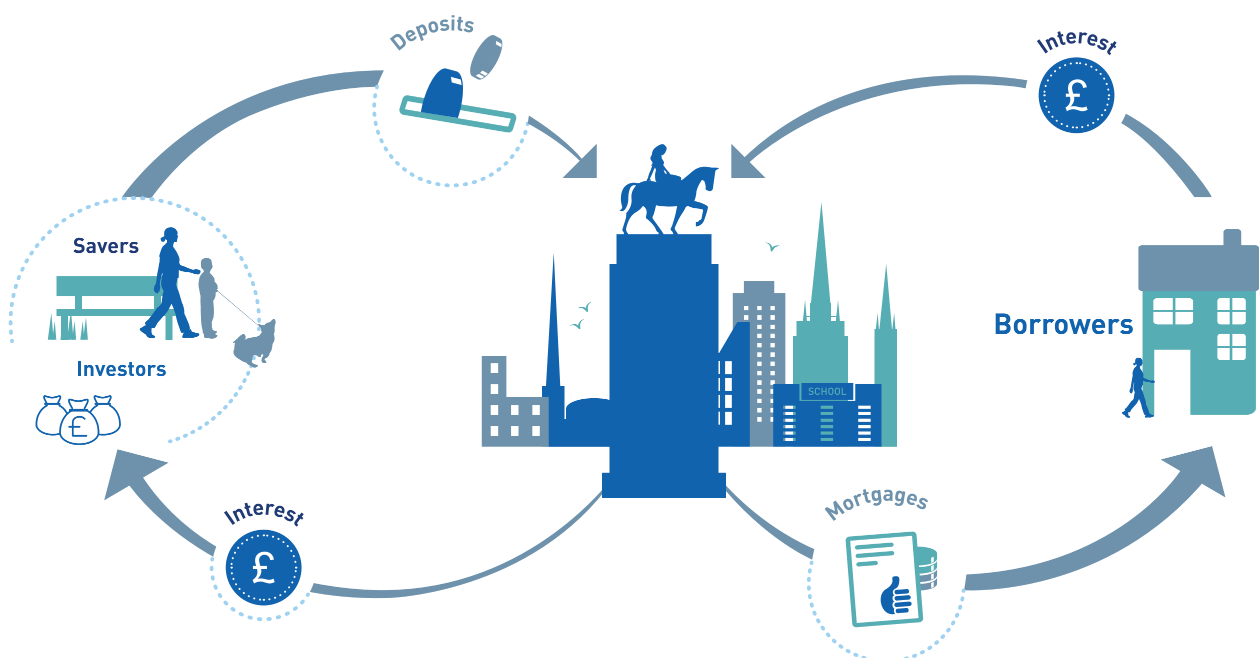
The Board chooses to operate a simple business model – simple products, simple ways of operating and simple communications to members.

The Society accepts deposits from savings members and provides loans secured on residential properties. We also raise funds from the wholesale markets to provide funding diversity. The difference between the interest earned on mortgages and the interest paid to savings members and to providers of wholesale funding generates net interest income.

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

As a mutual organisation, we do not have external shareholders or pay dividends; our customers (the members) are the 'owners' of the organisation. This creates clarity of purpose and strategic and operational decisions are based on the simple principle of Putting Members First. A core commitment of the Society is providing long-term sustainable value to members through competitively priced savings and mortgage products. This is supported by excellent customer service. We need to balance this commitment with the requirement to remain financially strong and secure and each year we retain only sufficient profit to meet capital requirements, enabling us to provide improved pricing for our members.

The mutual model allows the Society to focus on a longer-term strategy, maintaining a consistent presence in the savings and mortgage markets.



The Board chooses to operate a simple business model – simple products, simple ways of operating and simple communications.

Our 2017 performance against strategic goals

Our performance against our strategic goals is summarised below. Going forward, we will continue to focus on Putting Members First and providing good value, simple and transparent mortgage and savings products supported by a low cost base. Information on the Society's principal risks and uncertainties can be found in the Risk Management Report.
For additional information relating to non-financial performance, please read the Corporate Responsibility Report.

Strategy	Performance in 2017
Delivering sustainable growth, balancing the interests of current and future members	For the 11th successive year, the Society grew faster than both the UK savings and mortgage markets[1], increasing its market share overall. Savings balances grew by 10.6% and mortgage balances grew by 9.3%.
Offering products that deliver long-term value for money and provide good member outcomes	The average savings rate in 2017 was 1.49% compared with a market average of 0.63%[2]. The average interest rate on new mortgage lending continued to fall to 2.19% (2016: 2.45%). The Society received fewer than 3 complaints per 1,000 members and only 4% of complaints referred to the Financial Ombudsman Service[3] were overturned.
Simple products, easy to use UK-based customer services, transparent communications	The Society achieved a Net Promoter Score® of +73[4] (2016: +70[4]), a measure of those surveyed who strongly recommended our customer service experience. The awards and endorsements received during the year included the Fairer Finance Clear & Simple Mark for General Terms for savers.
Remaining safe and secure, only taking risks that we understand and can manage	The Society's Common Equity Tier 1 capital ratio remains the highest reported of any top 20 lender[5] at 34.9%, and the Liquidity Coverage Ratio at 208% also remains considerably above the minimum requirement. As at 31 December 2017 only 0.13% of mortgage balances were 2.5% or more in arrears compared with the latest available industry average of 0.81%[6].
Spending members' money wisely and being cost-efficient while investing for the long term	At 42p per £100 of assets, the cost to asset ratio[7] remains the lowest reported in the sector[8]. The Society has continued to invest in enhancing its core technology platforms and infrastructure.
Valuing the contribution, diversity and engagement of the Society's people and actively supporting them	The Society was rated 'Outstanding' for staff engagement in 2017 and rated as one of the 100 Best Companies to Work For, with 91% of employees proud to work for the Society. The Society was named one of the 'Best Employers for Race' by Business in the Community.
Enhancing the communities in which the Society operates and wider society	The Society's charitable donations, including donations to the Royal British Legion, reached £1.6 million in 2017. 79% of employees were actively involved in community programmes and activities, resulting in over 7,500 hours of volunteering by Coventry staff.

1. Source: Bank of England.
2. The Society's weighted average month end savings rate (Society mix of products) compared with the Bank of England weighted average rate for household interest bearing deposits (market mix of products).
3. Source: Financial Ombudsman Service – latest published information: 1 January 2017 to 30 June 2017.
4. Net Promoter®, Net Promoter Score®, and NPS® are trademarks of Satmetrix Systems, Inc., Bain &Company, Inc., and Fred Reichheld. NPS of +73, is a calculated average from six surveys; branch survey of 12,065 customers, savings contact centre survey of 13,642 callers, mortgage contact centre survey of 1,943 callers, online survey amongst 3,761 users, opening a savings account survey of 1,946 customers and a survey amongst 1,749 brokers.
5. Source: CML Economics – 2016 top mortgage lenders (balance outstanding) – latest published CET 1 data, as at 22 February 2018.
6. Prudential Regulation Authority latest available information as at 30 September 2017.
7. Administrative expenses, depreciation and amortisation/Average total assets.
8. UK building societies, as at 22 February 2018.

Strategic outlook

2017 has been marked by continued political and economic uncertainty and modest economic growth. Despite this, there has been sustained growth in the mortgage and savings markets which looks set to continue, albeit with pricing pressures, particularly in the mortgage market.

This section considers the outlook for the Society in the context of the main risks to which we are exposed. More information on how the Society manages risk is included in the Risk Management Report.

2017 has seen the first Bank of England Base Rate rise in 10 years. This, and the withdrawal of the Term Funding Scheme (TFS) in 2018, signals a return to pre-crisis normality which may provide some relief to savers who have continued to see a squeeze in savings rates in 2017. Whilst we expect further Bank of England Base Rate rises to be relatively modest and to be extended over a period of years, rising rates may have a pronounced impact on unsecured lending, the levels of which have received significant focus recently. The Society has no material exposure to unsecured portfolios but it may be indirectly impacted if customer affordability weakens. We work constructively with any members who experience short-term financial difficulties, and will continue to do so.

The Society's mortgage book is very low risk and, looking forward, our balance sheet is well positioned for rising rates. This focus on appropriate and affordable lending protects both the Society and its borrowing members.

There has been much debate on the impact of Brexit. We do not have any direct exposure to this as our business is entirely UK based and we have no significant treasury or other European exposures. However, there is a risk that uncertainty around Brexit or the political environment could impact the wider economy through reduced confidence, or through prolonged low interest rates.

A persistent low interest rate can make it difficult to deliver attractive rates to savers whilst providing sufficient margin, especially given requirements to generate adequate capital. It is not yet clear how withdrawal of the TFS will impact savings rates or wider funding costs. During 2017 the Society has again delivered above-market interest rates to savers whilst maintaining capital strength and providing good value mortgages.

House price growth has moderated in 2017 with new buy to let investment less buoyant than in previous years. There has been more remortgage activity which has supported resilient buy to let mortgage growth despite the regulatory and tax changes. The underlying fundamentals of the UK housing market remain strong and this, together with our nationwide distribution model delivered through intermediaries, means that our medium-term outlook remains strong.

We expect both the UK savings and mortgage markets to continue to be highly competitive in the medium term, in part due to the advent of new entrants and opportunities created by technological change. In the face of these factors, some financial institutions are diversifying as they seek new revenue generating opportunities. By contrast, we believe that we serve our members best by focusing on UK mortgages and savings markets and by leveraging our deep experience and effective partnerships with intermediaries. This will ensure that technology becomes an enabler of improved customer experiences and facilitates a lower cost of operations, which will allow the Society to continue to return superior value to members.

Financial resilience continues to be a focus for both regulators and financial services providers. Capital regulation is becoming more onerous as regulators look to ensure that banks are more financially resilient. Whilst initiatives such as Minimum Requirement for own funds and Eligible Liabilities (MREL) can disproportionately impact lower risk lenders such as the Society, our strong business fundamentals mean we are able to accommodate these changes.

Alongside financial resilience, the Society expects there to be growing focus on operational resilience. The financial services sector continues to see systems outages and issues where customer information is threatened by cyber criminals and we expect these threats to continue. We have been resilient, but these factors, together with rising customer expectations for service delivery and enhanced functionality, mean that the Society will need to deliver an increased level of technology change over the coming years.

The Society has initiated a number of wide-reaching change programmes to address these needs. Whilst these programmes can drive additional costs and carry execution risk, we believe that we are putting in place the controls necessary to ensure that this level of change can be delivered safely without disrupting core operations and that we have set appropriate investment budgets within our strategic plans.

In summary, whilst there are some headwinds facing the financial services sector, the Society's core savings and mortgage markets are expected to continue to grow faster than the economy as a whole. The Society believes that its Putting Members First mission and simple, low cost, low risk model mean it is well placed to thrive so that it can continue to deliver long-term value to its members.

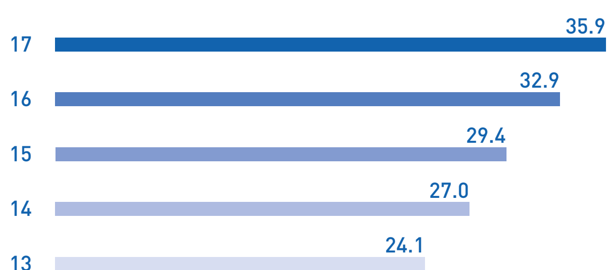
Financial Review

Overall performance

During 2017, the Society continued to grow both mortgage and savings balances and delivered a low management expense ratio and impairment charge, strengthening the Society's reserves and capital base.

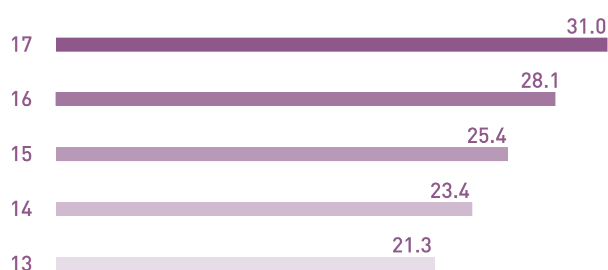
£35.9bn

Mortgages



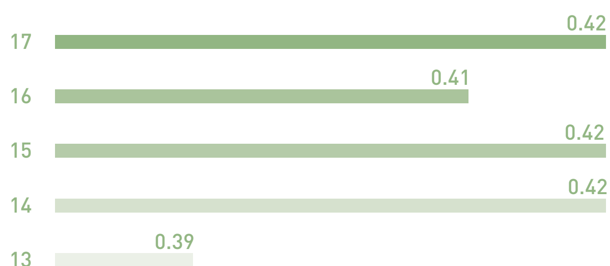
£31.0bn

Savings



0.42%

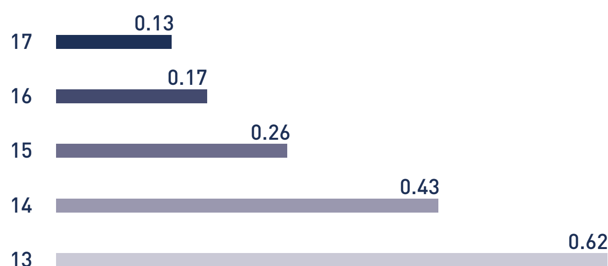
Cost to mean assets ratio[1]



0.13%

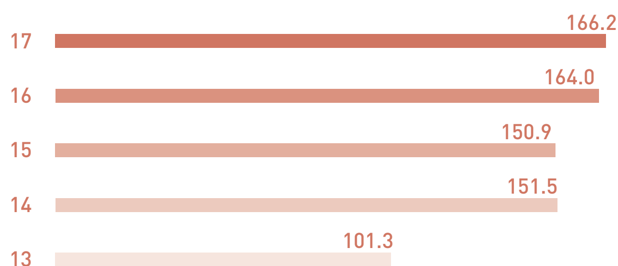
Arrears

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



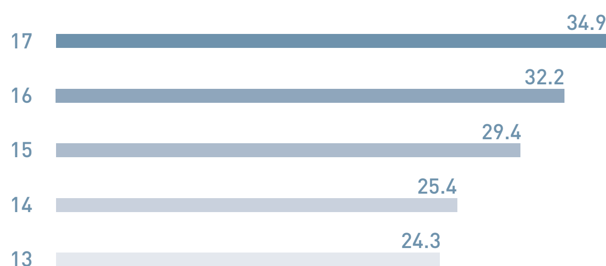
£166.2m

Added to Member reserves[2]



34.9%

Common Equity Tier 1 ratio



1. Administrative expenses, depreciation and amortisation/Average total assets.
2. Profit after tax including Additional Tier 1 capital distribution (net of tax).

Income Statement

Overview

Statutory profit before tax has increased by 2% to £242.7 million (2016: £239.1 million). Underlying profit[1] was £240.5 million (2016: £239.5 million) as set out in the summarised Income Statement below.

The 2017 profit performance primarily reflects an increase in net interest income offset by an increase in management expenses. This profit performance was achieved during a year when the interest paid by the Society's above market savings rates represented a return of value to members of over £210 million[2] compared with the market.

Year to 31 December 2017	Statutory profit £m	Gain on sale of VocaLink £m	Financial Services Compensation Scheme levy £m	Losses on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	411.0	–	–	–	411.0
Other income	5.1	(5.0)	–	–	0.1
Losses on derivatives and hedge accounting	(0.3)	–	–	0.3	–
Total income	415.8	(5.0)	–	0.3	411.1
Management expenses	(167.9)	–	–	–	(167.9)
Impairment charge	(0.2)	–	–	–	(0.2)
Provisions	(3.5)	–	2.5	–	(1.0)
Charitable donation to Poppy Appeal	(1.5)	–	–	–	(1.5)
Profit before tax	242.7	(5.0)	2.5	0.3	240.5

Year to 31 December 2016	Statutory profit £m	Gain on sale of Visa Europe Limited £m	Financial Services Compensation Scheme levy £m	Losses on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	385.0	–	–	–	385.0
Other income	10.5	(4.9)	–	–	5.6
Losses on derivatives and hedge accounting	(1.0)	–	–	1.0	–
Total income	394.5	(4.9)	–	1.0	390.6
Management expenses	(149.5)	–	–	–	(149.5)
Impairment credit	1.5	–	–	–	1.5
Provisions	(6.1)	–	4.3	–	(1.8)
Charitable donation to Poppy Appeal	(1.3)	–	–	–	(1.3)
Profit before tax	239.1	(4.9)	4.3	1.0	239.5

1. Underlying profit represents management's view of underlying performance and is presented to aid comparability across reporting periods.
2. Based on the Society's average month end savings rate compared with the Bank of England average rate for household interest bearing deposits on the Society's mix of products.

Net interest income

Net interest income in 2017 was £411.0 million, £26.0 million higher than in 2016 as a result of growth in mortgage assets offset by a modest decrease in the net interest margin.

Net interest income in 2017 includes a £12.6 million release of fair value adjustments which arose on the merger with the Stroud & Swindon Building Society. Credit performance of the book since the merger indicates that the adjustments were in excess of requirements.

The Society's net interest margin has decreased by 4 basis points to 1.02% in the year to 31 December 2017 as it continues to pay above market rates to savers despite market pressures on mortgage pricing. This margin has been sufficient to fund the Society's expenditure and support capital.

	Year to 2017 £m	Year to 2016 £m
Net interest income	**411.0**	385.0
Average total assets	**40,434**	36,205
	%	%
Net interest margin	**1.02**	1.06

The Board believes it is likely that that there will be a further modest decrease in the net interest margin in 2018 as a consequence of continuing pricing pressure in the mortgage market and its commitment to protect savings rates as far as possible.

Other income

Other income was £5.1 million, £5.4 million lower than in 2016 primarily as a result of lower general insurance fee income. Insurance fee income is not a strategic priority for the Society.

Other income includes a £5.0 million gain on sale of the Society's equity investment in VocaLink Holdings Limited to MasterCard. Other income in 2016 included a £4.9 million gain on sale of Visa Europe Limited to Visa Inc. Further information is set out in note 15 to the accounts.

Derivatives and hedge accounting

The Society uses derivative financial instruments solely for risk management.

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

Management expenses

Management expenses increased in 2017 to £167.9 million (2016: £149.5 million) reflecting substantial investment in operational resilience together with increased costs to support growth.

Nearly half of this increase relates to the Society's continued investment in core IT infrastructure and change programmes which have increased IT and project costs by £5.1 million year on year and depreciation and amortisation by a further £4.0 million. The Society expects cost growth to continue during 2018 as its change programmes progress.

The remaining £9.3 million of additional cost largely related to employee wage inflation and a 5% increase in head count to support business growth and continuing regulatory change.

Despite the investments made during 2017, the Society's ratio of costs to mean total assets has been broadly maintained at 0.42% (2016: 0.41%). For over 10 years the Society has achieved the lowest reported cost to mean asset ratio in the UK building society sector, reflecting a consistent focus on spending members' money wisely. The Society's ability to grow whilst retaining control of costs continues to represent a significant competitive advantage.

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

Arrears and impairment charge

The Society has a strong record of low impairments, reflecting its low risk and prudent lending strategy. The Society has never undertaken commercial lending or second charge lending[3], and its exposure to unsecured lending is negligible.

There was an impairment charge of £0.2 million in 2017 (2016: £1.5 million credit). This low impairment charge reflects a consistently prudent lending strategy together with continuing benign economic conditions including moderate house price growth, falling unemployment and prolonged low interest rates, notwithstanding the small increase in the Bank of England Base Rate late in the year.

From 1 January 2018, the introduction of IFRS 9 will mean that the Society calculates impairment provision on an expected credit loss basis, rather than on an incurred loss basis as is the case at 31 December 2017. The impact of this is not expected to be significant for the Society, as a result of the Society's high credit quality, low risk mortgage lending. The IFRS 9 impairment provision on loans and advances to customers at 31 December 2017 is £0.1 million

3. Other than as a result of small books acquired as part of the merger with Stroud & Swindon Building Society in 2010.

less than the existing IAS 39 impairment provision. In addition, the impact of IFRS 9 transition on regulatory capital is negligible. More information is included in note 1 to the accounts.

Provisions

Provisions for liabilities and charges have reduced to £3.5 million (2016: £6.1 million) as a result of lower Financial Services Compensation Scheme (FSCS) fees and customer redress provisions including Financial Conduct Authority (FCA) guidance on the calculation of monthly payments for customers in arrears.

FSCS fees reduced from £4.3 million in 2016 to £2.5 million reflecting the substantial repayment of the loan from HM Treasury to the FSCS during the year.

The charge for Payment Protection Insurance (PPI) was £1.0 million compared with £1.2 million in 2016. The Society's provisions for PPI claims continue to be materially lower than for many other organisations, reflecting the design of the PPI product previously offered by the Society. Further information on the provisions for liabilities and charges is included in note 24 to the accounts.

Charitable donation to the Poppy Appeal

The Society donated £1.5 million to The Royal British Legion's Poppy Appeal during the year (2016: £1.3 million) bringing the total donated over the Society's nine year relationship with the Legion to £15.4 million.

Taxation

In 2017 the corporation tax charge was £57.9 million (2016: £56.7 million). This represents an effective tax rate of 23.9% (2016: 23.7%) which is significantly above the statutory corporation tax rate of 19.25% (2016: 20.0%). This is mainly due to a charge of £11.1 million (2016: £9.4 million) in respect of the 8% surcharge on the profits of banking companies. The Society's subsidiaries are outside the scope of the surcharge. The Society expects that its future effective tax rate will continue to exceed the standard rate due to the surcharge. Further information is included in note 12 to the accounts.

Balance sheet

Overview

Mortgage balances and on-balance sheet liquidity have grown during the year by £3.0 billion and £1.4 billion respectively. This was funded by increases in retail funding of £3.0 billion and wholesale funding of £1.4 billion, mainly as off-balance sheet Funding for Lending Scheme (FLS) drawings were replaced by on-balance sheet Term Funding Scheme (TFS) funding.

	2017 £m	2016 £m
Assets		
Loans and advances to customers	35,930.9	32,881.6
Liquidity	6,209.5	4,827.8
Other	432.1	586.5
Total assets	42,572.5	38,295.9
Liabilities		
Retail funding	31,035.7	28,054.3
Wholesale funding	9,127.3	7,742.0
Subordinated liabilities and subscribed capital	67.1	67.1
Other	366.4	611.2
Total liabilities	40,596.5	36,474.6
Equity		
General reserve	1,553.1	1,376.1
Other equity instruments	396.9	396.9
Other	26.0	48.3
Total equity	1,976.0	1,821.3
Total liabilities and equity	42,572.5	38,295.9
Unencumbered FLS Treasury bills (off-balance sheet liquidity)*	–	1,142.8

* Treasury bills (obtained under the FLS quoted at market value above) 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 risks 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 loans within the prime residential market, through attractively priced mortgages. These loans are primarily distributed through third party intermediaries, giving the Society a regionally diverse mortgage portfolio in a cost-effective manner.

In 2017, the Society advanced £8.6 billion of mortgages, (2016: £9.0 billion). Mortgage balance growth was £3.0 billion (2016: £3.5 billion) increasing market share of stock to 2.6%[4] (2016: 2.5%). The year-on-year growth in mortgages of 9.3% was significantly above mortgage market growth of 3.4%[4]. As a result the Society expects to at least retain its end 2016 position as the eighth[5] largest UK mortgage lender by stock.

This is a strong performance in what has been an increasingly price competitive market and has been achieved whilst maintaining the low risk nature of the loan book. The overall indexed loan to value of the mortgage book at 31 December 2017 fell to 53.9% (balance weighted) (2016: 54.6%).

The Society's arrears performance continues to improve and to be significantly better than that of the industry as a whole. As at 31 December 2017, 0.13% of mortgage balances were 2.5% or more in arrears (2016: 0.17%) compared with the latest available industry average[6] of 0.81%.

Liquidity

On-balance sheet liquid assets have increased to £6.2 billion (2016: £4.8 billion). This growth is predominantly due to the replacement of off-balance sheet Funding for Lending Scheme (FLS) liquidity with on-balance sheet Term Funding Scheme (TFS) drawdowns.

Liquid assets are held primarily in deposits at the Bank of England and UK Government investment securities such that asset quality remains very high with 96% of the portfolio rated Aaa–Aa3 (2016: 96%) and 4% rated A1–A3 (2016: 4%). The Society has no direct exposure to the peripheral Eurozone countries and 99% of liquid assets are held in UK sovereign and financial institutions.

As at 31 December 2017, no liquidity investments were either past due or impaired and as such no impairment provision has been made.

Of the £6.2 billion liquid assets, £1.0 billion are held as Available-for-sale (AFS) assets and are marked to market with any changes in value recorded through other comprehensive income. As at 31 December 2017, the balance on the AFS reserve was a £5.7 million gain, net of tax (2016: £6.7 million gain, net of tax).

On-balance sheet liquid assets have previously been supplemented by unencumbered Treasury bills obtained under the FLS which were held off balance sheet in accordance with FLS scheme rules. At year end all FLS Treasury bills have been repaid (2016: £2.4 billion drawn with £1.1 billion unencumbered).

The Liquidity Coverage Ratio (LCR) at 31 December 2017 was 208% (2016: 151%), considerably above the minimum regulatory requirement. The LCR increase reflects amounts drawn down against the TFS ahead of its closure in February 2018.

Retail funding

Retail savings have increased in the year by £3.0 billion to £31.0 billion (2016: £28.1 billion), representing growth of 10.6%, in comparison with market growth of only 2.7%[4]. The Society's savings market share increased to 2.4%[4] (2016: 2.0%) with over 145,000 new savings accounts opened in 2017. The increase in savings balances allowed the Society to offer mortgages on 17,000 additional homes. In total over 91% of mortgage balances are funded by retail savings or capital.

The Society has continued to support the cash ISA market with competitive rates of interest, increasing its share of this market to 5.1%[4] (2016: 3.9%).

The growth in savings demonstrates the Society's commitment to providing its members with attractive rates of interest relative to the market despite the availability of cheaper wholesale funding. During the year the interest paid by the Society represented a return of value to savers of over £210 million relative to the average UK bank or building society[7].

Wholesale funding

The Society accesses the wholesale markets to provide funding diversity which reduces risk and also lowers the overall cost of funding.

In 2017, on-balance sheet wholesale funding increased by £1.4 billion to £9.1 billion (2016: £7.7 billion). The increase primarily reflects wholesale issuances (medium-term notes and covered bonds – see below) net of maturities and TFS drawdowns. At the year end, the Society had drawn down £3.0 billion under the TFS (2016: £nil) but had returned all of the £2.4 million FLS Treasury bills held at the 2016 year end.

In January 2017, the Society issued a €500 million euro covered bond. The Society also issued a £350 million medium-term note in May 2017 and a further £450 million medium-term note in October 2017.

4. Source: Bank of England, household sector.
5. Source: CML Economics – 2016 balance outstanding.
6. Source: Prudential Regulation Authority latest available information as at 30 September 2017.
7. Based on the Society's average month end savings rate compared with the Bank of England average rate for household interest bearing deposits on the Society's mix of products.

Equity

The Society's equity is predominantly made up of its general reserve and Additional Tier 1 capital; it also includes the Available-for-sale (AFS) reserve and cash flow hedge reserve. The Society's total equity increased by £0.2 billion to £2.0 billion, reflecting retained profits generated during the year.

Regulatory capital

Capital is held to protect members against future losses under the Capital Requirements Directive (CRD) IV.

The Society's CRD IV capital position (excluding any transitional provisions) as at 31 December 2017 is summarised below. During the year capital resources have increased primarily driven by profit after tax of £184.8 million.

At the same time, despite mortgage growth of 9.3%, risk-based capital requirements or risk weighted assets have only marginally increased as a result of house price inflation reducing effective risk weights and a continuing focus on low loan to value lending.

As a result, the Society's Common Equity Tier 1 (CET 1) ratio has increased from 32.2% to 34.9%.

The leverage ratio was stable at 4.1% as the increase in capital was matched by an 11% increase in non-risk-based leverage ratio exposures driven primarily by mortgage growth and higher liquidity assets.

During 2016, the Prudential Regulatory Authority (PRA) announced that the leverage ratio used within the UK leverage framework would exclude central bank reserves and on this modified basis the Society's leverage ratio is 4.6% (2016: 4.4%).

	End-point 31 Dec 2017 £m	End-point 31 Dec 2016 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	1,471.6	1,320.8
Total Tier 1 capital	1,868.5	1,717.7
Total capital	1,910.0	1,722.0
Risk weighted assets	4,213.1	4,099.3
Capital and leverage ratios:	%	%
Common Equity Tier 1 (CET 1) ratio	34.9	32.2
Leverage ratio[1]	4.1	4.1
Leverage ratio (modified)[2]	4.6	4.4

1. The leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation. The calculation reflects constraints in the inclusion of Additional Tier 1 capital in accordance with the Financial Policy Committee's leverage ratio regime regulations.
2. Leverage ratio modified under the UK regulatory regime by excluding central bank reserves from the calculation of leverage exposures.

The Society is provided with Individual Capital Guidance (ICG) by the PRA. Following a Supervisory Review process in the first half of 2016, the Society was issued with an ICG, which is currently 12.8% of risk weighted assets, or £539 million. This sets the minimum capital which the Society must hold under Pillar 1 and Pillar 2A requirements and is driven by both Balance Sheet growth and risk factors determined by the PRA. The Society comfortably meets this requirement using CET 1 capital alone.

Additional information

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

Corporate Responsibility Report

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

Coventry CARES

Coventry Building Society is an independent mutual organisation with a simple purpose – to meet the needs of our members for savings and residential mortgages. This is articulated as Putting Members First and this principle guides all decision making across the Society. It is underpinned by a set of Values: to be Caring, Attentive, Reliable, Ethical and Straightforward. Our commitment to the Coventry CARES Values is the foundation of our approach to corporate responsibility; for members, employees, the environment and the communities we serve.

We view our corporate responsibilities as intrinsic to the way we do business and evidence of our performance in meeting these responsibilities is shown throughout the Annual Report & Accounts, including our performance against our strategic measures. The following sections highlight specific examples of progress made during 2017.

Coventry CARES about members

As a mutual organisation, our customers are also members, and the owners, of the Society. The absence of shareholders gives clarity of purpose that means we are dedicated to meeting the needs and protecting the interests of our members. We do this by remaining strong and secure, by providing long-term value to our members and meeting their service expectations.

To ensure we capture their views we actively listen to our members. In addition to customer surveys covering all customer channels, we launched a Members Panel in 2017 which now has more than 2,500 members. This is an online community, open to all members, which provides a discussion forum and a feedback opportunity to the Society. Through this and other engagement channels, including Members Roadshows and focus groups, members have been consulted on a wide variety of topics.

We continue to drive forward our simple and open approach to serving members. We were one of the first financial institutions to confirm that we were raising the rate of interest on all variable rate savings and mortgage accounts when the Bank of England raised its Base Rate in November. Further examples include enabling members to compare our accounts against those of competitors and to provide interest rate details in pounds and pence, which is more understandable and relevant to many members.

In 2017, we were the first retail savings provider to be awarded the Clear & Simple Mark by Fairer Finance for our general investment terms and conditions. Fairer Finance also awarded the Society its Gold Ribbon status for both savings and mortgages, ranking the Society first for savings for the third year running.

We give additional support to vulnerable members, empowering and helping employees to find appropriate solutions for people's individual needs. This includes using dedicated communication channels or making referrals to an appropriate third party. In 2017 we also initiated a network of 'Vulnerability Experts' amongst our employees to enhance the support we provide.

Coventry CARES about employees

Our employees underpin our service delivery to members and the way we recruit, develop, support and engage employees is key to delivering our corporate responsibilities. In 2017, we were named one of the Sunday Times 100 Best Companies to Work For, reflecting our commitment to all employees.

This achievement reflects the positive actions taken to meet the needs of our employees for flexible working and wellbeing, as well as to support their personal development and career progression. In 2017, the Society launched a new Wellbeing programme with initiatives covering physical, mental and emotional wellbeing, with all employees being encouraged to spend time on their personal wellbeing.

> **The Society was rated 'Outstanding' for staff engagement in the 2017 Best Companies annual survey, with 91% of employees proud to work for the Society.**

We aim to encourage all employees to reach their potential and in 2017 added an apprenticeship programme to our existing graduate scheme. We also launched a new career programme to develop the skills and knowledge required for senior roles in the organisation. These initiatives aim to build a pipeline of future talent across the Society.

> **The Society was named one of the 'Best Employers for Race' by Business in the Community.**

As a result of new gender pay reporting legislation, the Society has published calculations showing the difference between average pay for male and female employees. These show a mean pay gap of 33.1%. Our gender pay gap is primarily due to the Society having a large proportion of women in non-managerial or customer service roles and more men than women in managerial, technical or specialist roles which attract higher pay. We continue to focus on making all roles accessible to everyone and creating genuine opportunities for talented people. Initiatives such as flexible working, career development programmes and the apprenticeship and graduate schemes will be important in progressing our commitment to reduce the gender pay gap.

More details can be found at thecoventry.co.uk/corporate-governance.

Coventry CARES about the environment

As we grow, the resources we use increase, with a potentially greater environmental impact.

We continue to work on becoming more efficient in heating and lighting our buildings, increasing the effectiveness of recycling programmes and improving employee awareness of environmentally responsible behaviour such as reducing paper use.

In 2017, the Society started to focus on improving biodiversity at our main Binley campus. The first stage of this was to install a number of bird boxes. To combine this with our Community programme, the Property team went along to a local primary school and built 25 boxes together with the children. These were then shared between the school and Society sites.

Coventry CARES about the communities we serve

Our community programme reflects the value we place on supporting our local communities. It delivers tangible benefit to charities, community groups and schools, and also improves employee engagement, as employees have the opportunity to support causes they feel passionate about and to develop skills away from the workplace. In 2017, over three quarters of employees were involved in some aspect of the community programme.

Increasingly, we are integrating the work we do with partner charities to align with other Society initiatives. The Employability programme, a series of employee led workshops that help 16/17 year olds prepare for work, has proved a successful route for students to join the Society's internship programme and subsequently secure full time employment. Likewise, the opportunity to volunteer on the programme has enabled employees to gain or practise the skills needed to progress their careers.

On the theme of financial education and life skills we also fund a Financial Inclusion Manager with Coventry Citizens Advice, who runs training sessions with branch staff to improve the support we offer to vulnerable members.

All aspects of our community programme builds links between our business activity and our local communities. A good example was the launch in 2017 of 'Serving our Communities' in the branch network. This encourages our branch teams to use their skills and expertise to understand and support local needs. Examples of activities include employees delivering fraud awareness sessions in Punjabi and the fire service being invited to talk to members following the Grenfell disaster. This shows how the branch network, which is central to the Society's ethos, goes beyond simply meeting the saving and borrowing needs of members.

> In 2017, our schools initiatives reached over 3,900 children and young people, and covered everything from basic literacy and numeracy skills to CV writing and fraud prevention.

Overall in 2017 we have supported over 75 local charities or community groups either through these types of initiatives or through employees fundraising and volunteering. We support this through paid volunteering time, matching of employee fundraising, and community grants. The Society's Charitable Foundation is a further source of funding for local charities.

> Our Charitable Foundation continues to provide essential grants to small grassroots organisations. The 2017 donations bring the total donated since 1998 to £1.2m.

We have also supported nationally recognised charities. We will shortly celebrate our 10 year partnership with The Royal British Legion. Since this began in 2008, we have donated over £15 million, predominantly as a result of our popular Poppy portfolio of savings accounts. In addition, over 900 volunteering hours were provided by Society employees during the 2017 Poppy Appeal.

Equally important is our support for Children in Need. We were once again chosen as an official contact centre for the appeal with volunteers from across the Society taking 3,300 calls with pledges of £140,000 on the night.

We were also a leading supporter of Coventry's bid to become the UK City of Culture in 2021. Coventry's success represents a fantastic opportunity for the city, and the Society, as Coventry features increasingly in the public eye over the coming years.

Risk Management

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

Introduction	23
Principal Risks	29
Capital	53

Introduction

Introduction and Principal risks

This Risk Management Report explains the Society's business, the Principal risks it is exposed to and how it manages them. Capital is one of the means by which the Society seeks to protect members from the impact of a risk event, so this report also summarises the Society's capital position.

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

The Society's purpose and objectives

The Board determines and revisits the Society's purpose and objectives through the annual strategic planning process. The risk management process complements and supports the Society's Strategic Plan.

The Society exists solely for the benefit of its current and future members, meeting their needs for savings and residential 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 drive the risk philosophy adopted by the Society to be a 'below median risk mutual', which in turn drives its risk culture, operations and appetite.

The Society operates a very simple business model delivering simple products, simple ways of operating, and simple and transparent communications. It operates solely within the UK retail financial services market and only takes risks that are understood and can be managed.

The Society's Principal risks are set out below.

Principal risks	Definition
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Retail credit risk and treasury credit risk are treated as separate Principal risk categories.
Market risk	The risk of a reduction in Society earnings and/or value resulting from adverse movements in financial markets. This includes a number of risks arising in the banking book such as interest rate and currency risks.
Liquidity and Funding risk	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk.
Conduct risk	The risk that the Society's behaviour and decision making fails to deliver good customer outcomes.
Operational risk	The risk of loss arising from inadequate internal processes, systems or people, or from external events.
Model risk	The risk that an ineffective model or incorrectly interpreted model output leads to a loss, reputational damage or regulatory censure.
Strategic risk	The risk arising from changes to the business model or that macroeconomic, geopolitical, regulatory or other factors may lead to the business model, strategy or Strategic Plan becoming inappropriate.

In addition to the Principal risks noted above, the Society also has pension obligation risk, because the Society previously offered a defined benefit pension scheme. As at 31 December 2017, the scheme had a surplus of assets over liabilities of £18.5 million. The scheme was closed to new entrants in 2001 and to future service accrual during 2013. These actions have served to reduce the potential volatility of the scheme's liabilities. Pension obligation risk is not considered to be a Principal risk, and therefore is not discussed further in this Risk Management Report. Additional information is included in note 19 to the accounts.

Controlling and managing risk

Overview

The Society's risk management approach is based on the Enterprise Risk Management Framework (ERMF) which has continued to operate effectively during 2017. Its primary purpose is to set out the Board's approach to managing risk and the provision of oversight by defining and documenting the Society's purpose and objectives; risk strategy; risk appetite; governance and control; and risk management. The Society will continue to enhance the ERMF to strengthen risk management in response to changes and developments within the Society, best practice and regulatory requirements.

Risk strategy

The risk strategy is set by the Board and translates the Society's purpose and objectives into an approach to risk management that incorporates risk culture, the Board risk appetite and the adoption of the 'three lines of defence' model (see diagram opposite).

Risk culture

Risk culture supports the Society in achieving its stated purpose and objectives. It is defined as the normal attitudes and behaviour exhibited by employees 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 employees to act with integrity, especially in the fair treatment of customers, and to escalate observed non-compliance. Employees are encouraged to report risk incidents and 'near misses'.
- Accountability – employees understand the core values of the Society and therefore the approach to risk. Where individuals have specific risk management responsibilities, these are included within role profiles and objectives, and employees understand that they will be held accountable for their actions and risk taking behaviours. Substantially all Society roles are covered by the 'Strengthening Accountability in Banking' regulatory framework, which addresses the conduct expected of those working within financial services.
- Incentives – the Society's performance management arrangements promote the Society's desired risk management behaviours and attitudes. In particular, the Society does not operate any sales incentives for employees.

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 backstop against the underlying risk appetite statements and limits. Where the Society can meet its strategic objectives and remain well within its risk appetite, the Board expects the Society to do so.

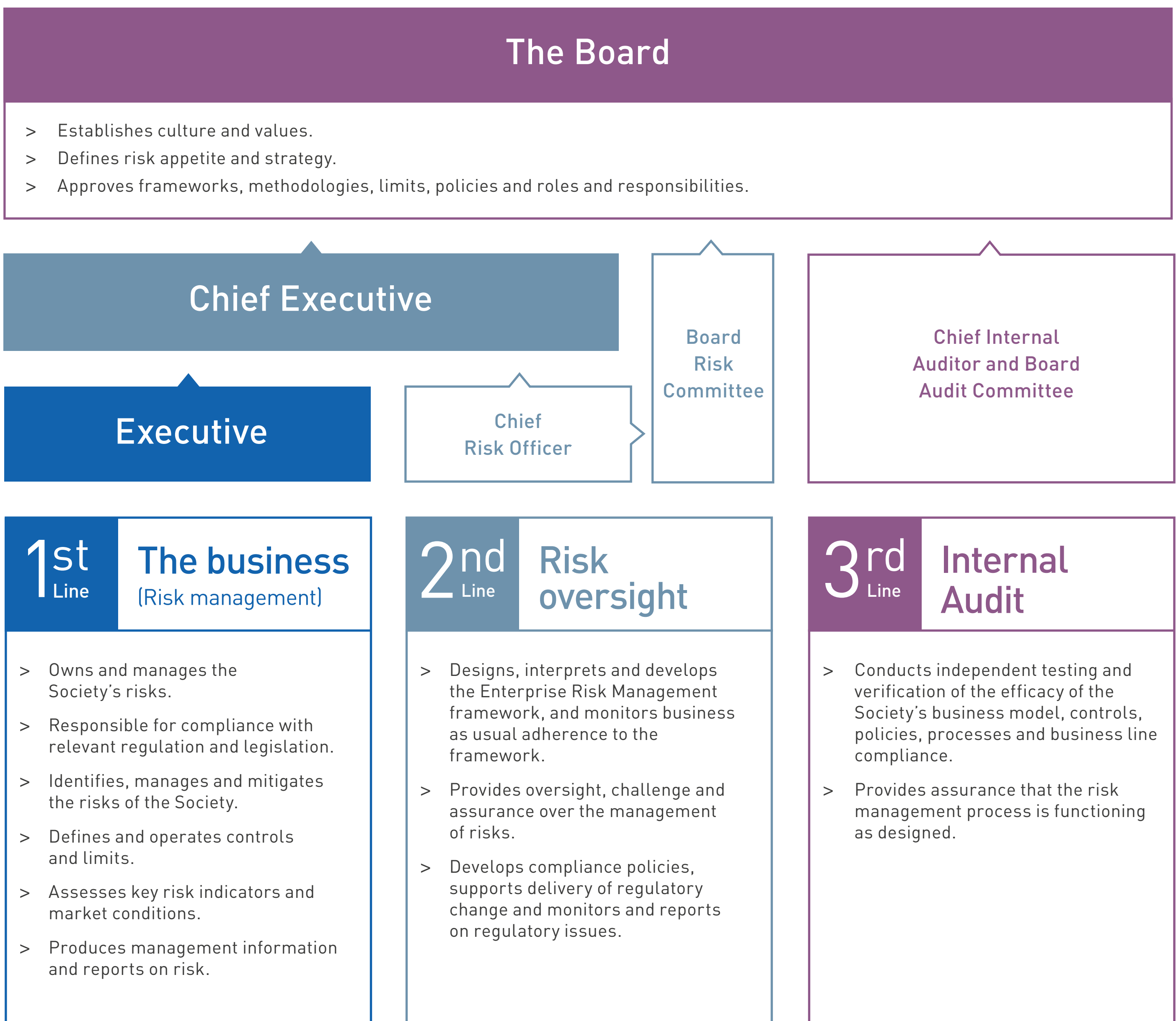
The Society's performance and adherence to Board limits is reviewed by the Executive Risk Committee (ERC), the Board Risk Committee (BRC) and the Board.

Three lines of defence

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

- First line of defence – risk management is primarily the responsibility of all managers and employees of the Society. Management has a responsibility to understand risks and to put in place controls or mitigating activities.
- Second line of defence – independent oversight is required to challenge managers and employees effectively and to provide risk management expertise. This is provided through the Risk function and Risk Oversight Committee (ROC). The Chief Risk Officer reports to the Chief Executive and has an independent reporting line directly to the Chair of BRC.
- Third line of defence – the Society's Internal Audit function is responsible for providing independent assurance. The Chief Internal Auditor has an independent reporting line directly to the Chair of the Board Audit Committee (BAC). BAC approves the work programme of Internal Audit and reviews outcomes from the work performed.

The application of the three lines of defence model within the Society is illustrated below:



Governance and control

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

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

The Board

Board Risk Committee (BRC)

Chair: Non-executive Director

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

Board Audit Committee (BAC)

Chair: Non-executive Director

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

Chief Executive

Executive Risk Committee (ERC)

Chair: Chief Executive

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

Risk Oversight Committee (ROC)

Chair: Chief Risk Officer

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

Conduct Risk and Compliance Committee (CRCC)

Chair: Chief Executive

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

Asset and Liability Committee (ALCO)

Chair: Chief Financial Officer

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

Retail Credit Risk Committee (RCRC)

Chair: Chief Risk Officer

> Monitors the management of retail credit risk across the Society and the performance of the mortgage book to ensure compliance with risk limits approved by the Board.
> Oversees management of model risk through its sub committee; Models and Ratings Committee.

Operational Risk Committee (ORC)

Chair: Chief Operating Officer

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

Risk management

The Society's risk management approach involves identifying, assessing, managing, monitoring, escalating and reporting risks through risk and control self-assessment, risk indicators and risk management information.

These processes deliver the Society's risk management objectives to:

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

Stress testing and planning

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

The stress testing that the Society undertakes is designed to:

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

More detail on the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) together with Reverse Stress Testing are set out in the sections covering Capital, and Liquidity and Funding risk below.

Top and emerging risks

The Society considers that its top and emerging risks relate to the state of the UK mortgage market and the extent of technology-based change that it needs to undertake over the coming years. To a lesser extent, wider economic and political uncertainty have the potential to impact the Society.

Mortgage market

There are a number of factors which taken together could exert pressure on the Society's net interest margin.

The UK mortgage market has seen increased price competition over 2017. The Society expects this trend to continue as new entrants emerge and as ring-fencing potentially increases the focus of UK ring-fenced banks on the core mortgage market.

There is some evidence that house purchases are slowing, but despite this the owner-occupier mortgage market remains strong, supported by a growing demand for remortgage business.

As anticipated, the expansion in the buy to let mortgage market has been more subdued following tax and regulatory changes and in 2017, lending was largely made up of remortgage activity. The Society is a relatively large participant in the buy to let market and will therefore continue to carefully monitor buy to let activity.

The Society is of the view that the fundamentals of the UK housing market remain strong and that its deep experience and expertise in UK residential mortgages, combined with its cost-efficient and highly effective intermediary distribution model, means that it is well placed to deliver on its strategic objectives.

Technology-based change

A number of factors are combining to drive an increased level of IT and technology change that needs to be delivered by the Society over the coming years. These factors include:

- Rising customer expectations for service delivery and enhanced functionality.
- Higher threat levels from increasingly sophisticated cyber criminals.
- Increased expectations for resilience from regulators.

The Society has initiated a number of change programmes to address these needs, in particular programmes to deliver enhanced data centre capability and upgrade the Society's core banking platform. The programmes will deliver additional resilience and flexibility over the next three years. However, these programmes also drive additional costs and carry execution risk. The Society believes that it is putting in place the controls necessary to ensure that this level of change can be delivered safely without disrupting its core operations and that it has set appropriate investment budgets to deliver the change.

UK economic and political uncertainty

The Society does not believe that it has any direct exposure to risks arising from the UK's exit from the European Union as its business is entirely UK based and it has no significant treasury or other European exposures. There is a risk that uncertainty around Brexit or the political environment could impact the wider economy through reduced confidence, which may lead to a contraction in house purchase levels or in house prices. This may result in a continuation of a very low interest rate environment for the medium term.

Whilst this would present a more difficult operating environment, the Society has demonstrated that its simple, low cost model designed to deliver value to members is able to thrive in a low rate environment and the Board is satisfied that it has positioned the Society to protect it against any adverse outcomes.

In addition to these top and emerging risks, each of the Society's Principal risks, as highlighted in the table on page 23, are discussed in detail in the following sections.

Principal Risks

Principal Risks

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 the contractual nominal amounts.

	On-balance sheet carrying value 2017 £m	Off-balance sheet exposures[1] 2017 £m	Maximum credit risk exposure 2017 £m	On-balance sheet carrying value 2016 £m	Off-balance sheet exposures[1] 2016 £m	Maximum credit risk exposure 2016 £m
Cash and balances with the Bank of England	4,995.2	–	4,995.2	3,260.0	–	3,260.0
Loans and advances to credit institutions	202.0	–	202.0	213.5	–	213.5
Debt securities	1,012.3	–	1,012.3	1,354.3	2,398.6	3,752.9
Loans and advances to customers	35,930.9	1,480.7	37,411.6	32,881.6	1,689.7	34,571.3
Hedge accounting adjustments	17.2	–	17.2	144.5	–	144.5
Derivative financial instruments	306.5	–	306.5	354.2	–	354.2
Total	42,464.1	1,480.7	43,944.8	38,208.1	4,088.3	42,296.4

1. Off-balance sheet exposures comprise loan commitments and, in 2016 only, Treasury bills relating to the Funding for Lending Scheme.

Retail credit risk

Retail credit risk profile

The Society continues to focus on low risk, high quality owner-occupier and buy to let mortgages. Non-traditional mortgage lending outside these core segments was discontinued in 2008 and balances on these legacy products, including loans acquired as a result of the merger with Stroud & Swindon Building Society in 2010 now comprise just 0.9% (2016: 1.2%) of total gross balances.

During 2017, arrears continued to fall, reflecting the benign economic environment and the consistent sound underwriting principles of the Society. Whilst Bank of England Base Rate rises may impact future arrears we expect the Society and its borrowing members to be resilient.

Exposure to owner-occupier interest only lending continues to reduce as a result of withdrawing these products in 2012 and only 8.6% of the owner-occupier portfolio was on interest only terms as at 31 December 2017 (2016: 11.1%). The Society actively manages contact with customers to help assess their ability to repay the capital when due or, if potential difficulties are identified, to seek suitable solutions. At the end of 2017, there were 305 owner-occupier interest only cases that were past term (2016: 404). The average loan to value of the interest only owner-occupier book was 39.2% (2016: 39.9%).

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

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

Loans and advances to customers (Audited)	2017 £m	2017 %	2016 £m	2016 %
Residential mortgages: owner-occupier	21,714.4	60.4	20,094.5	61.0
Residential mortgages: buy to let	13,905.9	38.7	12,423.8	37.8
Total traditional residential mortgages	35,620.3	99.1	32,518.3	98.8
Residential near-prime mortgages	77.2	0.2	87.8	0.3
Residential self-certification mortgages	215.9	0.6	252.9	0.8
Commercial mortgages[1]	2.8	–	3.6	–
Total non-traditional mortgages	295.9	0.8	344.3	1.1
Unsecured personal loans[1]	31.8	0.1	37.5	0.1
Total gross balance	35,948.0	100.0	32,900.1	100.0

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

Geographical concentration (Audited)

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

Region	2017 %	2016 %
London	26.1	24.6
South East England	18.4	18.1
Central England	15.0	15.9
Northern England	14.0	14.8
East of England	11.3	11.0
South West England	9.1	9.2
Scotland	3.6	3.7
Wales and Northern Ireland	2.5	2.7
Total	100.0	100.0

Loan to value and income multiples

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

The standard maximum income multiple for owner-occupier mortgages is 4.5. Any lending at or above 4.5 times income is closely monitored and in both 2017 and 2016 2% of advances were made at or above this level, which is well below the maximum limit of 15% set by the Financial Policy Committee (FPC). Maximum income multiples are also reduced if the loan term extends into retirement to ensure it remains affordable. Lower loan to value limits apply to larger loans.

The Society sets minimum interest coverage ratios to ensure that buy to let loans are affordable and that borrowers are able to withstand periods of rental voids and the costs of upkeep and repair associated with rental properties, as well as the effect of lost tax relief on mortgage interest for higher rate taxpayers. For higher tax rate buy to let customers impacted by restricted tax relief, the Society requires a minimum interest coverage ratio of 140%. A lower minimum interest coverage ratio of 125% was introduced in the year for basic rate tax payers. The Group's actual indexed interest coverage ratio at the end of the year using a stressed 5% interest rate was 176.7% (2016: 175.2%).

The loan to value distribution of the mortgage book as at 31 December 2017 has remained broadly stable as shown below. The following tables are by value of loans unless stated otherwise:

Total mortgage book profile by number of accounts (Audited)	2017 %	2016 %
Indexed loan to value:		
< 50%	51.0	49.7
50% to 65%	26.0	25.2
65% to 75%	13.9	14.3
75% to 85%	6.6	7.7
85% to 95%	2.4	2.9
> 95%	0.1	0.2
Total	100.0	100.0
Average indexed loan to value of stock (simple average)	47.1	47.8
Average indexed loan to value of stock (balance weighted)	53.9	54.6

For the London region, the average indexed loan to value of stock (balance weighted) is 50.9% (2016: 49.9%) and for the book excluding London is 55.0% (2016: 56.1%).

The profile of gross lending in the year is shown below and shows that there has been an increase in the proportion of owner occupier lending, reflecting market trends in the year:

Gross lending – new business profile (Audited)	2017 %	2016 %
Owner-occupier purchase	33.8	32.3
Owner-occupier remortgages	28.2	24.8
Owner-occupier further advances	1.7	1.3
Buy to let purchase	7.0	12.0
Buy to let remortgages	28.8	28.9
Buy to let further advance	0.5	0.7
Total	100.0	100.0
Average loan to value (simple average)	56.9	60.9
Average loan to value (balance weighted)	59.8	63.7

Retail credit risk management – mortgages

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

Credit risk is overseen by the Retail Credit Risk Committee (RCRC), and ultimately the Board via the Committee hierarchy set out previously. To assist RCRC in this activity, a specialist retail credit risk department reporting to the Chief Risk Officer monitors exposure to credit risk and provides information to RCRC on a regular basis.

Prudent risk limits within the context of the Society's overall risk appetite are set by the Board and are reflected in the Society's lending policy. RCRC ensures appropriate controls are in place to maintain the quality of lending within these limits. It reviews comprehensive management information, industry benchmarking data and publicly available information to aid its understanding of the quality of the portfolio.

The Society has an automated decision system that contains credit scorecards to provide a statistical assessment of the risk of each application, and policy rules which assess each application against key lending policy criteria. These statistical and policy rule assessments ensure consistent decision making, and highlight to underwriters any marginal applications that require a manual assessment.

Assurance that new lending processes and lending decisions are robust and operate within the Society's policy rules is provided through the three lines of defence model. The first line (the new lending operations teams) performs various checks whilst applications are being processed, and in the second line a quality assurance team within the risk function reviews lending decisions after completion. These risk function checks ensure that continuous learning and improvement is embedded, whilst minimising the chances of systemic issues remaining unidentified and adversely impacting the quality of new lending. The third line (Internal Audit) reviews the controls and processes across the lending operations function, including the quality assurance programme, to a frequency dictated by its risk assessment methodology.

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

Prudent loan to value limits are applied to both owner-occupier and buy to let mortgages, and in addition for buy to let loans properties are required to be readily saleable into the owner-occupier market. Loan applications are assessed using a stressed interest rate to ensure minimum income coverage levels are met even if interest rates rise significantly.

In 2017, further underwriting requirements were introduced to align with recent regulation changes for landlords with four or more mortgaged properties. The Society has consistently applied prudent lending criteria for these customers and is satisfied that these remain appropriate.

The Society has a natural concentration in the UK market, as it only lends on properties within the UK. It regularly monitors the geographical distribution of lending and any potential over-exposures in specific areas. Similarly, the Society monitors lending by distribution channel and product to ensure the risk of over-exposure to any one counterparty or region is managed.

The Society acknowledges that recent levels of growth mean that a relatively large proportion of the mortgage book is new and therefore may not have had sufficient time for its performance to be established. However, low loan to value limits protect the Society and its members from losses.

Regular stress testing is undertaken on the mortgage portfolio to establish the level of loss that 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.

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

In addition, as part of its commitment to Putting Members First, the Society proactively contacts borrowers most at risk of experiencing potential payment difficulties. This is one example of how the Society seeks to protect its members' interests whilst at the same time mitigating the risk of credit losses.

Arrears management is undertaken by a specialist department and overseen by Retail Credit Risk Committee. It applies the Society's overarching mission of Putting Members First and treating customers fairly. Repossession of a property is only sought when all reasonable efforts to regularise matters have failed or where the mortgage is unsustainable in the longer term.

Identifying impaired loans (Audited)

Loans are categorised by arrears status in line with industry practice. Loans are either up to date at the Balance Sheet date, past due by up to three months but not impaired, or impaired if more than three months in arrears or in possession.

The number of accounts in arrears as a percentage of loans and advances to customers has improved from the already low levels seen last year and is substantially lower than the sector average as reported by UK Finance (formerly the Council of Mortgage Lenders (CML)) data, as shown below:

(Audited)	2017 Society %	2017 UK Finance[1] %	2016 Society %	2016 UK Finance[1] %
Greater than three months	0.23	0.82	0.31	0.93
Greater than six months	0.09	0.49	0.12	0.54
Greater than one year	0.02	0.25	0.04	0.26
In possession	0.01	0.03	0.01	0.03

1. UK Finance data as at 31 December 2017 (31 December 2016 revised).

An analysis of past due and impaired loans by loan to value is shown below and this shows that arrears in all categories continue to fall, reflecting the benign economic environment and consistently sound Society underwriting principles.

	Not impaired		Impaired				
As at 31 December 2017 (Audited) Indexed loan to value:	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
< 50%	14,144.3	106.2	13.2	6.9	1.1	(2.7)	14,269.0
50% to 65%	11,244.9	85.1	12.2	9.9	0.2	(4.1)	11,348.2
65% to 75%	6,062.8	41.3	7.5	4.6	0.3	(1.5)	6,115.0
75% to 85%	2,935.5	23.6	5.0	4.3	0.2	(1.4)	2,967.2
85% to 95%	1,147.6	11.7	3.5	3.3	0.4	(1.1)	1,165.4
> 95%	31.0	3.7	1.4	1.5	3.0	(2.5)	38.1
Unsecured	28.9	2.5	0.3	0.1	–	(3.8)	28.0
Total	35,595.0	274.1	43.1	30.6	5.2	(17.1)	35,930.9

	Not impaired		Impaired				
As at 31 December 2016 (Audited) Indexed loan to value:	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
< 50%	12,456.7	106.9	15.9	7.6	0.1	(2.6)	12,584.6
50% to 65%	10,016.0	82.6	13.9	13.8	0.3	(3.8)	10,122.8
65% to 75%	5,764.1	48.7	10.4	4.8	–	(2.2)	5,825.8
75% to 85%	2,990.4	28.6	7.0	5.0	–	(1.4)	3,029.6
85% to 95%	1,199.3	17.5	5.7	4.0	0.1	(1.5)	1,225.1
> 95%	47.5	7.2	1.8	3.4	3.3	(2.7)	60.5
Unsecured	33.8	3.0	0.4	0.3	–	(4.3)	33.2
Total	32,507.8	294.5	55.1	38.9	3.8	(18.5)	32,881.6

As at 31 December 2017, the Society held properties valued at £5.1 million (2016: £3.3 million) pending their sale against balances net of provisions of £4.0 million (2016: £2.8 million). Any shortfalls between expected net sale proceeds and the balance outstanding are fully provided.

The table below provides further information regarding the impaired status of mortgages and loans:

As at 31 December 2017 (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	21,491.6	172.0	29.4	18.9	2.5	(3.8)	21,710.6
Buy to let	13,831.2	62.3	5.4	4.7	2.3	(6.9)	13,899.0
Non-traditional mortgages							
Residential near-prime	51.5	17.6	4.3	3.4	0.4	(0.4)	76.8
Residential self-certified	189.2	19.5	3.7	3.5	–	(1.4)	214.5
Commercial lending	2.6	0.2	–	–	–	(0.8)	2.0
Unsecured	28.9	2.5	0.3	0.1	–	(3.8)	28.0
Total	35,595.0	274.1	43.1	30.6	5.2	(17.1)	35,930.9

As at 31 December 2016 (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	19,844.2	189.1	35.1	24.4	1.7	(5.1)	20,089.4
Buy to let	12,348.9	61.8	6.0	5.6	1.5	(7.1)	12,416.7
Non-traditional mortgages							
Residential near-prime	57.5	18.6	7.8	3.9	–	(0.3)	87.5
Residential self-certified	220.1	21.7	5.8	4.7	0.6	(0.9)	252.0
Commercial lending	3.3	0.3	–	–	–	(0.8)	2.8
Unsecured	33.8	3.0	0.4	0.3	–	(4.3)	33.2
Total	32,507.8	294.5	55.1	38.9	3.8	(18.5)	32,881.6

Movement in impaired loans

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

As at 31 December 2017 (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 2017	61.2	13.1	11.7	11.1	–	0.7	97.8
Classified as impaired during the year	64.0	19.0	11.3	11.4	–	0.7	106.4
Transferred from impaired to unimpaired	(67.8)	(18.8)	(14.6)	(14.2)	–	(0.5)	(115.9)
Amounts written off	(0.6)	(0.3)	–	(0.1)	–	–	(1.0)
Charged to impaired loans	1.2	0.4	0.3	–	–	–	1.9
Repayments and other movements	(7.2)	(1.0)	(0.6)	(1.0)	–	(0.5)	(10.3)
Impaired at 31 December 2017	50.8	12.4	8.1	7.2	–	0.4	78.9

Loan balances are shown gross of provisions. Amounts written off reflect losses on properties sold from possession where the balance on the loan was in excess of the sale proceeds. Repayments and other movements include sale proceeds from properties in possession, and repayments from customers reducing 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 11 to the accounts.

Extent and use of forbearance (Unaudited)

The Society will always seek to work with existing borrowers who experience financial stress to arrive at a mutually acceptable, sustainable solution. It will consider exercising forbearance if it is in the best interests of both the borrower and the Society to do so. The principal forbearance measures provided by the Society are as follows:

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

On very rare occasions, capitalisation of the arrears may be considered but this will only be undertaken once during the lifetime of the mortgage and only in specific circumstances. Capitalisation of arrears has only been used on two occasions in 2017 (2016: seven). Whilst the Society also has the facility to put repayment mortgages on to interest only terms for a temporary period as a means of exercising forbearance, this tool has not been used on new cases in the last year.

Where a loan is not in arrears, the most common means of exercising forbearance is by granting a short-term payment holiday. Whilst payment holidays are a feature of some of the products offered by the Society, where financial difficulties are the reason for the payment holiday request the action is recorded as being a forbearance measure rather than as one where the borrower is using the product feature. Where payment holidays are granted as a forbearance measure, it is only for a maximum of three months and the monthly amount required upon resumption of payments must be assessed as being affordable and sustainable.

Details of forbearance activity are set out in the table below:

	2017		2016	
	No. of accounts	Carrying value £m	No. of accounts	Carrying value £m
Forbearance: Accounts past due				
Arrangements	950	104.4	1,263	136.3
Concessions	44	5.2	44	5.6
Term extensions[1]	16	3.1	18	2.8
Capitalisation of arrears[1]	–	–	1	0.1
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	438	52.0	485	55.9
Term extensions[1]	105	16.8	84	12.6
Capitalisation of arrears[1]	2	0.5	6	0.5

1. Granted in the last 12 months.

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

Provisions have been raised against accounts subject to a forbearance measure totalling £2.1 million (2016: £2.7 million) for all cases in these forbearance categories (see note 11 to the accounts).

In addition, the Society has identified a number of indicators of potential impairment amongst members whose mortgages payments are not overdue - for example, accounts where direct debits had been cancelled or returned but payment was subsequently made. The Society continually monitors potential signs of impairment such as requests for changes to terms and conditions.

As at 31 December 2017, 2,220 loans had such potential impairment indicators, with balances of £279.2million (0.8% of the mortgage book). A collective provision of £0.1 million is held against these loans, which reflects the low probability of default and high collateral values of these mortgages.

Expected impact of IFRS 9 on impairment

The transition to an expected credit loss framework for calculating impairment provisions as a result of the introduction of IFRS 9 from 1 January 2018 is anticipated to have only a modest impact on the Society as a result of the Society's high credit quality, low risk mortgage lending. The impairment provisions for loans and advances to customers calculated under IFRS 9 as at 31 December 2017 are £0.1 million less than the existing IAS 39 provisions. The impact of IFRS 9 transition on regulatory capital is negligible. This reflects the underlying strength of the mortgage book, achieved through robust underwriting against a prudent lending policy in combination with significant equity protection as a result of the Society's low loan to value lending. Additional information is included in note 1 to the accounts.

Credit risk outlook

The Society will continue to focus its lending on high credit quality, low risk business and on low loan to value business to protect it from the risk of unacceptable levels of losses.

Interest rates increased this year for the first time in 10 years (albeit by only 0.25%), and the outlook is for further increases. Whilst individually these are expected to be modest, the cumulative effect may start to place some borrowers under additional strain, particularly if house price growth stalls and levels of consumer debt, which has been an area of concern for the Bank of England, becomes unsustainable.

Since the introduction of the Mortgage Market Review (MMR) in 2014 loan applications have been assessed against stressed interest rates. This, together with the relatively high proportion of the loan book on fixed rates, should protect both the Society and its members from the impact of rising rates.

Treasury credit risk

Treasury credit risk arises from the liquid and other financial assets held, and represents the risk that counterparties will fail to repay amounts when due.

Management of treasury credit risk

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

Treasury investment limits are focused on highly rated UK institutions, with additional limits extended to a small number of highly rated and systemically important banks in Europe, Australia, Canada and the United States. The limits reflect internal analysis, external credit ratings and any other relevant factors. All treasury credit limits are reviewed and approved by the Board annually.

Exposures are reviewed continuously to ensure that they remain within the approved limits and ongoing developments with treasury counterparties are closely monitored and reviewed by the Treasury Credit Committee. The Committee is empowered to take immediate action to reduce or suspend limits where there are adverse changes in the creditworthiness of counterparties, markets or local developments. The Committee reports through the Asset and Liability Committee (ALCO) to the Board via the Committee structure set out previously.

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

Treasury liquid assets profile (Audited)

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities. Over 99% of the Society's treasury assets have an investment grade as set out below:

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

	Exposure value by Moody's rating				
2016 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	6,714.0[3]	–	–	–	6,714.0
Financial institutions	183.9	311.6	1.4[2]	1.7	498.6
Mortgage backed securities	13.8	–	–	–	13.8
Total	6,911.7	311.6	1.4	1.7	7,226.4

1. Unrated financial exposure comprises a single exposure to a building society.
2. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities.
3. Balance includes off-balance sheet Treasury bills of £2,398.6 million drawn under the Bank of England's Funding for Lending Scheme. No such Treasury bills were held at the 2017 year end.

The following table summarises the Society's treasury assets split by geographical domicile. The substantial majority of treasury assets continue to be held within the UK; the increase in exposure to France in 2017 relates to the introduction of central clearing of derivatives which has increased collateral held by French counterparties.

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

	Liquid assets				Of which, debt securities		
2016 (Audited)	Sovereign £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	6,714.0[2]	488.2	13.8	7,216.0	3,629.6[2]	123.2	3,752.8
Germany	–	1.4[1]	–	1.4	–	–	–
Australia	–	6.6[1]	–	6.6	–	–	–
Canada	–	2.4[1]	–	2.4	–	–	–
Total	6,714.0	498.6	13.8	7,226.4	3,629.6	123.2	3,752.8

1. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities.
2. Balance includes off-balance sheet Treasury bills of £2,398.6 million drawn under the Bank of England's Funding for Lending Scheme. No such Treasury bills were held at the 2017 year end.

Counterparty credit risk mitigation

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

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

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

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

Coventry Building Society Covered Bonds LLP undertakes swaps under a separate ISDA agreement. Each agreement includes a CSA which provides for collateralisation of the swap exposure with exposure thresholds in place for two agreements before collateral is exchanged. The £45.2 million net derivative credit exposure in the table below includes £34.5 million in respect of these two arrangements which will only be fully collateralised if the counterparties are downgraded to below specified credit ratings.

Counterparty credit risk – derivative financial instruments (Audited)

The balance sheet exposure values of derivative instruments are as follows.
The net derivative credit exposure has remained stable.

(Audited)	2017 Exposure value £m	2016 Exposure value £m
Gross positive fair value of contracts	306.5	354.2
Netting benefits	(95.1)	(185.2)
Net credit exposure	211.4	169.0
Collateral held	(166.2)	(124.0)
Net derivative credit exposure	45.2	45.0

As at 31 December 2017, £39.8 million of the £45.2 million exposure is to Aa3 rated institutions with a further £5.4 million to A2 or above rated financial institutions.

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

Available-for-sale assets: Impairment provisions

As at 31 December 2017, the Society held £1,014.8 million (2016: £1,360.2 million) of Available-for-sale (AFS) assets. Unrealised gains and losses arising from changes in the fair value of assets which are AFS assets are recognised directly in the AFS reserve, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income Statement. For more information on AFS assets see note 1 to the accounts.

As at 31 December 2017, no AFS assets were either past due or impaired, and as such no impairment provision has been made.

Treasury credit risk outlook

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

Market risk

Market risk is the risk of a reduction in Society earnings and/or value resulting from adverse movements in financial markets including; interest rate, basis, swap spread, currency, inflation, and product option risks arising in the banking book. This loss can be reflected in the near-term earnings by changing net interest income, or in the longer term because of changes in the economic value of future cash flows.

Management of market risk

The main sources of market risk within the Society are mismatches between the repricing profiles of mortgages and savings products, certain characteristics embedded within these products and basis risk. Market risk only arises in the banking book as the Society does not have a trading book.

The Chief Financial Officer and Treasurer are responsible for managing current and emerging market risks on a day-to-day basis in accordance with the Society's risk appetite. The Society's primary objective is to manage risk to earnings over the strategic planning horizon by managing its risk exposure within prudent limits, matching assets and liabilities and the use of derivative financial instruments such as interest rate swaps, cross currency swaps, and equity release swaps.

Market risk exposure is overseen by the Asset and Liability Committee (ALCO) and ultimately the Board via the Committee hierarchy set out above.

Interest rate risk (Audited)

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 on mortgages and interest rates paid on savings and wholesale funding. Interest rate risk can also arise from product features within the design of savings and mortgage products such as the ability to redeem or transfer mortgage products.

Where the Society has advanced fixed rate mortgages, there is a risk that an increase in interest rates it pays on deposits or wholesale funding would leave the Society facing a higher interest expense on its funding, but without a compensating increase in interest income from fixed rate mortgages. The Society manages this risk by offsetting fixed mortgages and deposits with similar interest features or by entering into interest rate swaps, under which the Society's fixed rate income or cost is exchanged for a variable rate.

Interest rate risk lasts for the fixed term of the mortgage or deposit and is particularly relevant for the equity release mortgages held by the Society due to their long term. At 31 December 2017, £134.7 million of the £264.5 million equity release mortgage balance is hedged with interest rate swaps (2016: £141.9 million, of £287.9 million), while the remainder is notionally matched against reserves. In addition, the Society ensures that it has a significant proportion of discretionary variable rate savings and mortgages on its balance sheet to give it flexibility to manage different interest rate environments.

The Society operates within a series of Board approved limits which mitigate the impact of a change in interest rates on both net interest income and the present value of the balance sheet. The limits reflect the maximum acceptable impact of a 200 basis point parallel shock to interest rates on the present value of the Society's assets and liabilities (PV200) and net interest income throughout the reporting period. The calculation includes a notional investment term for the reserves.

Within these calculations, assumptions on loan prepayments and non-maturing deposits are based on historical prepayment profiles. These assumptions are reviewed at least annually and are subject to independent oversight by the Society's risk function. The impact of a 200 basis point shock on both the present value of assets and liabilities and on net interest income is set out below. The balance sheet is positioned so that net interest income benefits from rising interest rates, as shown by the impact of an upward rate shock on the net interest income measure. It is broadly balanced for market value changes, as shown by the relatively small PV200 measure when viewed in relation to the overall balance sheet size.

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

Shock applied	**+200bps 2017 £m**	**-200bps 2017 £m**	+200bps 2016 £m	-200bps 2016 £m
PV200 results (impact on present value of assets and liabilities at year end)	**(22.0)**	**5.2**	(4.7)	(12.7)
Impact on net interest income for the year	**58.1**	**(14.6)**	49.9	(6.1)

The impact on net interest income reflects the impact of an immediate change in interest rates, typified by a Bank of England Base Rate rise, and the expected consequential effects that would occur (such as changes in customer behaviour) over the reporting period following the rate change.

The impacts of the rate change will vary over time with changes in the balance sheet mix and general market conditions and should not be considered predictive of future sensitivity.

Product option risk

The Society's products may give additional benefits to actual and prospective customers in the form of choices (or options) which can create interest rate risks to the Society.

The Society's main exposures to product option risk result from the mortgage pipeline, mortgage prepayment and savings access.

Mortgage pipeline risk is the risk that between the point of mortgage application and completion, customers choose not to complete on a mortgage. If this occurs during a period in which interest rate expectations have changed, this could leave the Society with an imbalance of funding that is no longer at prevailing interest rates.

This risk is managed by limiting the size of the pipeline in total and by individual product, and by entering into interest rate swaps for a proportion of the mortgage pipeline to manage interest rate risk.

Mortgage prepayment and savings access risk arises when customers have the option to reduce their mortgage loan in full or as a partial prepayment. Early withdrawal of fixed rate savings balances gives rise to interest rate risk for the same reason.

Mortgage prepayment and savings access risk is managed through a combination of:

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

Basis risk

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

The risk is managed through Board defined limits for the level of reduction in net interest income if market rates diverged from the Bank of England Base Rate. Assessments of potential basis shock are conducted regularly to ensure that the Society's exposure remains within these limits.

Swap spread risk

In order to diversify its liquidity holdings the Society maintains part of its liquidity portfolio in gilts, which are issued with long-term fixed rates. These gilts have associated derivatives (swaps) that turn the fixed income into a variable rate. The swap will provide some protection against offsetting movements in the present value of the gilts. However, the credit element of gilt value movements arising from changing perceptions of sovereign quality remains and creates 'swap spread risk'. This risk only crystallises if and when the gilts are sold. Generally gilts are held to their full term as part of the Society's liquidity resources and this policy mitigates against the risk crystallising. Under CRD IV the potential swap spread impacts capital assessment so it is monitored against a Board limit.

Reset risk

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

Foreign currency risk (Audited)

Foreign currency risk mainly arises as a result of raising funds. Non-sterling funding ensures 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.

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.

Market risk outlook

The Society anticipates operating in a low interest rate environment for the foreseeable future. The Society is comfortable that it is able to manage through this protracted low rate environment and continue to generate additional capital. The balance sheet is positioned to benefit the Society's net interest margin in a rising rate environment should interest rates rise further in the future.

Liquidity and Funding risk

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

Management of funding risk

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

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

Wholesale funding is used to diversify funding risk by source and term, and to provide value to members through lowering the overall cost of funding. To support this, the Society continues to retain access to a number of wholesale funding markets. Bank of England programmes such as the Term Funding Scheme (TFS) or its predecessor scheme Funding for Lending Scheme (FLS) are used to reduce funding costs and further diversify exposures. As at 31 December 2017, the Society has accessed £3.0 billion of TFS.

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

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

Management of liquidity risk

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

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

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

The Society's appetite for liquidity risk is set out in the Liquidity Risk Tolerance Statement as part of the ILAAP. This was last reviewed by the Board in December 2017 and contains the results of severe but plausible liquidity stress tests. The Society carries out these tests on a daily or monthly basis against the current balance sheet and latest projections to ensure that actual and forecast liquidity, including contingent liquidity, remains within appetite.

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

Liquidity resources

Liquidity resources comprise assets such as funds in cash accounts, other easily realisable liquid assets and contingent liquidity. Contingent liquidity comprises mortgage portfolios, self-issued covered bonds and self-issued Residential Mortgage Backed Securities (RMBS) notes which are prepositioned at the Bank of England and allow access to its liquidity facilities.

Liquidity resources are managed across distinct categories reflecting different features, principally the time taken to convert the resource into cash. Separate limits or requirements are applied to each category to ensure that the Society meets its prescribed risk appetite as set out in the ILAAP.

The amount of liquidity resources is subject to regulatory requirements set by the PRA. The Liquidity Coverage Ratio (LCR) is a 30 day short-term liquidity measure. The regulatory minimum LCR at 31 December 2017 was 90% but this has risen to 100% from 1 January 2018. The Society monitors compliance against this measure on a daily basis and as at 31 December 2017, the Society's LCR was 208% (2016: 151%). The LCR increase includes amounts drawn against the TFS ahead of its closure in February 2018 to pre-fund future customer loans.

CRD IV requirements include a Net Stable Funding Ratio (NSFR), a measure of stable funding, expected to be implemented during 2018. The Society continues to monitor its position relative to the anticipated NSFR requirement of 100% and, based on its current interpretation, the Society holds sufficient stable funding to meet this requirement.

The Society's liquidity resources at 31 December 2017 are set out in the following table. The amounts differ from those in the accounting balance sheet as this analysis excludes any encumbered assets such as cash held in the Society's covered bonds and RMBS programmes, and balances posted with counterparties as collateral under swap agreements and in 2016 includes unencumbered Treasury bills drawn under the FLS which are not recognised on the balance sheet. All amounts are held in sterling.

	2017 £m	2016 £m
Cash balances with the Bank of England	4,708.0	2,935.8
UK Government securities and other qualifying securities		
Securities – on-balance sheet	669.6	9.9
Securities – FLS Treasury bills	–	1,142.8
Sub-total high quality liquid assets	5,377.6	4,088.5
Other securities – on-balance sheet	10.7	15.5
Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS	2,183.2	2,720.8
Total	7,571.5	6,824.8

The amount of on-balance sheet high quality liquid assets has increased over the year with more cash held with the Bank of England, reflecting the drawdown of TFS to replace FLS, and an increase in UK Government securities due to a lower level of sale and repurchase transactions (repo). This has been partially offset by the full repayment of off-balance sheet FLS Treasury bills held at the end of 2016. The shift from FLS to TFS funding affects a number of measures presented in this report, and has been referred to as refinancing to TFS throughout.

Liquidity assets realise a relatively low yield, reflecting the Society's low treasury credit risk appetite.

Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS reflects approved portfolios of mortgage collateral that could be used to access Bank of England liquidity facilities or sold to and repurchased from third parties under repo agreements to realise contingent liquidity. Since the year end, the Society has pre-positioned an additional £5.1 billion of mortgages with the Bank of England to materially increase the value of contingent liquidity available to the Society as part of its liquidity risk management strategy.

Liquidity adequacy

The Internal Liquidity Adequacy Assessment Process (ILAAP) is the Society's assessment of its liquidity position and requirements, assessed against regulatory requirements and the Society's internal risk tolerance. It ensures compliance with regulatory minimum requirements such as the Liquidity Coverage Ratio (LCR) and with the ILAA Rules, including the need to meet the Overall Liquidity Adequacy Rule.

An integral component of this assessment is stress testing, some of which is prescriptive using detailed rules and guidance issued within prudential regulations and reported within regulatory returns. In addition, the Society undertakes its own stress tests against which it sets Board limits. The stress tests within the ILAAP also include 'alternative' stress tests which seek to identify whether there are other factors that could pose extreme liquidity risks. The stress tests consider each of the principal drivers of liquidity risk with the main risks to the Society being large unexpected withdrawals of retail deposits, the impact of a credit risk downgrade and lack of access to wholesale funding markets when wholesale funding matures. The ILAAP considers management actions that may be taken in a stress.

The Society considers the impact of a liquidity stress over different time horizons and specifies the type of liquidity resources that can be used to manage a stress in each of these. The time horizons considered are intra-day, seven day, thirty days and three months.

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

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

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

Recovery and Resolution Plan

The regulatory authorities are keen to avoid committing more taxpayers' funds towards resolving any failed banks and building societies and therefore require institutions to formulate plans to avoid such eventualities. As a result the Society is required to maintain a Recovery and Resolution Plan which outlines a menu of actions that can be undertaken to stop the Society from failing in extreme stress situations. It provides the data required by the Resolution Authority to affect stabilisation powers should the recovery options fail. This Recovery and Resolution Plan covers liquidity risk issues and capital.

The Society is currently undertaking additional analysis regarding operational continuity in resolution in line with new regulatory requirements for 2019.

Wholesale funding

The Society's wholesale funding at 31 December 2017 has increased by £1.4 billion to £9.1 billion. The increase primarily reflects wholesale issuances (medium-term notes and covered bonds) net of maturities and an increase in deposits from banks reflecting the refinancing to the Term Funding Scheme (TFS). At the year end, the Society had drawn down £3.0 billion under the TFS (2016: £nil) and had returned all of the £2.4 billion FLS Treasury bills held at the 2016 year end.

	Notes to the accounts	2017		2016	
		£m	%	£m	%
Deposits from banks, including repo agreements	21	3,499.0	38.3	2,937.5	37.9
Other deposits and amounts owed to other customers		739.5	8.1	826.4	10.7
Debt securities in issue					
Certificates of deposit	22	251.3	2.8	156.5	2.0
Medium-term notes	22	2,135.2	23.4	1,742.6	22.5
Covered bonds	22	2,309.4	25.3	1,847.8	23.9
Residential Mortgage Backed Securities	22	192.9	2.1	231.2	3.0
Total		9,127.3	100.0	7,742.0	100.0

Wholesale funding outstanding at 31 December 2017 remains significantly denominated in sterling as shown below:

	GBP £m	EUR £m	Total £m
Deposits from banks, including repo agreements	3,440.3	58.7	3,499.0
Other deposits and amounts owed to other customers	739.5	–	739.5
Debt securities in issue			
Certificates of deposit	251.3	–	251.3
Medium-term notes	1,557.3	577.9	2,135.2
Covered bonds	1,423.8	885.6	2,309.4
Residential Mortgage Backed Securities	192.9	–	192.9
Total as at 31 December 2017	7,605.1	1,522.2	9,127.3
Total as at 31 December 2016	6,283.0	1,459.0	7,742.0

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

The expected maturity analysis for wholesale funding is shown below, based on the earlier of first call date or contractual maturity. This shows that the overall maturity of funding has significantly lengthened following medium-term notes and covered bonds issuances in the year and refinancing to the Term Funding Scheme (TFS). The medium-term and covered bond issuances have primarily impacted the more than five year category and the TFS has impacted the two to five year category. The Society expects the maturity profile to gradually reduce again as TFS matures.

	2017		2016	
	£m	%	£m	%
Less than one year	2,281.4	25.0	4,371.6	56.5
One to two years	349.4	3.8	763.5	9.9
Two to five years	5,606.7	61.4	2,208.3	28.5
More than five years	889.8	9.8	398.6	5.1
Total	9,127.3	100.0	7,742.0	100.0

Contractual maturity profile of financial assets and liabilities

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

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

1. Includes £56.6 million mandatory reserve with the Bank of England.
2. Included in Deposits from banks on the Balance Sheet.

At 31 December 2016 (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]	3,260.0	–	–	–	–	3,260.0
Loans and advances to credit institutions	213.5	–	–	–	–	213.5
Debt securities	–	114.1	–	790.3	449.9	1,354.3
Loans and advances to customers	49.2	640.7	1,802.0	8,519.0	21,870.7	32,881.6
Derivative financial instruments	–	–	39.0	246.9	68.3	354.2
Other financial assets	–	1.1	10.3	94.0	45.0	150.4
Total financial assets	3,522.7	755.9	1,851.3	9,650.2	22,433.9	38,214.0
Liabilities						
Shares	24,996.1	–	1,937.1	1,121.1	–	28,054.3
Sale and repurchase agreements[2]	–	1,670.5	899.5	–	–	2,570.0
Deposits from banks – other	115.7	251.8	–	–	–	367.5
Other deposits	–	6.0	1.0	–	–	7.0
Amounts owed to other customers	–	710.3	105.1	4.0	–	819.4
Secured debt securities in issue – RMBS and covered bonds	–	0.3	24.9	2,053.8	–	2,079.0
Senior unsecured debt funding	–	93.4	493.1	914.0	398.6	1,899.1
Derivative financial instruments	–	3.4	15.0	197.1	151.2	366.7
Other financial liabilities	–	–	4.7	99.6	54.4	158.7
Subordinated liabilities	–	0.6	–	10.0	14.9	25.5
Subscribed capital	–	1.6	–	–	40.0	41.6
Total financial liabilities	25,111.8	2,737.9	3,480.4	4,399.6	659.1	36,388.8
Net liquidity gap	(21,589.1)	(1,982.0)	(1,629.1)	5,250.6	21,774.8	1,825.2

1. Includes £52.5 million mandatory reserve with the Bank of England.
2. Included in Deposits from bank on the Balance Sheet.

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

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

At 31 December 2016 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	24,968.9	1,980.3	1,149.8	–	28,099.0
Deposits, amounts owed to other customers and debt securities in issue	2,798.4	1,723.0	3,174.0	423.5	8,118.9
Other liabilities and adjustments	84.5	156.9	282.1	94.6	618.1
Subordinated liabilities	0.9	0.9	17.1	21.8	40.7
Subscribed capital	2.4	2.4	19.4	40.0	64.2
Total liabilities	27,855.1	3,863.5	4,642.4	579.9	36,940.9
Undrawn loan facilities	66.5	–	–	–	66.5
Leasing commitments	0.8	2.2	9.5	5.8	18.3

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

Asset encumbrance

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

Asset encumbrance at 31 December 2017 is set out in the table below. Encumbered assets pledged as collateral have reduced following the return of all FLS Treasury bills and as a result of lower levels of gilt repo. These impacts have then been partially offset by collateral used to support TFS drawings. Since the year end, unencumbered assets available as collateral have increased by £5.1 billion as the Society has prepositioned additional mortgages at the Bank of England to materially increase the value of contingent liquidity available to the Society.

	Encumbered		Unencumbered		
	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total 2017 £m
Cash and balances with the Bank of England	–	282.8	4,712.4	–	4,995.2
Loans and advances to credit institutions	202.0	–	–	–	202.0
Debt securities	300.4	30.0	681.9	–	1,012.3
Loans and advances to customers	7,687.8	–	2,194.5	26,048.6	35,930.9
Derivative financial instruments	–	–	–	306.5	306.5
Hedge accounting adjustments	–	–	–	17.2	17.2
Other assets	–	–	–	108.4	108.4
Total as at 31 December 2017	8,190.2	312.8	7,588.8	26,480.7	42,572.5
Total as at 31 December 2016[5]	10,016.0	297.2	6,862.7	23,518.6	40,694.5

1. Assets that have been used to support interest rate swap collateralisation agreements, third party secured funding operations, central bank operations or third party repo transactions and cannot be used for any other purpose.
2. Other encumbered assets are assets that cannot be used for secured funding due to legal or other reasons. This includes cash and assets supporting secured funding vehicles.
3. These assets are readily available as collateral to secure funding. Loans and advances to customers in this category comprise Bank of England approved portfolios, and those that although technically encumbered are held in respect of retained self-issued notes in the Society's covered bond and securitisation programmes.
4. Unencumbered other assets are therefore conservatively defined as not readily available for use as collateral. The loans and advances in this category include £18.5 billion at 31 December 2017 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.
5. Total assets at 31 December 2016 included £2,398.6 million of off-balance sheet FLS Treasury bills of which £1,255.8 million were encumbered and £1,142.8 million were available as collateral. At 31 December 2017 no FLS Treasury bills are held.

External credit ratings

The Society's long-term and short-term credit ratings were unchanged by Moody's in the year. In 2017, the Society's outlook returned to stable; a number of major banks and building societies had been on negative outlook since the Brexit vote. During the year Fitch affirmed the Society's 'A' rating for the 23rd consecutive year.

Short and long-term credit ratings as at 22 February 2017 are set out below:

	Long-term	Short-term	Subordinated	Outlook	Date of last credit opinion
Moody's	A2	P-1	Baa1	Stable	August 2017
Fitch	A	F1	n/a	Stable	May 2017

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

Liquidity and Funding risk outlook

The availability of funding through central bank schemes (e.g. TFS) has led to a sustained benign funding environment for UK banks and building societies. The TFS draw down availability ends on 28 February 2018 and no replacement has been signalled by the Government. This, together with the November rise in the Bank of England Base Rate, signals an end to tools used by the Bank to steady markets following the financial crisis. The Society expects this to be followed by a rebalancing of funding markets with potential for increased volatility particularly in pricing. The outcome of Brexit negotiations and market-wide funding requirements arising from regulatory requirements under the Minimum Requirement for own funds and Eligible Liabilities (MREL) could further impact the wholesale markets.

Wholesale market price changes together with any squeeze in household budgets arising from Bank of England Base Rate rises, inflation or other factors may impact the savings market.

The Society has a strong track record of being able to attract retail funds and with its competitive savings products is well placed to withstand any deterioration in savings markets. The 'A' credit ratings held by the Society and the underlying strength of its business model continue to support access to wholesale markets for funding.

Conduct risk

Conduct risk is defined as the risk that the Society's behaviour and decision making, at all levels, fails to deliver good customer outcomes.

Conduct risk profile

The Society's mutual ethos and culture, focused on Putting Members First, means it 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, and operations across the Society. This principle is embedded in the Society's people and communication strategies, and the Society's extremely high level of employee engagement is evidence that employees understand and share this commitment.

Putting Members First directly impacts the design of products and services. This is reflected in the resulting simple and transparent savings and mortgage products.

Management of conduct risk

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

During 2017, the Society has continued to use its Conduct Risk Framework to identify the potential conduct risks arising from the products, services and documentation it provides to its members and the control measures to manage, mitigate and monitor such risks.

The risk function undertakes second line monitoring programmes to provide assurance of adherence to regulatory standards and conduct risk expectations, and also support business change projects that have a regulatory aspect.

In 2017, the Society continued to have a much lower number of customer complaints upheld by the Financial Ombudsman Service than the industry as a whole, with only 4% of complaints upheld against an industry average of 36%. The Financial Ombudsman Service asked for the outcome of referred Society customer complaints to be changed on just four occasions.

In contrast with the industry, Payment Protection Insurance (PPI) is not a significant issue for the Society. Out of total PPI provisions of over £60 billion for the industry as a whole, the Society has set aside £6.1 million in total (for both complaints regarding the sale of the product and 'Plevin' commission remediation), including a provision of £1.0 million raised during the year.

This lower cost is a consequence of the design of the PPI product sold and the member-focused approach in distributing the product provided by the Society.

As previously identified, the Society is impacted by the FCA's 2016 publication in relation to the industry practice regarding the treatment of arrears when monthly mortgage payments have been recalculated from time to time. The Society has adopted the voluntary remediation framework proposed by the FCA and aims to complete the remediation exercise ahead of the regulatory deadline in June 2018.

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

Conduct risk outlook

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

Operational risk

Operational risk profile

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

The Society is focused on maintaining operational resiliency and reducing the risk that the Society will fail to deliver critical functions and services effectively after a shock event. This is in line with both industry practice and recent regulatory expectations.

Operational risk in the Society is managed across the following sub-categories: Legal, Regulatory, IT systems, Information security, Business continuity, Financial crime, People, Change, Premises and physical security, Third party, Business processes and Financial reporting and control. Any direct loss attributable to risks in these categories may also have a reputational impact which may damage the business. The most significant of the operational risk sub-categories relate to operational resilience, IT and change management, Information security and Financial crime for the Society and are considered further below.

Management of operational risk

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

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

The Society has developed, implemented and maintains a Risk and Control Self Assessment (RCSA) process owned by the Operational Risk function with the purpose of identifying, assessing and managing, at a business area level, those risks to which the Society is exposed. A detailed Risk Management Standard and Guidelines, owned by the Operational Risk function, provides further detail on the requirements of the RCSA process.

Regulatory environment

The regulatory landscape is constantly evolving and it is a constant challenge for financial institutions to implement the necessary changes to processes and systems whilst managing change and operational risks.

The Society complies with all laws and regulations relevant to financial crime, fraud, money laundering and terrorist financing including the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR 2017) that came into force on 26 June 2017. There are new regulatory compliance requirements coming into effect in 2018, namely Payment Services Directive 2 (PSD2) and the EU General Data Protection Regulation (EUGDPR). The Society has dedicated programmes and initiatives in place to implement these requirements.

Operational resilience

The Society is focused on maintaining operational resiliency, reducing the risk of major operational disruption to effectively deliver critical functions and services after a shock event and minimising customer impact and reputational damage.

In the event of resilience risk materialising a key mitigant is the ability to restore normal levels of operational service quickly and safely.

The Society continues to enhance its business continuity capability, investing in skills and physical continuity capacity and enhancing governance arrangements. This ensures that resilience and continuity capability meets the Society's risk appetite and is in line with industry standards.

IT and change management

The Society recognises the risk that not keeping pace with technology could introduce risk to the stability, security and resilience of technology systems. IT outages have been seen increasingly across the industry and have had significant customer and reputational impact. As a result the Society continues to invest in upgrading its IT estate and enhancing IT governance including monitoring systems availability.

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

Undertaking any change programme carries risk, as new systems and processes are introduced and integrated with existing ones. The Society has a strong focus on change governance and programme management to minimise these risks. It is also further enhancing governance over the development of IT systems and controls over system changes.

Information security and Financial crime

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

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

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

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

Operational risk outlook

The pace of regulatory change is expected to continue for the foreseeable future. In common with the wider sector, the Society will be particularly impacted by the new EUGDPR and the next phases of the Mortgage Credit Directive. The Payment Services Directive 2 and the broader Open Banking initiative will also impact the Society.

Initiatives driven by the FCA include embedding the Senior Managers and Certification Regime, the effectiveness of customer communications and the FCA's review of arrears calculations. Combined with the IT systems investment planned for the next few years, this represents the potential for significant change activity.

In addition to new regulatory requirements, Regulators have continued to focus on operational resilience and cyber security. This focus is expected to be maintained in the future and the Society expects to focus on improving business resilience through enhanced IT, change and business continuity capability, together with continued effective management of information security and financial crime risks.

Model risk

Model risk is defined as the risk that an ineffective model or incorrectly interpreted model output leads to a loss, reputational damage or regulatory censure. In 2017 the Society elevated model risk to the Principal Risk category. This recognises the increasing reliance on models in aiding management decisions and in assessing the Society's resilience to stressed events.

Model risk is managed by the Chief Financial Officer, with overall oversight from the Retail Credit Risk Committee and the Asset and Liability Committee. The Society has set out its model risk framework and uses a variety of techniques to mitigate model risk, including sensitivity analysis to key assumptions, comprehensive documentation and strong governance.

If model risk materialises it would impact the other Principal Risk categories which have been discussed in this report, such as credit risk and therefore the impacts of model risk have not been considered separately.

Strategic risk

Strategic risk is the risk arising from changes to the business model or that macroeconomic, geopolitical, regulatory or other factors may lead to the business model or strategy becoming inappropriate.

Managing strategic risk

Senior management and ultimately the Board manage Strategic risk. Executive Risk Committee, Board Risk Committee and the Board review the Strategic Plan assumptions and focus on risks that could become a material threat to the viability of the Society's business model over the medium or longer term.

The main risks arise from regulatory change, reputational risk, concentration of the business model and market or margin compression as outlined below.

Regulatory change

Regulatory changes have the potential to threaten the viability of the Society's low risk model through increased capital requirements arising from the review of Internal Ratings Based (IRB) modelling outcomes, Minimum Requirement for own funds and Eligible Liabilities (MREL) and proposed revisions to the Standardised approach and capital output floors.

The Board believes non-risk-based measures such as the leverage ratio and output floors can result in disproportionately high capital requirements for low risk lenders and can cause some to seek higher returns to compensate for the increased capital requirements. Maintaining focus on low risk lending is core to the Society's plans and consequently the new regulatory requirements have the potential to moderate the rate of growth targeted, or to lower the returns currently paid to savings members.

The continued volume and complexity of regulatory changes also represent a Strategic risk through increased costs, implementation risk and continuing compliance effort.

Reputational risk

In recent years, there have been a number of material risk events impacting the reputation of the financial services industry. The mutual sector has not been immune to these. Although the Society has been less impacted than many organisations, it will continue to manage its reputational risk carefully and invest significant resources in enhancing the robustness of its systems and controls, governance, product set and ongoing monitoring.

Concentration of business model

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

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

The Board believes that the intermediary market is well established and will remain responsible for the majority of mortgage distribution within the UK in the foreseeable future. The Society is well placed to continue to offer products through intermediaries as they evolve.

Market and margin compression

Compression risk is the risk that economic factors result in less margin and lower capital creation.

Changes to stamp duty on second homes and concerns about future restrictions of income tax relief are starting to impact the buy to let mortgage market. At the same time pricing pressure in the mortgage market is strong and ring-fencing regulation has the potential to increase the UK ring-fenced banks' focus on the mortgage market. This, in addition to emergence of new entrants, could increase market pressure further.

In addition, whilst the low interest rate environment has improved mortgage affordability it potentially encourages greater risk taking by both borrowers and savers looking for a better return. This may start to change as rates rise. Furthermore, the uncertainty created by the Brexit negotiations could lead to falling levels of investment and an increase in unemployment. This could have a knock-on effect on the housing market or could result in a longer period of very low interest rates.

Strategic risk outlook

The Board undertakes a robust strategic planning process which is subject to oversight by the risk function and capital and liquidity stress testing. A particular focus of the plan is ensuring that the Society balances the strategic advantage of a low cost base with the need to invest in operational resilience.

The Board considers that whilst there are Strategic risks that impact the Society, it is well placed to thrive in a low interest rate environment and that it has options to respond effectively to competition and regulatory headwinds and continue to fulfil its strategic purpose whilst generating sufficient capital to remain safe and secure.

Capital

Capital

Management of capital

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

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

The Internal Capital Adequacy Assessment Process (ICAAP) is the Society's evaluation of its capital position and requirements. This is assessed under the Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV) framework. The ICAAP provides details of the current approaches used to manage risk across the Society. It assesses capital requirements both against the Society's current and planned position and during severe but plausible stresses. The ICAAP was previously conducted annually but in line with Regulatory guidance will be completed bi-annually from 2018.

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

Reverse stress testing is integrated into existing stress testing. It goes beyond standard stress tests by considering extreme events that have the capacity to 'break' the Society. As such it complements the existing ICAAP processes, helping to identify risks and possible controls which might ordinarily be missed when using standardised risk assessments.

A key outcome from the process is to consider whether any of the scenarios are sufficiently plausible to necessitate a change to the Society's strategy or underlying controls.

The ICAAP and reverse stress test are reviewed by ALCO, BRC and ultimately by the Board.

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

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

The regulatory capital framework to which the Society is subject comprises:

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

Each of these is discussed further below. Further information on capital management is also included in the Society's 2017 Pillar 3 Disclosures (thecoventry.co.uk/2017pillar3).

Risk weighted capital requirements

The Society has permission from the regulator to use an Internal Ratings Based approach to retail credit risk and capital management. This approach allows the Society to calculate capital requirements for prime owner-occupier and buy to let mortgage exposures using internally developed models that reflect the credit quality of the Society's mortgage book. This permission reflects the Society's detailed understanding of its customer base and credit risk profile. The IRB model was used for around 99% of lending exposures throughout 2017. For other lending exposures and other risk areas, such as operational risk, the Society follows the Standardised approach, which uses capital risk weighting percentages set by CRD IV.

CRD IV sets the following minimum capital requirements: a Common Equity Tier 1 (CET 1) ratio of 4.5%; a Tier 1 capital ratio of 6%; and a total minimum capital ratio of 8%.

These ratios apply principally to credit and operational risk and are known as the Pillar 1 requirement.

The Pillar 2 capital requirement reflects the Society's ICAAP assessment and any capital add-ons arising from the supervisory review of those assessments. It 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 Pillar 1 (Pillar 2A), and risks to which a firm may become exposed under a severe but plausible stress (Pillar 2B).

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

CRD IV requires lenders, to hold supplementary capital buffers to ensure they build up adequate buffers that can be drawn down in periods of stress. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB).

The table below shows the elements of CRD IV capital requirements that impact the Society, the phasing in of these requirements, and the quality of capital that can be used to meet each requirement. Capital used to meet the firm-specific Pillar 1 and Pillar 2A capital requirements may not be used to meet the additional CRD IV supplementary buffers.

The PRA issues the Society with Individual Capital Guidance (ICG – from 1 January 2018 to be known as Total Capital Requirement). The latest ICG followed the Supervisory Review process in 2016, and requires the Society's Pillar 1 and Pillar 2A requirements to be at least 12.8%. The Society has a CET 1 ratio of 34.9% and therefore it comfortably meets this requirement using CET 1 capital alone.

The Society does not have a PRA buffer.

CRD IV risk adjusted capital requirements

To be covered by 100% Common Equity Tier 1

PRA Buffer (Firm specific)	Applicable from 1 January 2016. Firm specific buffer assigned by the PRA if CCoB and CCyB buffers are considered to be insufficient.
Capital Conservation Buffer (CCoB)	Phased in from 2016-2019. Used to absorb losses in periods of economic and financial stress. 0.625% from 1 January 2016, increasing to 2.5% by 1 January 2019.
Systemic Risk Buffer (SRB)	Full application from 1 January 2019 up to 3%. Set at 0% for institutions with total assets less than £175 billion.
Macro-prudential Countercyclical Buffer (CCyB)	Applies now and set at 0%, increasing to 1% from 28 November 2018. The FPC sets the CCyB within a range of 0% to 2.5%.

To be covered by minimum 56% Common Equity Tier 1, up to 44% Additional Tier 1 (incl. maximum 25% Tier 2)

Pillar 2A	Firm specific calculation for risks not fully captured under Pillar 1.
Pillar 1	Firm specific calculation based upon individual risks (IRB or standardised) – minimum of 8%.

Leverage ratio

The leverage ratio is a non-risk-based measure that is supplementary to the risk-based capital requirements and was originally proposed as a 'backstop' measure. It reflects the relationship between Tier 1 capital and total exposures, including off-balance sheet items. The leverage ratio does not distinguish between unsecured and secured loans, nor recognise risk factors such as the value of low loan to value mortgage lending.

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

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

Following the launch of the Term Funding Scheme (TFS) the FPC recommended that the leverage ratio exposures were modified to exclude central bank reserves.

The UK leverage ratio requires a minimum ratio of 3.25%[1], of which a maximum of 25% may be met using high quality Additional Tier 1 capital. There are two additional buffers that have to be met using CET 1 capital only. These are a Supplementary Leverage Ratio Buffer (SLRB), which does not impact the Society, and a macro-prudential Countercyclical Leverage Buffer (CCLB). The levels of these buffers will be set to 35% of the corresponding risk weighted SRB and CCyB within risk weighted capital requirements as described above.

The diagram below shows the elements of the UK leverage ratio framework as it applies to the Society, the phasing in of these requirements and the quality of capital that can be used to meet the minimum requirements.

The maximum theoretical leverage ratio requirement for the Society is 4.15% when buffers are at their maximum. The Board is confident that the Society will continue to meet this requirement.

UK Leverage Ratio Framework

To be covered by 100% Common Equity Tier 1

Supplementary leverage Ratio Buffer (SLRB)	Full application from 1 January 2019 up to 1.05%. Set at 0% for institutions with total assets less than £175 billion.
Macro-prudential Countercyclical Leverage Buffer (CCLB)	Currently set at 0%, increasing to 0.35% from 28 November 2018. Set at 35% of the risk weighted CCyB within a range from 0% to 0.9%.

To be covered by minimum 75% Common Equity Tier 1 and maximum 25% Additional Tier 1

Minimum Leverage	Applies from 1 January 2018. Minimum leverage ratio set at 3.25% (excluding central bank reserves with a maturity of no longer than 3 months).

1. Excluding Bank of England exposures.

Minimum Requirement for own funds and Eligible Liabilities (MREL)

The MREL requirements, announced in 2016, are designed to make it easier to manage the failure of banks and building societies in an orderly way and to prevent future taxpayer bail-outs in the UK. MREL capital requirements are based on a loss absorption amount to cover losses up to and in resolution and a recapitalisation amount, to enable continuation after resolution.

Under the rules the Society is required to meet an interim MREL requirement of 18% of risk weighted assets by 1 January 2020. The indicative end-state MREL requirement for all firms will be twice the binding capital requirement, for the Society this is currently two times Pillar 1 and Pillar 2a or 25.6% of risk weighted assets. If leverage becomes the binding constraint for the Society this will result in the need to raise MREL eligible debt.

Regulatory capital analysis

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

Risk weighted capital

The Society's capital position on a CRD IV end-point basis is set out below based on all CRD IV requirements that were in force during 2017 excluding transitional provisions. Further information on CRD IV disclosures on a transitional basis is included in the Society's 2017 Pillar 3 Disclosures (thecoventry.co.uk/2017pillar3).

Capital position	End-point 31 Dec 2017 £m	End-point 31 Dec 2016 £m
Common Equity Tier 1 (CET 1)		
General reserve	1,553.1	1,376.1
Available-for-sale reserve	5.7	6.7
Cash flow hedge reserve	20.3	41.6
Common Equity Tier 1 prior to regulatory adjustments	1,579.1	1,424.4
Common Equity Tier 1 regulatory adjustments		
Prudent additional valuation adjustment[1]	(1.0)	(1.3)
Intangible assets[2]	(40.8)	(32.5)
Cash flow hedge reserve[2]	(20.3)	(41.6)
Pension fund surplus adjustment[2]	(14.2)	(1.9)
Excess of expected loss over impairment[3]	(21.9)	(17.1)
Foreseeable distributions[4]	(9.3)	(9.2)
Common Equity Tier 1 capital	1,471.6	1,320.8
Additional Tier 1 (AT 1) capital		
Additional Tier 1 – Perpetual Capital Securities	396.9	396.9
Total Additional Tier 1 capital	396.9	396.9
Total Tier 1 capital	1,868.5	1,717.7
Tier 2		
Collective provisions for impairment	1.5	4.3
Permanent Interest Bearing Shares (PIBS)[5]	40.0	–
Total Tier 2 capital	41.5	4.3
Total capital	1,910.0	1,722.0
Risk weighted assets		
IRB approach		
Credit risk – retail exposures	3,270.8	3,175.0
Standardised approach		
Credit risk – retail exposures	159.5	180.4
Credit risk – liquidity book	99.0	110.8
Credit risk – other	50.0	52.4
Credit valuation adjustment risk	46.8	26.3
Operational risk	587.0	554.4
Total risk weighted assets	4,213.1	4,099.3
Common Equity Tier 1 ratio	34.9%	32.2%

1. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
2. Items do not form part of regulatory capital, net of associated deferred tax.
3. The expected loss over accounting provisions is deducted, gross of tax.
4. Foreseeable distributions in respect of AT 1 securities are deducted, net of tax.
5. During 2017, the Society concluded that its PIBS are eligible to be classified as Tier 2 capital on an end-point basis.

At 31 December 2017, and throughout the year, the Society complied in full with the capital requirements that were in force. Following an internal reassessment during 2017, the Society has concluded that its PIBS are eligible to be classified as Tier 2 capital on an end-point basis.

CET 1 capital, Tier 1 capital and total capital have increased primarily as a result of retained profits for the year. Despite the growth in the mortgage book of over 9%, total risk weighted assets have only increased by around 3% as a result of house price inflation reducing effective risk weights and continued low loan to value lending.

As a result, CET 1 ratio has increased by 2.7% to 34.9%. The Individual consolidated CET 1 ratio on an end-point basis at 31 December 2017 was 0.9% higher than the Group ratio due to assets held by entities that sit outside of the Individual consolidation.

Leverage ratio analysis

The Society's leverage ratio position on an end-point basis is set out below. The calculation reflects constraints on the inclusion of Additional Tier 1 (AT1) capital under the FPC's UK leverage ratio framework which mean that only £329.2 million (2016: £296.8 million) of a total of £396.9 million AT 1 capital is eligible for leverage on the original basis.

The leverage ratios are shown on both the original basis and the modified basis which excludes central bank reserves.

In contrast with the growth in CET 1, the leverage ratio has remained broadly static at 4.1% on the original basis and 4.6% on the modified basis (2016: 4.1% and 4.4% respectively) as the increase in eligible Tier 1 capital was matched by a 10.9% increase in leverage ratio exposures, largely driven by the growth in the mortgage book and a £1.4 billion increase in liquidity assets. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Leverage ratio	End-point 31 Dec 2017 £m	End-point 31 Dec 2016 £m
Total Tier 1 capital	1,868.5	1,717.7
Adjustment for AT 1 restriction	(67.7)	(100.1)
Total Tier 1 capital for leverage ratio	1,800.8	1,617.6
Leverage ratio exposures		
Total balance sheet assets	42,572.5	38,295.9
Mortgage pipeline[1]	714.1	816.1
Other committed facilities (undrawn lending)[1]	22.7	27.0
Repurchase agreements[2]	869.3	793.9
Netted derivative adjustments[3]	(94.4)	(146.5)
Other adjustments[4]	(192.6)	(216.6)
Total leverage ratio exposures	43,891.6	39,569.8
Leverage ratio	4.1%	4.1%
Leverage ratio (modified)[5]	4.6%	4.4%

1. Mortgage pipeline and other commitments are subject to a 50% risk weighting as per the delegated regulation amending CRD IV.
2. Repurchase agreements represent the extent to which collateral provided on repurchase agreements exceeds the amount borrowed.
3. The netted derivative adjustment figure converts the accounting value of derivatives to an exposure measure.
4. Other adjustments predominantly relate to asset balances that have already been included in the capital calculation and these are therefore removed from the total Balance Sheet assets figure.
5. Leverage ratio under the UK regulatory regime by excluding central bank reserves from the calculation of leverage exposures.

The required leverage ratio disclosures using the European Banking Authority Templates are available in the Society's 2017 Pillar 3 Disclosures (thecoventry.co.uk/2017pillar3).

Capital outlook

The Society continues to monitor regulatory developments that could lead to increased capital requirements including the final calibration of MREL requirements.

The Basel 4 reforms were announced in December 2017 and include output floors for calculating capital requirements for mortgages.

This will mean that reported capital ratios for the Society will not reflect its low risk profile. The Society is still considering the impact of Basel 4 on its capital position, including local regulatory interpretations. The Society expects its risk-based capital ratios assessed against the Basel 4 reporting requirements to show a significant reduction. However the Society is confident that it will continue to have a substantial capital surplus above regulatory minima.

Governance

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

Board of Directors	60
Directors' Report on Corporate Governance	66
Board Audit Committee Report	74
Directors' Remuneration Report	79
Directors' Report	88

Governance

Board of Directors

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

Ian Geden

Catherine Doran

Andy Deeks

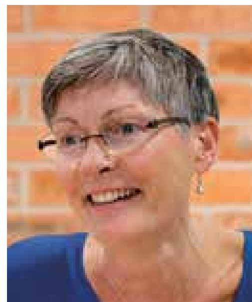
Peter Ayliffe

Roger Burnell

Mark Parsons

Peter Frost

Michele Faull


Jo Kenrick

Peter Ayliffe
Chairman

Committee membership
Board Risk Committee
Nominations & Governance Committee
Remuneration Committee
Non-executive Directors' Remuneration Committee

Tenure
Appointed to the Board in May 2013 and as Chairman in October 2017 following the unexpected death of Ian Pickering.

Experience
Peter, like our late Chairman Ian Pickering, has an unwavering focus on Putting Members First. Peter leads the Board ensuring that we continue to invest in the business to meet the future needs of our members, that we grow safely and securely whilst developing our employees and supporting our local communities.

Peter has many years' experience of working in retail banking and payments.

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 for the last two of these was a main board director at Lloyds TSB with responsibility for the UK retail bank. He was on the board of Investors in People (UK) and Visa International, president of the Chartered Management Institute and Chairman of Monitise until it was sold in September 2017.

External appointments
Peter is Chairman of truRating Limited and is a trustee of The Pennies Foundation charity.

Roger Burnell
Senior Independent Non-executive Director

Committee membership
Board Audit Committee (Chair)
Board Risk Committee (Chair)
Nominations & Governance Committee

Tenure
Appointed to the Board in September 2008 and Senior Independent Director in April 2016.

Experience
Roger is a Chartered Accountant with over 35 years' senior executive and non-executive experience. He worked for several businesses within the Thomson Travel Group before becoming group chief operating officer and has also been chairman of a number of businesses and senior independent director of the Thomas Cook Group.

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

External appointments
None.

Andy Deeks
Executive Director

Committee membership
None.

Tenure
Appointed to the Board in April 2017.

Experience
Andy is responsible for the Society's products, customer communications, digital channel and strategy development. He graduated with a first class degree from the University of Nottingham and holds an MBA from Warwick Business School. Before joining the Society, Andy was a management consultant, advising UK retail banks, building societies and insurers.

Andy is leading the Society's simple and open approach to financial services, giving members the information they need easily and clearly, as well as providing long-term value through the Society's savings and mortgage rates. He is especially proud of the recognition the Society receives via independent third parties for this.

External appointments
None.

Catherine Doran
Independent Non-executive Director

Committee membership
Board Risk Committee
Remuneration Committee

Tenure
Appointed to the Board in August 2016.

Experience
Catherine is an experienced IT executive who has worked for regulated businesses for 30 years, latterly as chief information officer of Royal Mail from 2011 to 2015. Previous posts have included six years at National Westminster Bank, most recently as head of department, retail services; three years as chief information officer of Capital One; two years as chief information officer, BT Retail; and five years at Network Rail rising to director of corporate development.

Catherine's interest in technology and desire to ensure customer care remains at the heart of what we do motivates her to ensure the Board is effective in overseeing the Society's future development plans.

External appointments
Catherine is a non-executive director of the Department for Environment, Food & Rural Affairs.

Michele Faull
Executive Director

Committee membership
Non-executive Directors' Remuneration Committee
Models and Ratings Committee (Chair)

Tenure
Appointed to the Board in April 2017.

Experience
Michele is the Society's Chief Financial Officer. A Fellow of the Association of Chartered Certified Accountants, Michele has over ten years' senior director-level experience in financial services and was previously a tax partner at PwC.

Michele was previously group risk director at Nationwide Building Society. Prior to that she served as director for financial reporting & tax at Nationwide.

Michele is a steadfast supporter of mutuality and simplicity in business. She believes that the Society's performance over time demonstrates that this model provides a valuable alternative in a complex and competitive financial services market, delivering tangible value to members.

External appointments
Michele is a trustee and treasurer at the Bow Arts Trust where she chairs the Core Services Committee.

Peter Frost
Executive Director

Committee membership
None.

Tenure
Appointed to the Board in November 2012.

Experience
Peter is the Society's Chief Operating Officer and has responsibility for all aspects of the Society's operations, including IT and Change. He sees his role as supporting our employees to deliver service which is member-focused, straightforward, secure and easy-to-use.

A graduate of Liverpool University, Peter has over 25 years' experience in financial services. Prior to joining the Society, Peter worked at Barclays Bank 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.

External appointments
Peter serves the local community as Governor and Chair of the Resources Committee of Little Heath Primary School, Coventry.

Ian Geden
Independent Non-executive Director (Deputy Chairman)

Committee membership
Board Audit Committee
Nominations & Governance Committee
Remuneration Committee (Chair)

Tenure
Appointed to the Board in September 2008.

Experience
Ian has over 40 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.

With a long career in the mutual sector, Ian firmly believes that mutual businesses offer a real alternative for members and their families and he is dedicated to ensuring that the voice of members is heard in board discussions and decision-making.

External appointments
Ian is Chairman of Faraday Underwriting Limited.

Jo Kenrick
Independent Non-executive Director

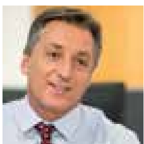
Committee membership
Board Audit Committee
Remuneration Committee

Tenure
Appointed to the Board in November 2017.

Experience
Jo is an experienced director with a commercial and marketing background. She has served as marketing director of FTSE 250 house builder Wilson Connolly, Homebase Limited and B&Q plc. Jo brings building society and payments experience through her previous non-executive role at Principality Building Society, and her current non-executive directorship of BACS.

Jo is an experienced and enthusiastic communicator who wants the Society to help members make good decisions by making financial services easier to understand and use.

External appointments
Jo is a non-executive director of Dŵr Cymru Welsh Water, Safestore Holdings plc and BACS Payment Schemes Limited. She is also a trustee of Global Charities.



Mark Parsons
Chief Executive Officer and Executive Director

Committee membership
Non-executive Directors' Remuneration Committee (Chair)

Tenure
Appointed to the Board in July 2014.

Experience
Mark is absolutely committed to the Society's mission of Putting Members First.

He 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. His career spans 30 years in retail financial services, having worked at Abbey National and PwC prior to Barclays Bank, in leadership roles covering finance, products, branches and personnel. He has previously served as deputy chairman of the Council of Mortgage Lenders.

In his leadership role he is passionate about engaging and empowering all members of the Coventry team to meet the expectations of the Society's members.

External appointments
None.

Directors' Report on Corporate Governance

Dear Member

I report to you on the Society's corporate governance arrangements in my capacity as Chairman, a role I have held since Ian Pickering, our Chairman since 2013, passed away unexpectedly in September 2017.

Effective corporate governance is a high priority for the Board. We are focused on the Society's mission and our role: leading and managing the Society in a safe, secure and sustainable way. Our 'CARES' Values and commitment to Putting Members First inform the Board's decisions and are at the heart of everything we do.

Succession planning was a key activity during 2017. We have focused on the search for a Chairman-elect and securing a pipeline of non-executive talent to enable the progressive refreshing of the Board. This recognises the importance of having a blend of skills, experience and knowledge on the Board. More information on the Society's succession planning for executive and non-executive roles is in the report of the Nominations and Governance Committee.

This year, the Board welcomed Andy Deeks and Michele Faull as executive directors, and Jo Kenrick as a non-executive director. John Lowe stepped down and Janet Ashdown retired from the Board after many years' service. Both made very significant contributions to the Society. The Board and I thank them for their dedication and support. Alasdair Lenman resigned as a non-executive director, in September, to become Chief Finance Officer of Yorkshire Building Society. We thank Alasdair and wish him well for the future. Andy, Jo and Michele will stand for election at the 2018 Annual General Meeting (AGM).

The Board believes diverse leadership is a recipe for balanced decision making. All Society recruitment, including Board appointments, is carried out in line with the Diversity and Equality Policy. Improving gender balance is an important part of this. Today, women represent 33% of the Board's membership and 36% of the executive. The Board recognises that the current percentage has been affected by the sad and unexpected passing away of our previous Chairman and is supportive of increasing the proportion of female Board members. In line with the Hampton-Alexander review, the Board has resolved to maintain at least this level until 2020, even as the total number of directors increases. Further information on the Diversity and Equality Policy and the Society's objectives in this area are on page 71.

Peter Ayliffe
Chairman
22 February 2018

Report on Corporate Governance

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

UK Corporate Governance Code

The Society is committed to effective corporate governance. It adopts the UK Corporate Governance Code 2016 (the Code) to the extent that it is appropriate given the Society's legal form and mutual ownership structure. It was not, for instance, possible to comply with provisions relating to dialogue with 'major shareholders' due to the Society's mutual status and 'one member, one vote' principle. The Society is committed to maintaining a dialogue with its members and details of engagement activities are included in the Corporate Responsibility Report. Unforeseen changes to the Board in September meant that for a short period of time, excluding the Chairman, less than half of the directors were non-executive. Jo Kenrick's appointment addressed this imbalance.

The Board

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

The Board's responsibilities

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

Activities during 2017

Notably, the Board:

- Reviewed and agreed the Society's long-term strategy.
- Received and constructively challenged Assurance Reports from the Chief Executive and other executive directors on the Society's performance, financial matters, external developments and other significant matters.
- Approved the Society's internal capital and liquidity assessments after critical reviews by the Board Risk Committee, and received reports on changes to prudential regulations and assurance that plans were in place to manage the potential impact on the Society's business model and strategy.
- Reviewed and set its risk appetite, considered the Principal risks faced by the Society, and approved the Society's Enterprise Risk Management Framework.
- Approved the Society's Recovery and Resolution Plan after review by the Board Risk Committee.
- Approved the publication of the Annual Report & Accounts and risk disclosures.
- Discussed the Society's culture, member experience and service, and how this aligned with the Strategic Plan.
- Approved the inception of programmes to modernise elements of the Society's IT infrastructure.
- Discussed progress towards the delivery of the People Vision, including diversity and wellbeing and employee engagement.
- Reviewed and approved a number of policies including the Board lending, health and safety and treasury credit limit policies.
- Approved the Society's cyber strategy.
- Received a report by and updates from the Money Laundering Reporting Officer.
- Considered a report by the Whistleblowers' Champion and determined that the Society's arrangements for enabling employees to speak up had worked effectively, after review by the Board Audit Committee.
- Critically reviewed reverse stress testing scenarios which could be adverse to viability and received assurance on the effectiveness of risk management arrangements.

Delegation of authority

The Board reserves to itself matters to decide and monitor or oversee. It delegates other matters to its Committees or the Chief Executive. This allocation of responsibility enables the Board to spend time on the most significant matters and make best use of the knowledge, skills and experience on the Board. The Board has documented this arrangement and reviews it annually.

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

The Board ensures oversight of its committees by receiving a report detailing key matters discussed from the committee Chairs following each meeting. Each committee carries out a review of its own effectiveness annually, including an assessment of its work against its terms of reference, published guidance and best practice. All committees were confirmed as effective during 2017.

Terms of Reference for all the Board committees can be found on the Society's website and are available from the General Counsel and Secretary.

Board of Directors

Brief biographies of the directors are included in the Board of Directors section. Details of those seeking election/re-election can be found in the Notice of the 2018 AGM.

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

The names of the directors who served on the Board and its Committees, and their attendance records are included below. Changes to the Board during 2017 are as follows:

27 April		
Janet Ashdown	Non-executive Director	Retirement
Andy Deeks	Executive Director	Appointment
Michele Faull	Executive Director	Appointment
John Lowe	Executive Director	Resignation
28 September		
Ian Pickering	Chairman	Passing
Alasdair Lenman	Non-executive Director	Resignation
6 November		
Jo Kenrick	Non-executive Director	Appointment

Governance

Independence

The Board has reviewed the independence of its non-executive directors. In line with the Code, it considered whether there were any relationships or circumstances that were likely to affect, or could appear to affect, a director's judgement. Under the Code, one of the factors to be considered is length of service longer than nine years and, in April 2018, both Roger Burnell and Ian Geden will have served nine years since they were first elected. However, the Board concluded that there is a clear division of responsibility between the executive and non-executive directors, and evidence of both Roger and Ian bringing thoughtful and constructive challenge to the Board and the Committees they serve.

In the opinion of the Board, Roger Burnell, Catherine Doran, Ian Geden and Jo Kenrick are independent in character and judgement. The Board considered Peter Ayliffe was independent when appointed as Chairman on 1 October 2017. Letters of appointment for the non-executive directors are available from the General Counsel and Secretary on request. Details of the directors' external appointments are in the Annual Business Statement.

Time commitment

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

Independent advice and insurance

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

Chairman and Chief Executive

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

Deputy Chairman

The principal role of the Deputy Chairman is to deputise for the Chairman at meetings of the Board and to support the Chairman in his role. Peter Ayliffe served as Deputy Chairman for a considerable part of 2017 until he succeeded Ian Pickering on an interim basis. Ian Geden was appointed as Deputy Chairman in November 2017.

Senior Independent Director

The role of the Senior Independent Director is to provide a sounding board for the Chairman and a means for the other directors to voice any concerns to the Chairman. In conjunction with the other directors, the Senior Independent Director evaluates the performance of the Chairman and leads succession planning for the role of Chairman. Roger Burnell has been the Senior Independent Director since April 2016.

Training and development

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

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

- The digital landscape.
- Operational resilience: IT systems risk and continuity.
- Retail credit risk.
- The Senior Managers Regime.
- Balance sheet management.
- Liquidity management in practice.

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

Board and Board Committee attendance 2017

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

Name	Title	Board	Board Risk Committee	Board Audit Committee	Remuneration Committee	Non-Executive Directors' Remuneration Committee	Nominations and Governance Committee
Ian Pickering[1]	Chairman	8/8			5/5	1/1	4/4
Peter Ayliffe[2]	Chairman	11/11	8/8		1/1		6/6
Janet Ashdown[3]	Non-executive Director	4/4		1/1	4/4		
Roger Burnell[4]	Senior Independent Director	11/11	8/8	5/5			6/6
Andy Deeks[5]	Product, Marketing and Strategy Director	7/7					
Catherine Doran[6]	Non-executive Director	9/11	5/5	2/2	6/6		
Michele Faull[5]	Chief Financial Officer	7/7					
Peter Frost	Chief Operating Officer	11/11					
Ian Geden[7]	Deputy Chairman	11/11	3/3	3/3	6/6		6/6
Jo Kenrick[8]	Non-executive Director	2/2		0/1	1/1		
Alasdair Lenman[9]	Non-executive Director	7/8	5/6	4/4			
John Lowe[10]	Finance Director	4/4				1/1	
Mark Parsons	Chief Executive	11/11				1/1	

1. Chairman of the Board and Chair of Nominations & Governance Committee until 28 September 2017.
2. Appointed as Chairman on 1 October 2017 and Chair of the Nominations and Governance Committee on 5 October 2017.
3. Retired on 27 April 2017.
4. Chair of the Board Risk Committee. He was Chair of the Board Audit Committee until 9 May 2017 and from 12 December 2017.
5. Appointed on 27 April 2017.
6. Moved from the Board Audit Committee to the Board Risk Committee on 27 June 2017.
7. Left the Board Risk Committee after the 25 April 2017 meeting and joined the Board Audit Committee on 27 July 2017. He was appointed Deputy Chairman in November 2017.
8. Appointed as a Non-executive Director and member of the Board Audit Committee and Remuneration Committee on 6 November 2017.
9. Member (and from 9 May 2017 the Chair) of the Board Audit Committee, and a member of the Board Risk Committee until he resigned on 28 September 2017.
10. Stepped down on 27 April 2017.

The Board held 11 meetings during 2017. One of these was a special meeting called at short notice following the passing of Ian Pickering to appoint an interim Chairman. Another was a specially-formed Committee of the Board to sign the Annual Report and Accounts. In addition, the Board held two off-site strategy days, to reflect upon and contribute to the Society's strategic planning process.

Board effectiveness

The Board reviews its performance and that of its Committees annually. The Board's last internal review was in January 2018. Each Board member considered the effectiveness of the Board and its Committees using a questionnaire, and by considering its terms of reference.

An external evaluation of Board effectiveness is carried out every third year. The last such review was carried out in 2015.

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

Member relations

A key responsibility of the Board is to ensure it remains accountable to the Society's members. In practice this means ensuring the views of members are understood and taken into account when decisions are made. In 2017, directors attended five meetings of the Members' Council, which is a body of members who volunteer to provide their views directly to the Society's management, and travelled to two evening member roadshows. In 2017, the Society launched the Members Panel, an online community established for sharing feedback with the Society. The Board received updates on the views and experiences of members during the year.

All directors attended and were available to answer questions at the Society's 2017 AGM.

All members who are eligible to vote at the 2018 AGM are encouraged to do so by one of the following means:

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

Voting by proxy means members do not vote in person. All resolutions are taken on a poll to enable proxy votes to be counted and the 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.

Culture

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

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

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

Internal controls and risk management

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

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

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

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

The Board has carried out a review and is satisfied that during 2017 the Society maintained adequate risk management arrangements and systems of internal control given the Society's size and scale, strategy and risk profile.

Nominations and Governance Committee

Dear Member

I present to you the report of the Nominations and Governance Committee for the year ended 31 December 2017.

Current membership[2]	Member since	Years on the Committee
Peter Ayliffe[1]	2014	4.0
Roger Burnell	2016	2.0
Ian Geden	2014	4.0

1. Chair since 5 October 2017.
2. Ian Pickering was the Chair of the Committee until he passed away on 28 September 2017.

Succession planning and policy

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

The Committee gave particular focus during the year to succession planning and contingency planning. There was continued emphasis on the development of senior managers with potential to become effective executive leaders and the search for non-executives to fill key Board roles.

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

Diversity

The Society values and promotes diversity and inclusion. The Nominations and Governance Committee and the Board are active sponsors of the Society's inclusion agenda. All recruitment, including Board appointments, is carried out in line with the Diversity and Equality Policy. In 2016, to improve gender balance on the Board, the Committee recommended a target of 25% female directors by December 2017. Currently, the actual percentage is 33% which the Board has resolved to maintain as a minimum until 2020 even if directors numbers grow.

The Society works with specialist search advisors in relation to executive and non-executive director appointments and diversity and inclusion credentials are a key factor in selecting advisors. Active management of shortlisting by the Committee, and the willingness to extend a search in order to find suitably diverse talent, has been important to improving diversity on the Board. In 2017 the Committee used the services of specialist external search advisors, selected for their market expertise as well as their track record of making placements of diverse candidates as follows:

Director	Search firm
Michele Faull	Korn Ferry
Jo Kenrick	Norman Broadbent
Board Chairman	Zygos
Chair of Board Audit Committee	Zygos
Chair of Board Risk Committee	Zygos

None of these firms is a related party to the Society.

Governance

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

Key activities in 2017

The Committee:

- Reviewed the Society's Board Succession Plan with particular reference to executive succession and securing a pipeline of non-executive directors.
- Oversaw the recruitment and induction of new directors.
- Oversaw changes to the Chairs and membership of the Board's Committees, and reviewed the Society's Management Responsibilities Map, before submission to the Board for approval.
- Oversaw the ongoing search for a new Chairman and two further non-executive directors intended to be able to succeed the current Chair of the Board Risk and Board Audit Committees.
- Oversaw the application of the various policies designed to ensure the Society's Board is effective.
- Reviewed the matters reserved for the Board and the Board timetable to ensure matters were considered or delegated appropriately.
- Reviewed directors' proposed external appointments to ensure they did not represent a conflict of interest or exceed the number of permitted directorships or prevent directors devoting sufficient time to the Society.
- Reviewed the roles of the Chairman and Chief Executive.
- Oversaw actions to improve the effectiveness of the Board and its Committees, including coordinating the 2017 effectiveness review and agreed follow-up actions.
- Received updates on corporate governance developments.

Annual election/re-election

Andy Deeks, Michele Faull and Jo Kenrick were appointed to the Board during the year and will for the first time stand for election at the 2018 AGM.

The Board has considered the provisions of the Corporate Governance Code relating to re-election of directors, and considers that it is in the best interests of members to submit the entire Board for annual re-election. This means all directors who were re-elected at the 2017 AGM have voluntarily submitted themselves for re-election.

Time commitment

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

Peter Ayliffe
Chair of the Nominations and Governance Committee

22 February 2018

Board Risk Committee

Dear Member

Set out below is the report of the Board Risk Committee for the year ended 31 December 2017.

Current membership[2]	Member since	Years on the committee
Roger Burnell[1]	2010	8.0
Peter Ayliffe	2016	1.5
Catherine Doran	2017	0.6

1. Chair since January 2013.
2. Ian Geden was a member of the Committee until 25 April 2017 and Alasdair Lenman until 28 September 2017.

Responsibility

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

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

In 2017, the Committee received and considered reports relating to Principal and emerging risks faced by the Society. Please see the Risk Management Report for more information.

At each meeting the Committee considered a detailed consolidated risk report from the Chief Risk Officer. In addition, during 2017 the Committee:

- Scrutinised internal assessments of capital and liquidity resources, including a range of stress testing scenarios, prior to the Board providing its approval.
- Critically reviewed the Society's plan for meeting future capital requirements prior to submission to the Board.
- Reviewed the Society's Enterprise Risk Management Framework and recommended it for approval by the Board.
- Reviewed the Society's operational resilience, sought assurance as to the effectiveness of IT systems and business continuity arrangements.
- Received reports on changes to lending policy and processes in general to meet with regulatory expectations surrounding portfolio landlords and buy to let mortgages.
- Reviewed the Society's overall risk appetite and the risk appetites for each of the Principal risks faced by the Society, including risk limits and tolerances.
- Agreed an integrated risk assurance plan and monitored second line risk oversight and progress in delivering a programme of thematic reviews.
- Reviewed the Conduct Risk Framework and received assurance from the Chief Risk Officer that employees are risk-aware and encouraged to contribute to identifying and managing risks faced by the Society.
- Agreed the approach to evaluating the risks and benefits of data storage options as part of a project to modernise the Society's IT infrastructure.
- Discussed macro and micro risks to financial stability following the publication of the Bank of England Financial Policy Committee's half yearly report.
- Critically reviewed treasury credit limits and recommended changes to the Board for approval.
- Reviewed the Financial Crime Policy and received a report from the Money Laundering Reporting Officer.

Roger Burnell
Chair of the Board Risk Committee

22 February 2018

Governance

Board Audit Committee Report

Board Audit Committee

Dear Member

Set out below is the report of the Board Audit Committee for the year ended 31 December 2017.

Current membership[2]	Member since	Years on the committee
Roger Burnell[1]	2013	4.9
Ian Geden	2017	0.5
Jo Kenrick	2017	0.1

1. Chair from 1 October 2016 until 9 May 2017, and from 12 December 2017.
2. Janet Ashdown was a member of the Committee until 27 April 2017, Catherine Doran was a member of the Committee until 27 June 2017 and Alasdair Lenman was a member of the Committee until 28 September 2017.

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

The Committee invites the Chief Executive, Chief Financial Officer, Chief Risk Officer, General Counsel and Secretary, Deputy Secretary, Chief Internal Auditor and the external auditor to attend 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 Chief Internal Auditor in the absence of management to enable issues to be raised directly if necessary. The Committee Chair also meets privately with the Chief Internal Auditor and the external auditor on a regular basis.

Following each Committee meeting, the minutes of the meeting are distributed to the Board and the Committee Chair provides an update to the Society's Board on key matters discussed.

Responsibilities

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, and to ensure that the interests of the Society's members are properly protected, with specific regard to:

- Monitoring the integrity of the interim and annual financial statements, summary financial statements and Pillar 3 disclosures, focusing particularly on significant financial reporting judgements, and ensuring the financial statements overall are fair, balanced and understandable.
- Reviewing the adequacy of systems of internal control and the risk management systems.
- Monitoring the external auditor's independence and objectivity, and the effectiveness of the external audit process.
- Reviewing the activities, findings and performance of Internal Audit.
- Agreeing the appointment and remuneration of the Chief Internal Auditor.
- Recommending the appointment and approving the remuneration and terms of engagement of the external auditor.
- Overseeing the Society's whistleblowing arrangements.

In 2017, 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 2017 financial statements, the Committee considered in detail areas subject to management judgement and received a report from the Chief Financial Officer on each area setting out the approach adopted, methodology, key assumptions and comparison with the prior year. Each of the reports presented to the Committee by management was subject to scrutiny by the external auditor. There were no 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 and fee income using a rate of return that reflects a constant income yield over the expected behavioural life of the mortgage loan, based on expectations of interest rates at the time of loan origination. 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 (SVR). This methodology 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 SVR margin and redemption assumptions.

The Committee reviewed updated assumptions used for 2017, reflecting the latest experience, together with the impact on the EIR asset of higher levels of redemptions and expectations of future SVR rates. The Committee concluded that the basis of calculation and value of the asset was appropriate. Further information can be found in note 3 to the accounts.

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. The sensitivity of the provision calculation to various assumptions was considered in the light of the low levels of mortgage arrears experienced. The Committee was satisfied with the adequacy of the provisions recorded within the Balance Sheet. Further information can be found in the retail credit risk section of the Risk Management Report and note 11 to the accounts.

Derivatives and hedge accounting

The Committee reviewed the Society's use of derivatives and its approach to hedge accounting. Derivatives are used solely for risk management purposes, to manage either interest rate risk or foreign exchange risk, and are economically effective. The Committee noted that the Society's application of hedging and hedge accounting strategies had remained unchanged during 2017 and was satisfied that the approach adopted was appropriate. Further information can be found in note 23 to the accounts.

Other matters relevant to the accounts

In addition to the areas of management judgement set out above, the Committee also specifically considered the following in relation to the interim and full year accounts:

- The release of £12.6 million of excess fair value adjustment for credit risk initially made on the merger with Stroud & Swindon Building Society in 2010.
- Accounting for equity investments in Visa Inc. and VocaLink Holdings Limited (VocaLink).
- The capitalisation of internal resource costs in relation to the Society's ongoing change programme.
- Disclosures made in the financial statements in respect of adopting IFRS 9 from 1 January 2018.

Further information on these matters can be found in the notes to the accounts.

Going concern and long-term viability

The Committee evaluated whether adopting the going concern basis of accounting was appropriate by considering a report presented by the Chief Financial Officer which covered the Society's projected profitability and liquidity and capital positions, together with the availability of funding, and regulatory considerations. The Committee also considered the Society's longer-term viability, taking account of the Principal risks facing the Society, including those that could threaten the Society's business model, future performance, solvency and liquidity.

In particular, the Committee considered the extent to which the Society's long-term viability is dependent on the existence of the intermediary channel within the UK mortgage market and the impact of inherent uncertainty with regard to a number of factors in the outer years of the Strategic Plan. The Committee concluded that whilst these uncertainties are significant to the Society's Strategic Plan, they do not in themselves challenge the Society's long-term viability.

Fair, balanced and understandable

The Committee considered whether the 2017 Annual Report & Accounts were fair, balanced and understandable. The Committee did this by satisfying itself that there was a robust process of review and challenge at different levels within the Society to ensure balance and consistency, which included:

- Issuing guidance to those involved in drafting or reviewing the Annual Report & Accounts.
- Ensuring all key messages are included within the Strategic Report, and that they are communicated in a simple and straightforward manner.
- A thorough internal verification process of the factual content of the reports.
- Central coordination ensuring a sufficient cycle of review and adequate review time at each level within the Society.
- Independent review by a non-specialist.
- Comprehensive review by senior management, executives and the Committee Chair, prior to a meeting of the 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 2017 Annual Report & Accounts are fair, balanced and understandable.

Transfer pricing and tax strategy

The Society is the only Group entity subject to the 8% tax surcharge on banking profits. As a result the Society is required to have a transfer pricing policy, in respect of transactions between the Society and its subsidiaries, to ensure it meets the requirements of the tax legislation.

A transfer pricing policy was therefore considered and approved by the Committee.

During 2017 the Committee also reviewed and approved the Society's Tax Strategy and this was published on the Society's website in December 2017 in accordance with regulatory requirements.

New accounting standards

Regular updates and training 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.

During the year, the Committee was updated on the progress of the project to implement IFRS 9 *Financial Instruments*, which will replace IAS 39 *Financial Instruments: Recognition and Measurement* in 2018. The Committee has also received training on IFRS 9 and reviewed the key judgements and calculation basis to be adopted regarding classification and measurement, staging, calculation of expected losses and the use of alternative economic scenarios. It has reviewed governance and oversight arrangements to be adopted by management and considered guidance on the external audit of IFRS 9. It has also reviewed the work performed to date by the external auditor in relation to IFRS 9 implementation. The Committee was satisfied that the new reporting standard is being implemented appropriately.

The Committee also received training associated with IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases.* IFRS 15 is applicable for reporting periods beginning on or after 1 January 2018 and IFRS 16 is applicable for reporting periods beginning on or after 1 January 2019.

As a result of the new IFRS 15 reporting standard, the Society has reviewed its revenue streams and confirmed their treatment remains appropriate under the new standard. IFRS 16 will require the Society to review its current leases and confirm their treatment under the new standard. The standard materially changes accounting for leased assets by requiring certain leases, currently expensed to the Income Statement, to be capitalised on the Balance Sheet. The Committee was satisfied that work to apply these amendments was appropriately advanced at this stage.

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

The Society's internal control and risk management arrangements

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

The Society has an established and embedded Enterprise Risk Management Framework, giving a cohesive approach to risk management. Whilst recognising that the Society's low risk appetite and simple business model are important factors in mitigating risk, the framework is designed to promote risk management and responsibility for risks throughout the Society.

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

With respect to the Society's whistleblowing arrangements, the Committee received regular reports during 2017 on the application of the whistleblowing policy. The Committee also considered an annual report on the operation of these arrangements and a thematic summary of concerns raised during 2017 and concluded that the arrangements were operating effectively, and there were no material matters of concern.

The activities of Internal Audit

The roles and responsibilities of Internal Audit are set out within Internal Audit's Charter. These were reviewed and approved by the Committee during the year and a copy is available on the Society's website (thecoventry.co.uk/InternalAudit).

The Committee received regular reports from the Chief Internal Auditor setting out the results of assurance activity related to Society operations and change initiatives, progress in delivery of the Internal 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, the Committee reviewed and approved amendments to the Internal Audit plan and resources throughout the year.

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

External auditor

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

Audit plan

Prior to the annual audit commencing, the Committee considered a report presented by the external auditor, Ernst & Young LLP, 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.

Audit quality

The Committee maintains oversight of external audit quality. Consideration at all Committee meetings is given to factors which impact on external audit quality, with conclusions on external audit effectiveness being formalised as part of the year end reporting process. The views of members of the Committee, the Chief Financial Officer, Internal Audit and key members of the finance team were sought. The factors considered included, but were not limited to:

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

The review also considered the Financial Reporting Council's (FRC) Audit Quality Inspection Annual Report 2016/17 (June 2017) and the Audit Quality Inspection Report on Ernst & Young LLP (June 2017). 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 a resolution at the 2018 AGM that Ernst & Young LLP be reappointed.

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

The Committee regularly reviews and monitors the Society's relationship with the external auditor to ensure that auditor independence and objectivity is maintained at all times. The Committee has developed a policy and framework which 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 its own work, make management decisions for the Society, create a conflict of interest or find itself in the role of advocate for the Society. The Committee keeps non-audit engagements under review and receives regular reports from the external audit partner confirming that adequate safeguards remain in place. Furthermore, the Society's policy and framework require that the external auditor should only be appointed if the threat to objectivity is clearly insignificant, unless appropriate safeguards can be applied to eliminate or reduce such threat to an acceptable level.

During 2017, the Society engaged the external audit firm to provide certain non-audit services. These engagements included work relating to IFRS 9 model validation, reviewing the Society's Pillar 3 disclosures, and assurance work in relation to the Society's debt issuances. 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 9 to the accounts.

Future audit tender

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 the most recent Financial Reporting Council guidance at that time. The UK Corporate Governance Code requires that the audit contract be put out to tender every 10 years, with transitional provisions for compliance. Additionally, European Union regulations now require the auditor to be changed at least every 20 years. These requirements mean that the Society's external audit contract must be re-tendered no later than 2020 for the 2021 year end audit.

The Committee has reviewed the timing of audit firm rotation and expects that the tender of the external audit will commence during 2018, and that a new external auditor will be appointed no later than 2019 for the 2020 year end.

The effectiveness of the Committee

The Committee carried out a review of its effectiveness during 2017, including an assessment of its work against its terms of reference, published guidance and best practice. The review was facilitated by the General Counsel and Secretary and considered questionnaires which were completed by both Committee members and regular attendees. The review concluded that the Committee had operated effectively throughout the year.

Roger Burnell
Chair of the Board Audit Committee

22 February 2018

Directors' Remuneration Report

Dear Member

I am pleased to present the Remuneration Committee's annual report for 2017.

The Society's performance in 2017

The Society delivered a strong and balanced performance in 2017, outperforming five of the twelve strategic measures and performing in line with six measures set for the period. This performance stems from an ongoing commitment to deliver long-term value for our members based on efficient operations, low-risk lending and high-quality service. This provides the basis for appropriate levels of profitability to enable sustainable growth and provide a highly secure capital position.

Approach to decision-making

The Society's performance is considered across a balanced scorecard of measures. The Committee's assessment of remuneration is guided by the balanced scorecard but the Committee retains discretion in appropriate circumstances to consider wider factors. The Committee balances paying fairly; controlling costs; and the need to attract and retain people with the right skills, experience and values. The Committee considers the remuneration policy and its application to all employees, including executive directors and executive managers.

The Committee's work

The Committee oversees the Society's overall remuneration framework including matters relating to directors.

During 2017 the Committee:

- Considered the outturn of the 2016 balanced scorecard and approved the measures for the 2017 scorecard.
- Approved variable pay awards under the 2014-16 Long Term Incentive Plans (LTIPs) and the 2016 Executive Variable Pay Plan (ExVPP), ensuring awards were consistent with the Society's member-focused culture. The Committee also agreed an approach to the 2015-2017 LTIP award.
- Approved a payment under the 2016 Success Share scheme, which was paid to all employees, including executive directors and executive managers.
- Approved the remuneration of an executive director on appointment.
- Approved the salary review approach for the Society and considered Executive salaries in this context, with reference to individual performance and external benchmarking data.
- Approved an increase in the Chairman's fee consistent with the increase awarded to the Society as a whole.
- Approved a payment to executive directors and executive managers of an amount which had been retained for six months in compliance with the Prudential Regulation Authority (PRA) Remuneration Code.
- Received a report from the Chief Risk Officer (CRO) that gave assurance that the Society's remuneration framework had not encouraged excessive risk-taking.
- Considered the CRO's annual review of whether there had been grounds to recover or withhold variable pay awards.
- Endorsed the Society's remuneration policy including a restatement of the guiding principles that ensure the same pay approach is applied to executive directors, executives and all employees.
- Oversaw an assessment of staff whose responsibilities could impact the Society's risk profile.

Content of this report

Although not required to do so, the Society has prepared this report in line with legislation applicable to quoted companies. The report presents a summary of the Society's Remuneration Policy, and explains in the Annual Remuneration Report how the Committee intends to apply the Policy in relation to the 2017 and 2018 performance years. This report also explains how the PRA's deferral rules apply to the directors, including a change which has increased from six to twelve months the retention period for some variable pay awards.

Annual General Meeting

Last year's Annual General Meeting was held on 27 April 2017. The Remuneration Policy was submitted to an advisory vote at that meeting and was approved, with 92% of voting members showing their support. The Policy will be submitted to an advisory vote of members every three years. The next vote will be in 2020, or sooner if changes are proposed or members do not approve by advisory vote the Annual Remuneration Report, which will be submitted to a vote of members annually. These voting arrangements are advisory and the directors' remuneration is not conditional upon them. Regardless of this the Committee intends to take account of members' feedback and is committed to effective corporate governance.

Ian Geden
Chair of the Remuneration Committee

22 February 2018

Remuneration Policy Summary

The Remuneration Policy approved by members at the 2017 AGM remains in force and is summarised below. It does not replace or override the full approved policy which is available at thecoventry.co.uk.

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

The Remuneration Policy is aligned with the business strategy, objectives, values and long-term interests of the Society and with the Prudential Regulation Authority's (PRA's) Remuneration Code. The Remuneration Policy is consistent with the overall financial stability of the Society, promotes sound and effective risk management and does not encourage excessive risk taking.

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

Annual Remuneration Report

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

The total pay package earned by each executive director in respect of the years ended 31 December 2017 and 2016 are shown below.

Total remuneration earned by each executive director

	Fixed remuneration			Variable remuneration				
Audited information	Base salary £000	Taxable benefit £000	Pension allowance[1] £000	Annual Success Share bonus £000	ExVPP £000	Legacy LTIP[2] £000	Total (including legacy LTIP) £000	Total (excluding legacy LTIP) £000
2017								
Mark Parsons	509	19	102	62	185	116	993	877
John Lowe[3] (until 27.4.17)	108	13	16	n/a	n/a	n/a	137	137
Peter Frost	276	26	41	33	100	60	536	476
Andy Deeks[4] (from 27.4.17)	140	7	21	25	76	18	287	269
Michele Faull[5] (from 27.4.17)	230	7	34	31	93	n/a	395	395
Total	1,263	72	214	151	454	194	2,348	2,154
2016								
Mark Parsons	493	19	99	69	194	96	970	874
John Lowe	320	12	48	45	126	75	626	551
Peter Frost	267	26	40	38	105	60	536	476
Total	1,080	57	187	152	425	231	2,132	1,901

1. Pension allowance includes both contributions to the Group's defined contributory pension scheme and cash payments in lieu of contributions.
2. The LTIP figure for 2017 is the amount earned in respect of the LTIP award granted in 2015 and based on performance for the three years ended 31 December 2017. The LTIP is a legacy arrangement which concluded in 2017. The 2015-2017 LTIP payment for Mark Parsons is based on a full 36 months whereas the 2014-2016 payment received in 2016 was pro rata for 30 months from his date of joining.
3. John Lowe's remuneration comprises all payments made to him in respect of service until 27 April 2017. Further information is detailed under Payments to former directors.
4. Andy Deeks' remuneration comprises base salary and benefits from his appointment to the Board on 27 April 2017. The variable remuneration shown is for a full performance year and therefore includes some pre Board service.
5. Michele Faull's remuneration comprises base salary and benefits from her appointment to the Board on 27 April 2017. The variable remuneration shown is from the date of joining the Society (1 April 2017).

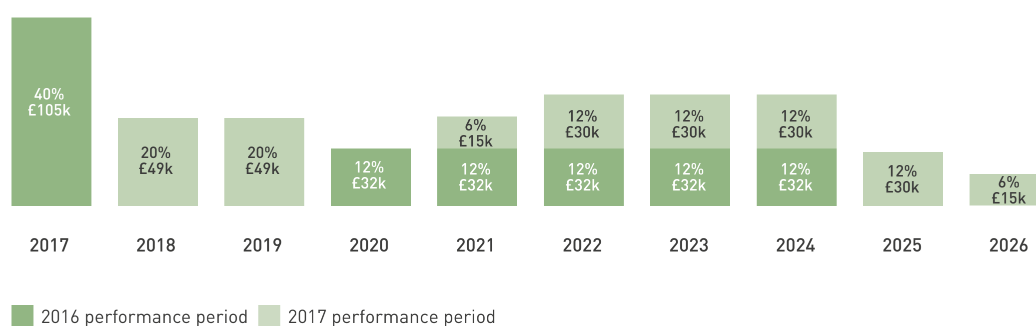
The impact of deferral

The variable remuneration shown above is the total award due but is subject to deferral arrangements.

For executive directors and executive managers whose total remuneration is above the regulatory deferral threshold of £500,000, 60% of their total variable pay (annual Success Share bonus and Executive Variable Pay Plan (ExVPP)) is subject to an extended deferral period of seven years. The deferred award is released in equal installments on the third to seventh anniversaries of the assessment date after the end of the performance period. For each of these annual payments, half of the awards are made in cash with the other half retained in an equivalent share-like instrument for a further period. This retention period has increased from six months for the 2016 performance period to twelve months for the 2017 performance period, as illustrated below. The valuation of the equivalent share-like instrument is formula driven with an uplift for inflation to protect the real term value of the award during the retention period. The formula then reduces the payment if there has been a material reduction in profit performance or capital strength during the retention period.

As the Long Term Incentive Plan (LTIP) is a legacy scheme which has already been subject to a three year deferral, it is outside the scope of the extended deferral and retention rules, and does not contribute to the regulatory threshold.

The impact of deferral in relation to the 2016 and 2017 performance periods is illustrated below by reference to the CEO's variable pay.



In respect of variable pay earned in 2017, Mark Parsons and Michele Faull will each receive a payment of 20% of this in 2018 (£49,243 and £24,840 respectively) and an equivalent 20% in 2019. The remaining 60% (£147,290 and £74,520 respectively) will be paid in installments from 2021 onwards until the final payment is received in 2026.

For executive directors and executive managers below the regulatory deferral threshold, 40% of the ExVPP only is deferred until the second anniversary of the assessment date after the end of the performance period. For the annual Success Share bonus and the ExVPP payments, half of the awards are made in cash with the other half retained in an equivalent share-like instrument for a further period of six months. Consequently, Peter Frost and Andy Deeks will each receive 100% of the annual Success Share bonus (£33,342 and £25,200 respectively) and 60% of the ExVPP (£60,014 and £45,360 respectively) in 2018 with the remaining 40% (£40,010 and £30,240 respectively) payable in 2020.

Further information on individual remuneration elements: executive directors

Base salary 2017

The annual review of salaries conducted in April 2017 saw a 2% basic increase for all employees and an additional 1.25%, where appropriate, to progress towards market levels. The executive directors received 3.25% in line with this approach. The table below sets out the current base salary for the executive directors compared with the previous year:

Executive director	2017 £	2016 £	% increase
Mark Parsons	512,946	496,800	3.25%
Andy Deeks[1]	210,000	–	–
Michele Faull[1]	345,000	–	–
Peter Frost	277,846	269,100	3.25%

1. Andy Deeks and Michele Faull were appointed to the Board on 27 April 2017.

Variable pay 2017

The Society delivered a strong and balanced performance in 2017. This is reflected in the balanced scorecard of measures which determine variable pay as outlined below. The Society outperformed against five of the twelve strategic measures, performed in line with six measures and did not meet the stretching target set for community involvement. Over 79% of employees did undertake activity to support the community in 2017 and this remains an area of strength for the Society. Further information on the Society's performance can be found in the Strategic Report. Performance against the balanced scorecard measures, which are equally weighted, is summarised below:

Performance measure	Performance relative to target range
Financial:	
Mortgage balance growth	In line
Savings balance growth	Outperformed
Cost to mean asset ratio	In line
Capital ratios:	
Leverage ratio	In line
Common Equity Tier 1 ratio	Outperformed
Risks and projects:	
Mortgage balances in arrears (%)	Outperformed
Liquidity Coverage Ratio	Outperformed
Investment programme delivery	In line
Members:	
Experience Net Promoter Score®[1]	Outperformed
Relationship Net Promoter Score®[1]	In line
People:	
Employee engagement	In line
Community involvement	Target not met

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

Given the performance outlined above, the Committee considered the level of variable awards and determined:

- An annual Success Share bonus for all 2,418 eligible employees, including executive directors equivalent to 12% of base salary from a potential maximum of 20%.
- An Executive Variable Pay Plan (ExVPP) award to executive directors equivalent to 36% of base salary from a potential maximum of 60% and to executive managers of 18% of base salary from a potential maximum of 30%.

For executive directors and executive managers these amounts will be deferred as described on page 82.

The maximum award levels under the variable plans awarded in 2017 are unchanged from 2016.

Long Term Incentive Plan 2017

The last of the legacy Long Term Incentive Plans (LTIP) awarded in 2015 and based on performance in the financial years 2015-2017, paid out at 25.2% (from a potential maximum of 40%) for executive directors and 12.6% (from a potential maximum of 20%) for executive managers.

50% of the payments made under the LTIP will be retained in an equivalent share-like instrument for a further six months.

There were no LTIP grants in 2017 as the plan was replaced by the ExVPP in 2016 and there will be no further LTIP payments.

Benefits and pension 2017

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

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

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

Remuneration elements in 2018

Base salary 2018

The base salaries for executive directors will be revised from April 2018 in line with the approach outlined in the Remuneration Policy.

Benefits and pension 2018

No changes are anticipated to the Society's approach to benefit and pension provision in 2018.

Variable pay 2018

The 2018 annual Success Share bonus scheme and ExVPP will be reviewed in line with business strategy and the impact of changes to relevant regulation. It is anticipated that there will be no significant changes to variable pay arrangements for 2018. Details of the performance metrics for both variable pay plans will be provided in the 2018 Directors' Remuneration Report.

Payments to former directors (Audited information)

In September 2016 John Lowe advised the Board of his intention to step down from the role of Finance Director and this came into effect at the AGM on 27 April 2017. All payments made to him in respect of his service up until this date are reported in the table of total remuneration earned by each executive director. John was contracted to a 12 month notice period and received the remaining payment in lieu of notice in monthly instalments, comprising base salary and benefits only, for the remainder of his notice period ended 30 September 2017. All elements of deferred remuneration lapsed.

Change in remuneration of director undertaking the role of Chief Executive

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

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

Relative importance of spend on pay

The following table sets out the change in profit in 2017 and 2016 and compares these with the overall spend on remuneration over the two years. As a mutual organization the Society does not seek to maximise profit. Rather, the Society's activity is driven by mortgages and savings and the percentage change in total assets has been included to give an appropriate indication of growth.

	2017 £m	2016 £m	Percentage change %
Total assets	**42,572.5**	38,295.9	11.2
Employee remuneration costs	**73.7**	67.6	9.0
Profit after tax	**184.8**	182.4	1.3

The increase in employee remuneration costs results from the annual salary review and additional headcount to support the growth of our business and investment in our technology and infrastructure, to comply with new regulations and to further improve the quality of service offered to members.

Total remuneration earned by each non-executive director

Audited information	Base fees 2017 £000	Base fees 2016 £000	Committee Chair and other fees 2017 £000	Committee Chair and other fees 2016 £000	Taxable benefits 2017 £000	Taxable benefits 2016 £000	Total fees and taxable benefits 2017 £000	Total fees and taxable benefits 2016 £000
Non-executive directors:								
Ian Pickering (Chairman – until 28.09.17)	109	141	–	–	6	6	115	147
Peter Ayliffe (Deputy Chairman – until 30.09.17) (Chairman – from 01.10.17)	73	48	5	4	5	3	83	55
Janet Ashdown (retired 27.04.17)	16	48	–	–	2	4	18	52
Bridget Blow (retired 28.04.16)	–	16	–	2	–	–	–	18
Roger Burnell (Chair of the Board Risk Committee and Senior Independent Director) (Chair of the Board Audit Committee – until 09.05.17 and from 12.12.17)	49	48	28	22	–	–	77	70
Catherine Doran (from 01.08.16)	49	20		–	6	1	55	21
Ian Geden (Chair of the Remuneration Committee) (Deputy Chairman – from 21.11.17)	49	48	12	11	2	3	63	62
Jo Kenrick (from 06.11.17)	8	–	–	–	1	–	9	–
Alasdair Lenman (from 01.11.2016 until 28.09.17) (Chair of the Board Audit Committee – from 09.05.17 until 28.09.17)	45	8	8	–	–	–	53	8
Glyn Smith (Chair of the Board Audit Committee and Models and Ratings Committee – resigned 30.09.16)	–	36	–	18	–	5	–	59
Total	398	413	53	57	22	22	473	492

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

A Non-Executive Directors' Remuneration Committee reviews the fees of the non-executive directors annually in light of their responsibilities and with reference to market competitive ranges and recommends to the Board for approval the remuneration of the non-executive directors, other than the 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 increased from January 2017. 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 base fee, plus a Committee Chair fee as appropriate. The Chairman does not receive additional fees for roles carried out other than that of Chairman. The fees for non-executive directors will be reviewed from April 2018.

Non-executive director fees	2017 £000	2016 £000
Chairman	145	141
Base fee	49	48
Deputy Chairman	7	6
Chair of the Remuneration Committee	11	11
Chair of the Board Audit Committee	13	13
Chair of the Board Risk Committee	13	13
Chair of the Models and Ratings Committee[1]	–	11
Senior Independent Director (if different from Deputy Chairman)	7	6

1. The Models and Ratings Committee is now chaired by the Chief Financial Officer.

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.

Details of the Remuneration Committee

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

Current membership[2]	Member since	Years on committee
Ian Geden[1]	2012	6.0
Peter Ayliffe	2017	0.1
Catherine Doran	2016	1.2
Jo Kenrick	2017	0.1

1. Chair of the Committee since January 2016.
2. Ian Pickering was a member of the Committee until he passed away on 28 September 2017. Janet Ashdown was also a member of the Committee until April 2017.

The Remuneration Committee has delegated authority from the Board to:

- Review and approve the Society's Remuneration Policy.
- Approve the remuneration of the executive directors and executive managers.
- Oversee the remuneration of all employees in scope of the PRA Remuneration Code.
- Approve all variable pay schemes together with relevant targets.
- Review the remuneration of the Chairman for recommendation to and approval by the Board.
- Review and approve the Society's PRA Remuneration Policy Statement.
- Review and approve the Directors' Remuneration Report.

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

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

Remuneration Committee advisors and fees

The Remuneration Committee considers external data from independent national surveys of the financial services sector 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. 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 £12,508, (including VAT) for the year ended 31 December 2017.

Details of the Non-Executive Directors' Remuneration Committee

The members of the Committee are:

Current membership[2]	Member since	Years on committee
Mark Parsons[1]	2014	3.1
Peter Ayliffe	2017	0.1
Michele Faull	2017	0.8

1. Chair of the Committee.
2. Ian Pickering was a member of the Committee until he passed away on 28 September 2017. John Lowe was also a member of the Committee until April 2017.

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 variable pay schemes.

The Committee met once during the year to conduct the annual remuneration review and carry out other activities within its remit.

Statement of Member vote at AGM

At the 2017 AGM, two ordinary resolutions (advisory votes) were proposed to Members to approve the Directors' Remuneration Policy and the Annual Remuneration Report for the year ended 31 December 2016 for which the following votes were received

Remuneration Policy	Number of votes	% votes cast
Votes cast for	123,277	91.8%
Votes cast against	11,043	8.2%
Total votes cast	134,320	100%
Votes withheld	2,607	–

Annual Remuneration Report	Number of votes	% votes cast
Votes cast for	124,542	92.5%
Votes cast against	10,097	7.5%
Total votes cast	134,639	100%
Votes withheld	2,298	–

Remuneration disclosures (Material Risk Takers)

The disclosures required under the Capital Requirements Regulations (CRR) Part Eight Article 450 in respect of the Society's Material Risk Takers for the performance year ended 31 December 2017 are included in this report. The Society's remuneration policies, practice and governance comply with the Remuneration Part of the Prudential Regulation Authority (PRA) Rulebook and the Financial Conduct Authority (FCA) Remuneration Code for dual-regulated firms (SYSC 19D 'the Remuneration Code'). Material Risk Takers are those individuals whose actions have a material impact on the risk profile of the Society, based on criteria set by the European Banking Authority (EBA) and those individuals identified outside the EBA criteria, that the Society has determined have a material impact on the risk profile of the Society.

During the year there were a total of 48 Material Risk Takers. Of these, 20 fall within the Senior Management category (being the executive and non-executive directors of the Board and executive managers).

The following table shows the remuneration of the Society's Material Risk Takers for the performance year ended 31 December 2017. Senior Management includes non-executive directors, executive directors and executive managers.

Analysis of remuneration by fixed and variable elements

	Senior Management	Other Material Risk Takers	Total
Number of Material Risk Takers	20	28	48
Fixed pay (£000)[1]	3,761	3,072	6,833
Variable pay (£000)[2]	1,000	297	1,297
Total (£000)	4,761	3,369	8,130

1. Fixed pay includes base salary, benefits, pension and severance pay and fees for non-executive directors.
2. Variable pay includes the 2017 annual Success Share bonus and 2017 ExVPP awards.

Governance

Directors' Report

The directors have pleasure in presenting their Annual Report & Accounts for the year ended 31 December 2017.

Business objectives, future developments and key performance indicators

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

Profit and capital

Profit before tax for the year ended 31 December 2017 was £242.7 million (2016: £239.1 million). The profit after tax transferred to the general reserve was £184.8 million (2016: £182.4 million).

Total Group reserves and equity at 31 December 2017 were £1,976.0 million (2016: £1,821.3 million). Further details on the movements on reserves and equity are given in the Group Statement of Changes in Members' Interests and Equity (page 102).

Gross capital at 31 December 2017 was £2,043.1 million (2016: £1,888.4 million), including £25.5 million (2016: £25.5 million) of subordinated debt, £41.6 million (2016: £41.6 million) of subscribed capital and £396.9 million (2016: £396.9 million) of Perpetual Capital Securities. The ratio of gross capital as a percentage of savings and borrowings at 31 December 2017 was 5.09% (2016: 5.28%) and the free capital ratio was 4.91% (2016: 5.11%). The Annual Business Statement gives an explanation of these ratios.

Mortgage arrears

At 31 December 2017, there were 84 mortgage accounts more than 12 months in arrears (including those in possession) (2016: 117). The balance on these accounts totalled £13.1 million (2016: £17.0 million) and the value of these arrears was £0.8 million (2016: £1.2 million) or 0.002% (2016: 0.004%) of total mortgage balances. The mortgage arrears methodology is based on the UK Finance (formerly 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 £1.6 million (2016: £1.4 million) to charitable organisations during the year. This included an amount of £1.5 million (2016: £1.3 million) to The Royal British Legion's Poppy Appeal and £70,000 (2016: £70,000) to the Coventry Building Society Charitable Foundation.

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

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

Creditor payment policy

The Society's policy is to agree the terms of payment at the start of trading with suppliers and to pay in accordance with its contractual and other legal obligations. The Society's creditor days were nine days as at 31 December 2017 (2016: 17 days).

Country-by-country reporting

The nature of activities of the Society is set out in the Strategic Report and for each of the Society's subsidiaries in note 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 10 to the accounts, are related to the United Kingdom. The Society and its subsidiaries have not received any public subsidies.

Risk management

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

Employees

The Society recognises that its mission of Putting Members First is best achieved through a knowledgeable, skilled and motivated workforce.

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

In 2017, the Society continued to invest significantly in developing its employees, and deploys a broad scope of activities that provide training, career advancement and personal development opportunities at all levels of the organisation. The Society is committed to equal opportunities, encouraging diversity and fostering inclusion. The Chief Operating Officer is the Board member who sponsors Equality, Diversity and Inclusion activities and he is supported in this by a Steering Committee of leaders from across the Society.

In the past year the Committee has focused on a number of key areas such as hiring practices, education for managers and talent development. The actions taken have resulted in positive and tangible changes: 36% of executives are female and 60% of executive hires made in the past three years are female. The Society's Black, Asian and Minority Ethnic (BAME) population has increased from 11% to 15% over the past two years. Business in the Community recognised the Society's commitment and progress in relation to BAME through inclusion in its Best Employers for Race list for 2017.

The Society published gender pay gap data on its website in December 2017 and continues to focus on an agenda of diversity and inclusion.

Additional support is given to those who need it; for example, if someone has a disability the Society makes appropriate adjustments during the recruitment process so that they have an equal opportunity to perform to the best of their ability. Similarly, if someone becomes disabled during their employment with the Society, it will support them according to their individual needs, which may include retraining and redeployment.

The Society recognises the importance of effective internal communications and operates a number of channels to inform and engage with employees. 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.

During 2017, an employee forum was established which includes 22 representatives from across the Society. This has been an excellent addition to the existing communication channels and enhances the opportunity to engage with employees and listen to their views.

For further information see the employees section of the Corporate Responsibility Report.

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

The following statement, which should be read in conjunction with the statement of the auditor's responsibilities on page 98, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' Remuneration Report, the Annual Business Statement and this Directors' Report.

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

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

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

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

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

Directors' responsibilities in respect of accounting records and internal control

The directors are responsible for ensuring that the Group:

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

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

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

Directors' statement pursuant to the Disclosure and Transparency Rules

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

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

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

Directors' statement pursuant to the UK Corporate Governance Code

As required by the UK Corporate Governance Code, the directors confirm their opinion that the 2017 Annual Report & Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for members to assess the performance, strategy and business model of the Society.

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

Going concern and long-term viability

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

Directors' responsibilities in respect of going concern

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

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

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

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

Long-term viability statement

In accordance with provision C.2.2 of the UK Corporate Governance Code, the directors have assessed the prospects of the Society over a longer period than the 12 months required by the 'going concern' basis.

The directors' assessment is based on a robust review of the Society's principal risks, the Strategic Plan and the risk management framework (including risk appetite and risk culture) described within the Risk Management Report. This assessment is further supported by the Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), reverse stress testing and Recovery and Resolution Plan.

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

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

The Strategic Plan projects the Society's ongoing profitability, capital and funding positions as satisfactory throughout the five year plan period even in a range of adverse scenarios. Inherent uncertainty with regard to a number of factors, including geopolitical, economic and regulatory factors, increases over the planning period. However, the directors do not consider this a threat to the viability of the Society.

Based upon the assessment set out above, the directors have a reasonable expectation that the Society will continue in operation and meet its liabilities as they fall due over the period to December 2022.

Directors

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

The auditor

A resolution to reappoint Ernst & Young LLP as auditor of the Society will be proposed at the 2018 AGM.

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

Peter Ayliffe
Chairman

22 February 2018

Financial Statements

In this section you will find our primary statements and related notes.

Independent Auditor's Report 93
Accounts 100
Notes to the Accounts 104

Independent Auditor's Report to the Members of Coventry Building Society

Opinion

In our opinion, the financial statements:

- give a true and fair view, in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, of the state of the Group's and Society's affairs as at 31 December 2017 and of the Group's and Society's income and expenditure and cash flows for the year then ended; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the International Accounting Standards (IAS) Regulation.

We have audited the financial statements of Coventry Building Society which comprise:

Group	Society
Consolidated Balance Sheet as at 31 December 2017	Balance Sheet as at 31 December 2017
Consolidated Income Statement for the year then ended	Income Statement for the year then ended
Consolidated Statement of Comprehensive Income for the year then ended	Statement of Comprehensive Income for the year then ended
Consolidated Statement of Changes in Members' Interests and Equity for the year then ended	Statement of Changes in Members' Interests and Equity for the year then ended
Consolidated Statement of Cash Flows for the year then ended	Statement of Cash Flows for the year then ended
Related notes 1 to 34 to the financial statements, including a summary of significant accounting policies	Related notes 1 to 34 to the financial statements, including a summary of significant accounting policies

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (FRC) Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Use of our report

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

Conclusions relating to principal risks, going concern and viability statement

The directors have voluntarily complied with the UK Corporate Governance Code (the Code) and Listing Rule 9.8.6(R)(3)(a) of the Financial Conduct Authority (FCA) and provided a statement in relation to going concern, required for companies with a premium listing on the London Stock Exchange.

We have nothing to report in respect of the following information in the annual report, in relation to which the ISAs(UK) require us to report to you whether we have anything material to add or draw attention to:

- the disclosures in the Annual Report set out on page 23 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation set out on page 70 in the Annual Report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' statement set out on page 91 in the Annual Report about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements;
- whether the directors' statement in relation to going concern required under the Listing Rules in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit; or
- the directors' explanation set out on page 91 in the Annual Report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

Overview of our audit approach

Key audit matters	• Revenue recognition and the risk of management override of internal control in relation to EIR. • Measurement of loan impairments relating to retail mortgages. • Fair value and hedge accounting of the cross currency swaps.
Audit scope	• We performed an audit of the complete financial information of the Group and Society.
Materiality	• Overall Group materiality of £16 million which represents 1% of members' interests and equity (excluding other equity instruments).

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matters	Our response to the risk	Key observations communicated to the Board Audit Committee
Revenue recognition and the risk of management override of internal control in relation to EIR		
Interest income on mortgages is recognised using the Effective Interest Rate (EIR). For products with introductory rates such as mortgages where the reversionary interest rate in future years is expected to be higher than initial rates, the interest income recognised and the EIR approach depends on the period of time until redemption of mortgage, and future interest rates that will apply. There is significant judgement involved in forecasting customer behaviour and estimating the future expected cash flows.	We gained an understanding of key controls and challenged the appropriateness of key assumptions used within the EIR model, being: • the expected lives of loans by comparing them to recent actual redemption behaviours; and • future changes in yields to current market data and historical experience of mortgage yields. We performed completeness and accuracy testing of source data used in cash flow forecasts on a sample basis. We recalculated the EIR asset for a sample of loans and agreed the total EIR balance to the general ledger. We reviewed and substantiated a risk-based sample of journal entries recorded during the year.	The EIR model assumptions were reasonable in the context of current market data and observable customer behaviours. We gained assurance over the completeness and accuracy of data used within EIR models through reconciliation to source systems and sample testing of data attributes. We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger. We gained assurance that there was no evidence of management override of controls.
Measurement of loan impairments relating to retail mortgages		
The measurement of the loan impairment provision is subjective and requires management to exercise judgement with regard to estimating losses that have already been incurred within the retail mortgage book.	We performed a walkthrough of the impairment process, understood any changes in the calculation methodology and identified key controls. Our substantive audit procedures over the collective provision model included assessing and substantiating the key assumptions, such as: • Probabilities of default; • Probabilities of possession given default (PPD); • Time to sale; and • Forced sale discounts. We assessed these assumptions through substantiating to historical data and with reference to our knowledge of the Society's portfolios, including testing for appropriate and accurate data. We performed data integrity testing on the key sources of information feeding the collective model on a sample basis. We challenged collective model overlays for completeness, appropriateness of methodology, and accuracy of calculation using our knowledge and experience across the industry.	The Group's impairment models and assumptions have led to adequate provisions for incurred losses being recorded as at 31 December. We challenged the collective model assumptions and overlays employed by management and observed that management had adopted a conservative approach. We assessed the calculations for a sample of collective impairment provisions and did not identify any material differences. We were satisfied that the Group had applied its impairment policies on a consistent basis with the prior year and that key assumptions determined by management were appropriate as at the balance sheet date.

Key audit matters	Our response to the risk	Key observations communicated to the Board Audit Committee
Fair value and hedge accounting of the cross currency swaps		
The Group uses cross currency swaps to manage foreign currency risk and uses hedge accounting to reduce income statement volatility that would otherwise result from changes in the fair value adjustment of the Group's derivative financial instruments. Hedge accounting is complex and therefore inherently more susceptible to error, which could lead to incorrect measurement of hedge ineffectiveness in the Income Statement.	We performed a walkthrough of the hedge accounting process, understood any changes and identified key controls. We assessed the compliance of hedge accounting documentation with accounting standards. We engaged our in-house derivative valuation specialists to independently revalue a sample of cross currency swaps. We tested the valuation of hedged items on a sample basis. We tested that sources of ineffectiveness were appropriately identified, leading to appropriate hedge ineffectiveness being recorded in the Income Statement.	We confirmed that the Group's hedge documentation, and the valuation of derivatives and hedged items that are within designated hedge relationships, meet the requirements of the relevant accounting standards. We were satisfied that the valuation of cross currency swaps are materially correct as at 31 December 2017. The results of our assessment of hedge effectiveness testing identified that the Society's cross currency swap hedges lie within the required effectiveness range in accordance with IAS 39.

Our application of materiality

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

Audit materiality

Audit materiality is the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Group to be £16.0 million (2016: £14.2 million), which is 1% (2016: 1%) of members' interests and equity (excluding other equity instruments).

We determined materiality for the Society to be £11.5 million (2016: £10.6 million), which is 1% (2016: 1%) of members' interests and equity (excluding other equity instruments).

We assessed that members' interests and equity (excluding other equity instruments) provides us with an 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. We exclude other equity instruments from our basis of materiality on the basis that the issuance of £400m Additional Tier 1 capital securities has not materially changed the business of the Society.

Performance materiality

Performance materiality is the application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2016: 75%) of our planning materiality, namely £12.0m (2016: £10.7m). We have set performance materiality at this percentage based upon our recent experience of auditing the Group, from which we concluded that there is a lower expectation of undetected misstatement due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate.

We used a proportion of this value for performing the audit work on the subsidiaries, taking into consideration account size, risk profile, the organisation of the group and effectiveness of Group-wide controls, changes in the business environment and other factors such as recent Internal audit results when assessing the level of work to be performed at each entity. The performance materiality set for each subsidiary is based on the relative scale and risk of the subsidiary to the Group as a whole and our assessment of the risk of misstatement at that subsidiary. Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in the financial statements did not exceed our materiality level. Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.

Reporting threshold

This is the amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Board Audit Committee that we would report to them all uncorrected audit differences in excess of £0.8 million (2016: £0.7 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the Annual Report set out on pages 6 to 91, including the Chairman's Statement, Chief Executive's Review, Business Review, Corporate Responsibility Report, Risk Management Report, Directors Report on Corporate Governance, Directors' Remuneration Report and the Directors' Report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

The directors have voluntarily complied with the UK Corporate Governance Code (the Code) and prepare a Corporate Governance Statement in accordance with the Disclosure Guidance and Transparency Rules of the Financial Conduct Authority (FCA).

In this context, we also have nothing to report in regard to our responsibility to specifically address the following items in the other information and to report as uncorrected material misstatements of the other information where we conclude that those items meet the following conditions:

- fair, balanced and understandable set out on page 75 – the statement given by the directors that they consider the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- Board Audit Committee reporting set out on page 74 – the section describing the work of the Board Audit Committee does not appropriately address matters communicated by us to the Board Audit Committee; or
- directors' statement of compliance with the Code set out on page 90 – the parts of the directors' statement required under the Listing Rules relating to the Society's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the Code.

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Building Societies Act 1986 requires us to report to you if, in our opinion:

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

Other voluntary reporting matters

Directors' Remuneration Report

The Society voluntarily prepares a Report of the directors on remuneration in accordance with the provisions of the Companies Act 2006. The directors have requested that we audit the part of the Report of the directors on remuneration specified by the Companies Act 2006 to be audited as if the Society were a quoted company.

In our opinion, the part of the Director's Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 89, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group and Society's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit, in respect to fraud, are: to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and to respond appropriately to fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests both with those charged with governance of the entity and with management.

Our approach in respect of irregularities, including fraud, was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Group and determined that the most significant were the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations identified in the paragraphs above. Our procedures involved enquiries of legal counsel, executive management and internal audit.
- We understood how the Group is complying with those frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Board Risk Committee meetings held; and gained an understanding of the Group's approach to governance, demonstrated by the Board's review of the Group's Enterprise Risk Management Framework ('ERMF') and internal control processes.
- We assessed the susceptibility of the Group and Society's financial statements to material misstatement, including how fraud might occur, by considering the entity level controls that the Group has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We also considered performance and incentive plan targets and their potential to influence management to manage earnings.
- The Group operates in the financial services industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters we are required to address

- The period of total uninterrupted engagement including previous renewals and reappointments of predecessor firms is 87 years, covering the years ending 31 December 1930 to 31 December 2017.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society and we remain independent of the Group and the Society in conducting the audit.
- The audit opinion is consistent with the report to the Board Audit Committee.

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

22 February 2018

Income Statements

For the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Interest receivable and similar income	3	895.1	907.3	846.1	883.0
Interest payable and similar charges	4	(484.1)	(522.3)	(522.2)	(598.7)
Net interest income		411.0	385.0	323.9	284.3
Fees and commissions receivable	5	9.1	13.3	7.3	11.5
Fees and commissions payable	6	(9.1)	(8.9)	(7.1)	(7.0)
Other operating income	7	5.1	6.1	5.1	5.1
Net losses from derivatives and hedge accounting	8	(0.3)	(1.0)	(1.8)	(1.9)
Total income		415.8	394.5	327.4	292.0
Administrative expenses	9	(148.9)	(134.5)	(140.8)	(125.2)
Amortisation of intangible assets	17	(12.3)	(9.1)	(12.3)	(9.1)
Depreciation of property, plant and equipment	18	(6.7)	(5.9)	(6.7)	(5.9)
Impairment (charge)/credit on loans and advances to customers	11	(0.2)	1.5	0.1	1.5
Provisions for liabilities and charges	24	(3.5)	(6.1)	(3.5)	(5.9)
Charitable donation to Poppy Appeal		(1.5)	(1.3)	(1.5)	(1.3)
Profit before tax		242.7	239.1	162.7	146.1
Taxation	12	(57.9)	(56.7)	(43.0)	(37.9)
Profit for the financial year		184.8	182.4	119.7	108.2

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 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Profit for the financial year		184.8	182.4	119.7	108.2
Other comprehensive income					
Items that will not be transferred to the Income Statement:					
Remeasurement of defined benefit pension plan	19	14.5	(13.7)	14.5	(13.7)
Taxation	12	(3.9)	3.8	(3.9)	3.8
Effect of change in corporation tax rate	12	0.2	(0.3)	0.2	(0.3)
Items that may be transferred to the Income Statement:					
Available-for-sale investments:					
Fair value movements taken to reserves		(21.6)	33.5	(21.6)	33.5
Amount transferred to Income Statement	28	20.1	(26.7)	20.1	(26.7)
Taxation	12	0.4	(2.8)	0.4	(2.8)
Effect of change in corporation tax rate	12	0.1	0.2	0.1	0.2
Cash flow hedges:					
Fair value movements taken to reserves		(10.9)	213.6	(29.3)	144.0
Amount transferred to Income Statement		(17.9)	(198.2)	14.2	(138.7)
Taxation	12	7.9	(4.3)	4.2	(1.4)
Effect of change in corporation tax rate	12	(0.4)	0.7	(0.3)	0.3
Other comprehensive income for the year, net of tax		(11.5)	5.8	(1.4)	(1.8)
Total comprehensive income for the year, net of tax		173.3	188.2	118.3	106.4

The notes on pages 104 to 143 form part of these accounts.

Balance Sheets

As at 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Assets					
Cash and balances with the Bank of England		4,995.2	3,260.0	4,763.1	3,010.3
Loans and advances to credit institutions		202.0	213.5	202.0	213.5
Debt securities	13	1,012.3	1,354.3	982.3	1,354.3
Loans and advances to customers	14	35,930.9	32,881.6	23,064.3	21,384.8
Hedge accounting adjustment		17.2	144.5	17.2	144.5
Derivative financial instruments	23	306.5	354.2	215.2	256.0
Investment in equity shares	15	2.5	5.9	2.5	5.9
Investments in group undertakings	16	–	–	12,557.5	11,182.6
Intangible assets	17	40.8	32.5	40.8	32.5
Property, plant and equipment	18	36.2	35.7	36.2	35.7
Investment properties	18	–	0.2	–	–
Pension benefit surplus	19	18.5	2.5	18.5	2.5
Deferred tax assets	20	–	1.9	–	–
Prepayments and accrued income		10.4	9.1	10.3	9.1
Total assets		42,572.5	38,295.9	41,909.9	37,631.7
Liabilities					
Shares		31,035.7	28,054.3	31,035.7	28,054.3
Deposits from banks	21	3,499.0	2,937.5	3,440.3	2,887.7
Other deposits		4.0	7.0	4.0	7.0
Amounts owed to other customers		735.5	819.4	735.5	819.4
Debt securities in issue	22	4,888.8	3,978.1	4,695.9	3,746.9
Hedge accounting adjustment		76.5	158.7	71.0	132.7
Derivative financial instruments	23	214.0	366.7	214.0	366.7
Current tax liabilities		23.2	25.1	16.7	15.7
Deferred tax liabilities	20	10.3	13.7	9.4	9.3
Accruals and deferred income		28.0	28.5	23.1	23.7
Other liabilities		8.7	11.0	8.7	10.6
Provisions for liabilities and charges	24	5.7	7.5	5.5	7.3
Subordinated liabilities	25	25.5	25.5	25.5	25.5
Subscribed capital	26	41.6	41.6	41.6	41.6
Total liabilities		40,596.5	36,474.6	40,326.9	36,148.4
Members' interests and equity					
General reserve		1,553.1	1,376.1	1,163.1	1,051.2
Other equity instruments	27	396.9	396.9	396.9	396.9
Available-for-sale reserve	28	5.7	6.7	5.7	6.7
Cash flow hedge reserve		20.3	41.6	17.3	28.5
Total members' interests and equity		1,976.0	1,821.3	1,583.0	1,483.3
Total members' interests, liabilities and equity		42,572.5	38,295.9	41,909.9	37,631.7

The notes on pages 104 to 143 form part of these accounts.

Approved by the Board of directors on 22 February 2018 and signed on its behalf by

Peter Ayliffe
Chairman

Mark Parsons
Chief Executive

Michele Faull
Chief Financial Officer

Statements of Changes in Members' Interests and Equity

For the year ended 31 December 2017

Group	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2017	1,376.1	396.9	6.7	41.6	1,821.3
Profit for the financial year	184.8	–	–	–	184.8
Net remeasurement of defined benefit plan	10.8	–	–	–	10.8
Net movement in Available-for-sale reserve	–	–	(1.0)	–	(1.0)
Net movement in cash flow hedge reserve	–	–	–	(21.3)	(21.3)
Total comprehensive income	195.6	–	(1.0)	(21.3)	173.3
Distribution to Additional Tier 1 capital holders*	(18.6)	–	–	–	(18.6)
As at 31 December 2017	1,553.1	396.9	5.7	20.3	1,976.0
As at 1 January 2016	1,222.3	396.9	2.5	29.8	1,651.5
Profit for the financial year	182.4	–	–	–	182.4
Net remeasurement of defined benefit plan	(10.2)	–	–	–	(10.2)
Net movement in Available-for-sale reserve	–	–	4.2	–	4.2
Net movement in cash flow hedge reserve	–	–	–	11.8	11.8
Total comprehensive income	172.2	–	4.2	11.8	188.2
Distribution to Additional Tier 1 capital holders*	(18.4)	–	–	–	(18.4)
As at 31 December 2016	1,376.1	396.9	6.7	41.6	1,821.3

Society	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2017	1,051.2	396.9	6.7	28.5	1,483.3
Profit for the financial year	119.7	–	–	–	119.7
Net remeasurement of defined benefit plan	10.8	–	–	–	10.8
Net movement in Available-for-sale reserve	–	–	(1.0)	–	(1.0)
Net movement in cash flow hedge reserve	–	–	–	(11.2)	(11.2)
Total comprehensive income	130.5	–	(1.0)	(11.2)	118.3
Distribution to Additional Tier 1 capital holders*	(18.6)	–	–	–	(18.6)
As at 31 December 2017	1,163.1	396.9	5.7	17.3	1,583.0
As at 1 January 2016	971.6	396.9	2.5	24.3	1,395.3
Profit for the financial year	108.2	–	–	–	108.2
Net remeasurement of defined benefit plan	(10.2)	–	–	–	(10.2)
Net movement in Available-for-sale reserve	–	–	4.2	–	4.2
Net movement in cash flow hedge reserve	–	–	–	4.2	4.2
Total comprehensive income	98.0	–	4.2	4.2	106.4
Distribution to Additional Tier 1 capital holders*	(18.4)	–	–	–	(18.4)
As at 31 December 2016	1,051.2	396.9	6.7	28.5	1,483.3

* The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £7.0 million (2016: £7.2 million).

The notes on pages 104 to 143 form part of these accounts.

Statements of Cash Flows

For the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Cash flows from operating activities					
Profit before tax		242.7	239.1	162.7	146.1
Adjustments for:					
Impairment provisions and other provisions	11, 24	3.7	4.6	3.4	4.4
Depreciation and amortisation		19.0	15.0	19.0	15.0
Interest on subordinated liabilities and subscribed capital		6.7	11.7	6.7	11.7
Changes to fair value adjustment of hedged risk		(68.6)	(208.0)	(41.3)	(147.6)
Other non-cash movements		15.6	13.2	15.8	14.3
Non-cash items included in profit before tax		(23.6)	(163.5)	3.6	(102.2)
Loans to credit institutions		7.5	15.0	7.4	15.1
Loans and advances to customers		(3,049.1)	(3,469.3)	(1,679.0)	(1,737.4)
Prepayments, accrued income and other assets		11.8	(16.3)	11.9	(16.5)
Changes in operating assets		(3,029.8)	(3,470.6)	(1,659.7)	(1,738.8)
Shares		2,987.7	2,696.7	2,987.7	2,696.7
Deposits and other borrowings		474.6	1,144.4	465.7	1,094.6
Debt securities in issue		159.6	268.7	159.3	268.9
Accruals and deferred income and other liabilities		(8.1)	(7.5)	8.2	10.4
Changes in operating liabilities		3,613.8	4,102.3	3,620.9	4,070.6
Interest paid on subordinated liabilities and subscribed capital		(6.7)	(12.4)	(6.7)	(12.4)
Taxation		(50.0)	(41.7)	(50.2)	(41.7)
Net cash flows from operating activities		746.4	653.2	2,070.6	2,321.6
Cash flows from investing activities					
Purchase of investment securities		(65.2)	(143.6)	(35.2)	(43.5)
Sale and maturity of investment securities and equities		357.0	372.1	357.0	198.0
Proceeds from sale of properties		0.2	3.5	–	–
Repurchase of subordinated liabilities and subscribed capital		–	(152.7)	–	(152.7)
Purchase of property, plant and equipment and intangible assets		(28.7)	(34.6)	(28.7)	(34.6)
Net cash flows from investing activities		263.3	44.7	293.1	(32.8)
Cash flows from financing activities					
Loans to connected undertakings		–	–	(1,374.9)	(1,646.2)
Distribution paid to Additional Tier 1 capital holders		(25.6)	(25.6)	(25.6)	(25.6)
Repurchase and repayment of debt securities		(479.8)	(282.3)	(441.3)	(14.9)
Issue of debt securities		1,226.8	275.0	1,226.8	–
Net cash flows from financing activities		721.4	(32.9)	(615.0)	(1,686.7)
Net increase in cash		1,731.1	665.0	1,748.7	602.1
Cash and cash equivalents at start of year		3,207.5	2,542.5	2,957.8	2,355.7
Cash and cash equivalents at end of year		4,938.6	3,207.5	4,706.5	2,957.8
Cash and cash equivalents:					
Cash and balances with central banks*		4,938.6	3,207.5	4,706.5	2,957.8

* This does not include the mandatory reserve with the Bank of England of £56.6 million (2016: £52.5 million).

The notes on pages 104 to 143 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 assets, liabilities and results of the Society and its consolidated subsidiaries and structured entities are included in the financial statements of the Group.

The Group consolidates another entity from the date on which it: (a) has power over the entity; (b) is exposed to, or has the right to, variable returns from its involvement with the entity; and (c) has the ability to affect those returns through the exercise of its powers. Upon consolidation, intra-group transactions, balances and unrealised gains and losses are eliminated. The Group reassesses whether it controls an entity if facts and circumstances indicate that there are changes in one or more of these three elements. The Group deconsolidates entities from the date that control ceases. Upon consolidation, intra-group transactions, balances and unrealised gains and losses are eliminated.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control. In making this judgement, the Group considers factors such as the purpose and design of the entity, size and exposure to variability of returns. and the nature of the relationship, including power over the structured entity.

The Society's investment in its subsidiaries is recognised in the Balance Sheet at cost less any provision for impairment in value.

Derecognition of financial assets and liabilities

The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial assets expire or where the Group transfers substantially all of the risks and rewards of ownership of the financial assets to another party.

The Group derecognises financial liabilities when the obligation is discharged, cancelled or has expired.

Changes in accounting standards

There were no new or amended accounting standards or interpretations that had a significant impact on the preparation of the 2017 financial statements other than IAS 7 *Statement of Cash Flows*. An additional movement analysis is included in note 22 to meet IAS 7 requirements.

Future accounting developments

There are a number of accounting standards, relevant to the Group's future reporting, that were not effective as at 31 December 2017 and have therefore not been applied in preparing these financial statements. Of these the most significant is IFRS 9 *Financial Instruments,* which will lead to substantial changes in the accounting for financial instruments. This is described below, along with details of the other standards.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* and will be implemented in the financial statements for the year beginning 1 January 2018. The standard requires changes to the classification and measurement of financial assets and liabilities, the recognition of impairment of financial assets and hedge accounting. The Society does not currently plan to adopt the changes to hedge accounting until the International Accounting Standards Board finalises its revised approach to macro hedge accounting. The Group will not restate comparatives on the initial adoption of IFRS 9 and will provide detailed transitional disclosures in the 2018 Interim Financial Report.

Classification and measurement

Financial assets will be classified and measured based on the business model under which they are held and the characteristics of their contractual cash flows. Financial assets will be classified as held either at amortised cost, at fair value through other comprehensive income or at fair value through profit or loss. The Group's assets have been analysed and there will be a change in classification of some financial assets under IFRS 9; however, these changes will not have a significant impact on the opening balance sheet. There are no significant changes to the classification and measurement of financial liabilities under IFRS 9.

Impairment of financial assets

IFRS 9 replaces the existing IAS 39 incurred loss approach to calculating impairment with an expected credit loss approach, resulting in earlier recognition of credit losses.

IFRS 9 requires the Society to categorise its financial assets, principally its mortgage loans, into one of three stages at the Balance Sheet date. Assets that are performing are shown in stage 1, assets where there has been a significant increase in credit risk since inception are in stage 2 and accounts which are in default are in stage 3. The Society is required to recognise a 12 month expected credit loss allowance on all stage 1 assets and a lifetime expected credit loss allowance on all stage 2 and 3 assets. The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology and involves quantitative measures such as forward looking probabilities of default that are derived from reasonable and supportable forecasts (scenarios) of future economic conditions, as well as other qualitative factors, and therefore requires significant management judgement. The stage 2 assessment is also supported by an objective 'back stop' measure of arrears.

The calculation of lifetime expected losses also requires significant management judgement.

The Board Audit Committee has considered and approved the Group's methodology for allocating mortgages between the three IFRS 9 stages, the different economic scenarios and weightings about past, current and future economic conditions and the overlay of management and expert judgement where required. The Group has used four economic scenarios to assess expected credit losses:

- A central scenario based on the Group's Strategic Plan (base case).
- A downside scenario based on the Internal Capital Adequacy Assessment Process (ICAAP) high rate stress (being the worst case scenario from a credit loss perspective used in capital stress testing).
- An upside view based on an improved credit environment (best case), given the current benign conditions the improvement on base case is minor.
- A mid point scenario between the best and worst cases.

The relative weighting of the scenarios is a key area of judgement. Within the scenarios the macroeconomic factors that have the most significant influence on projected losses are unemployment, which impacts default rate projections, and house price movements, which impacts the size of losses. Additional information on scenarios and weightings will be provided in the Group's 2018 Interim Financial Report.

1. Accounting policies continued

Impact assessment

IFRS 9 is expected to result in a decrease of £0.1 million to the Group's Balance Sheet impairment provision for credit losses relating to loans and advances to customers on transition. The Society notes that the IFRS 9 requirement to incorporate forward looking information into the expected credit loss calculations could result in impairment charges being more volatile when compared with the current IAS 39 model.

The impact of IFRS 9 on the Group's treasury assets is expected to be immaterial due to the high credit rating of the Group's portfolio.

Hedge accounting

The hedge accounting requirements of IFRS 9 are designed to create a stronger link between hedge accounting and financial risk management. A separate financial reporting standard will be developed on accounting for dynamic risk management (or macro hedge accounting) and IFRS 9 permits application of the existing hedge accounting requirements of IAS 39 until this is implemented. The Group will continue to apply IAS 39 hedge accounting and therefore hedge accounting policies will be updated when the separate standard is finalised.

IFRS 9 Implementation

The required changes to systems and business processes for IFRS 9 are now complete. During the first half of 2017 expected credit loss models were built and tested in accordance with the Group's modelling policies and standards and approved by the Group's Models and Rating Committee in October 2017. IFRS 9 impairment provisions and associated management information were produced from mid-2017. Ongoing governance arrangements have been approved by the Board Audit Committee and are in operation. Ernst & Young are currently reviewing the IFRS 9 implementation and no significant issues have been identified.

Governance

The Group's IFRS 9 implementation was managed by a separate programme with governance reporting to the Chief Financial Officer. Progress was reported regularly to the Board Audit Committee, and the credit loss modelling process was overseen by the Models and Ratings Committee which reports into the Retail Credit Risk Committee.

Given the progress outlined above, the Board closed the IFRS 9 implementation programme in January 2018.

Other accounting standard developments

In addition to IFRS 9, the following standards will be relevant to the Group's future reporting but have not been applied in preparing these financial statements as they are not effective as at 31 December 2017:

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 does not anticipate that IFRS 15 will have a significant impact on its Financial Statements.	1 January 2018
IFRS 16 *Leases*	IFRS 16 requires operating leases to be capitalised on the Balance Sheet, as is currently the case for finance leases. The Group expects an increase in the quantum of assets and liabilities that are currently accounted for as operating leases. A further update on accounting and capital impacts will be provided in the 2018 financial statements.	1 January 2019

Securitisation and covered bond transactions

The Group has securitised certain mortgage loans by the transfer of the loans to structured entities controlled by the Group. The securitisations enable issuance of debt to investors, who gain the security of the underlying assets as collateral. The structured entities are fully consolidated into the Group accounts.

The transfers of the mortgage loans to the structured entities are not treated as sales and the loans are not derecognised but remain on the transferor's own Balance Sheet as it retains the risks and rewards of the mortgage loans through the receipt of substantially all of the profits of the structured entities. In the accounts of the transferor, the proceeds received from the transfer of mortgage loans to structured entities are accounted for as a deemed loan from the structured entity and are disclosed within other liabilities on the Balance Sheet.

For covered bonds, the Society itself and not the structured entity issues the covered bonds and then lends the proceeds to the structured entity on back to back terms. In the accounts of the Society, neither the loan to the structured entity nor the consideration for the transfer of mortgage loans are recognised separately as an additional asset and liability. This avoids the 'grossing up' of the financial statements that would otherwise arise.

The Group has also issued debt to be used as collateral for central government schemes or for use in sale and repurchase agreements (repos) and similar transactions. Some or all of the debt issuances may be retained by the Society. Investments in such self-issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Society's financial statements. This avoids the 'grossing up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with its structured entities, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with 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. All other derivatives relating to securitisations and covered bonds are explained in the derivatives and hedge accounting policy below.

Funding for Lending Scheme

The Society participated in the Funding for Lending Scheme (FLS), which provided Treasury bills in return for eligible collateral. During 2017, the Society repaid all FLS Treasury bills. FLS transactions did not involve the transfer of risk on the pledged collateral and are not derecognised under IAS 39. Therefore, for accounting purposes, the underlying collateral was retained on the Balance Sheet and the Treasury bills were not separately recognised.

Interest receivable and interest payable

For instruments measured at amortised cost, the Effective Interest Rate (EIR) method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The EIR is the rate that discounts the estimated future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

In calculating the EIR, the Group estimates cash flows considering all contractual terms of the financial instrument. Future credit losses are not considered as they are not contractual. The EIR calculation includes all fees received and paid and costs borne 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.

1. Accounting policies continued

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 Balance Sheet date.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which they can be utilised.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled. Deferred tax assets and liabilities are offset when there is both a legally enforceable right and intention to settle on a net basis.

Corporation tax is charged or credited directly to the Statement of Comprehensive Income if it relates to items that are credited or charged to the Statement of Comprehensive Income, and to the Statements of Changes in Members' Interests and Equity if it relates to other equity instruments. Otherwise corporation tax is recognised in the Income Statement.

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 under IAS 39:

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 and receivables are recognised when the funds are advanced to customers and 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 the amount due and the fair value is subsequently 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.

Fair value through profit or loss

All derivatives are carried at fair value and are initially recognised at the trade date.

Changes in the fair value of derivatives other than those in cash flow hedge accounting relationships are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy below.

For changes in the fair value of derivatives in cash flow hedge accounting relationships, see the hedge accounting policy for cash flow hedges on page 112.

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are not classified as loans and receivables and comprise debt securities (e.g. certificates of deposit or Government investment securities (gilts)) and investment in equity shares.

Available-for-sale assets are measured at fair value based on quoted market prices or prices obtained from market intermediaries where available. In cases where quoted market prices are not available, discounted cash flow valuations are used.

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 the Available-for-sale reserve and there is objective evidence that the asset is impaired, the cumulative loss recognised in the Available-for-sale reserve is removed and recognised in the Income Statement.

1. Accounting policies continued

Impairment of loans and advances to customers

The Group assesses its loans and advances to customers for objective evidence of impairment at each Balance sheet date. An impairment loss is recognised if there is a loss event that has occurred after initial recognition and before the Balance sheet date which 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). In addition, impairment losses are recognised for 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 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.

Estimating future cash flows

Future cash flows are based on prudent assumptions about the value of the property representing the underlying security for the mortgage, costs that might be incurred in realising the value of the property following repossession and sale, the likelihood of repossession and the time it takes to repossess and sell properties.

- All properties used as security are valued at the outset of the loan and at the time of any further advance made during the lifetime of the loan.
- Once the value of the property has been established, the Nationwide Regional House Price Index is used on a quarterly basis to provide an updated estimate of the property's value. If repossessed, a current valuation is professionally undertaken.
- Assumptions are continuously updated to reflect the time taken to sell a repossessed property and the likely discount to the latest property valuation.
- 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

Loans are identified for individual impairment through a days-past-due trigger or if, in the opinion of management, there is evidence of impairment even if the days-past-due trigger has not yet been met, for example customers who have been declared bankrupt but continue to make their mortgage repayments as scheduled.

The Group uses financial models to assess the level of impairment, including models to predict roll rates to default, the likelihood of possession given default, 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 which capture experience of different mortgage types 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

Collective impairment assessments are made against segments of the mortgage book where there is objective evidence of impairment or where there is evidence of an increased risk of credit losses being present which cannot be individually attributed. Examples include provisions held to collectively address the risk that, in a downturn, issues will emerge that will adversely affect the value and saleability of certain types of properties that would otherwise be masked in a growing housing market.

Management judgement

Management judgement is used to apply overlays to assumptions in cash flow forecasts. For instance, current point-in-time experience may indicate improvement in a particular roll rate, but if the longer-term view is that the risk remains higher than that used in the model, an overlay may be applied to reflect the forward looking expectation of cash flows.

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, an appropriate amount of the previously recognised impairment loss is reversed and 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. Such loans are written off after all normal collection options have been completed and the amount of the loss has been determined. Any subsequent recoveries of amounts previously written off are recorded in the Income Statement.

Sale and repurchase agreements (repos)

Securities sold subject to a commitment to repurchase them are retained on the Balance Sheet when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately on the Balance Sheet, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the EIR method.

Derivative financial instruments

The Group holds derivative financial instruments only to manage the risks associated with its non-variable rate assets and liabilities and its foreign currency transactions and not for speculative or trading purposes.

All external derivative financial instruments are carried at fair value. Derivatives are principally valued by discounting cash flows using yield curves that are based on observable market data. 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

Where the documentation, eligibility and testing criteria for hedge accounting set out in IAS 39 are met, the Group uses hedge accounting and designates the hedging derivative as either hedging fair value or cash flow risks.

Fair value hedges

The Group undertakes both individual and portfolio fair value hedge accounting. Changes in the fair value of derivatives that qualify as fair value hedges are recorded in the Income Statement under net losses from derivatives and hedge accounting in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that is attributable to the hedged risk (interest rate risk). This also applies if the hedged item is classified as an Available-for-sale financial asset.

1. Accounting policies continued

Cash flow hedges

Gains and losses on derivative financial instruments hedging the variability in cash flows of a designated asset or liability are recognised directly through the Statement of Comprehensive Income in the Cash Flow Hedge Reserve. The relevant portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately to the extent that the hedge is deemed ineffective under IAS 39. Any amounts deferred to the Cash Flow Hedge Reserve are subsequently recycled to the Income Statement when the underlying asset or liability being hedged impacts the Income Statement, for example when foreign exchange movements occur.

Leases and contract purchase agreements

Where the Group enters into a lease that involves taking substantially all the risks and rewards of ownership of the asset, this is treated as a finance lease and the asset is recorded in the Balance sheet and depreciated over its estimated useful life. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life. Future instalments under such leases, net of finance charges, are included within other liabilities. Lease rentals are apportioned between the finance element, which is charged to the Income Statement, and the capital element, which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and payments are charged to administrative expenses on a straight line basis over the period of the lease. Rents receivable are credited to other operating income on a straight line basis over the period of the lease.

Intangible assets

Software development costs and purchased software that is not an integral part of a related hardware purchase are recognised as an intangible asset if it is probable that the asset created will generate future economic benefits. Internally generated intangible assets are primarily related to development costs of internal systems which are capitalised if they satisfy the criteria of IAS 38. Intangible assets are stated at cost less accumulated amortisation and any impairment. Amortisation is charged to the Income Statement on a straight line basis over the useful life of the asset commencing from the date the asset is ready for use. The useful life of computer software is reviewed by management and is currently between three and eight years.

Computer software is reviewed at each reporting date for impairment or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where this is the case the asset is written down immediately to the estimated recoverable amount.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment. The carrying values of property, plant and equipment are reviewed at each reporting date for impairment or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Where this is the case the asset is written down immediately to the estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying value of the asset and are included within the Income Statement.

Depreciation is provided on a straight line basis over the anticipated useful life of the asset which is currently as follows:

Freehold buildings	Over a period of 50 years
Leasehold buildings	Shorter of remaining term of the lease and useful life
Equipment, fixtures, fittings and vehicles	Three to eight years

Employee benefits

Pensions

The Group operates a defined benefit pension scheme and a defined contribution scheme for employees.

Contributions to the defined contribution pension scheme are recognised as an expense in the Income Statement as incurred, on an accruals basis.

The Group's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds. This calculation allows the net obligation of the scheme to be expressed as either a surplus or deficit, which is recognised as either an asset or a liability respectively in the Group's accounts at the Balance Sheet date.

Gains or losses arising from the remeasurement of the defined benefit plan are recognised in full, in the year they occur, in the Statement of Comprehensive Income.

Other long-term employee benefits

The cost of bonuses payable 12 months or more after the end of the financial years in which they are earned is recognised in the year in which the employees render the related service 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 include shares, bank and other deposits, amounts owed to other customers, debt securities in issue, derivative financial liabilities, subordinated liabilities and subscribed capital. The Group classifies its financial liabilities into the following categories:

Amortised cost

Financial liabilities, other than derivatives, are measured on an amortised cost basis reflecting their face value adjusted for any unamortised premiums, discounts and transaction costs directly attributable to the acquisition or issue. Amortisation is recognised in interest payable and similar charges at the effective interest rate of the liability.

Fair value through profit or loss

All derivatives are carried at fair value.

Changes in the fair value of derivatives other than those in cash flow hedge accounting relationships are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy above.

For changes in the fair value of derivatives in cash flow hedge accounting relationships, see the hedge accounting policy for cash flow hedges on page 112.

Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably. For the Financial Services Compensation Scheme (FSCS) Levy, a provision is recognised when the levy is legally enforceable, in accordance with IFRIC 21 *Levies*.

Contingent liabilities are potential obligations from past events which will only be confirmed by future events. Contingent liabilities are not recognised within the Balance Sheet.

1. Accounting policies continued

Equity instruments

Financial instruments are classified as equity instruments where the contractual arrangements with the holder do not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity net of the costs directly attributable to the issuance.

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, as a deduction from the general reserve.

Foreign currency translation

The consolidated financial statements are presented in pounds sterling, which is the functional currency of the Group.

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the Balance Sheet date. Foreign exchange gains and losses resulting from retranslation and settlement are recognised in the Income Statement.

Cash and cash equivalents

Cash and cash equivalents in the Statement of Cash Flows comprise balances with less than three months'maturity from the date of acquisition, including cash and non-restricted balances with central banks and loans and advances to credit institutions.

IFRS disclosure

For ease of reference, certain audited IFRS disclosures related to credit, market and liquidity and funding risks are included within the Risk Management Report.

A maturity analysis for all assets and liabilities is presented in the Risk Management Report Liquidity and Funding section.

Audited information is also included within the Directors' Remuneration Report. These disclosures, where marked as 'audited', are covered by the Independent Auditor's Report.

2. Judgement in applying accounting policies and significant accounting estimates

There are no judgements relating to the application of the Group's accounting policies which have had a significant effect on the amounts recognised in the financial statements. However, the Group has made significant judgements relating to assumptions and estimates that could affect the reported amount of assets and liabilities both in the accounts and in the following financial years. The most significant assumptions and estimates are disclosed in the following notes:

Significant assumptions and estimates	Note
Mortgage EIR	3
Impairment provisions on loans and advances to customers	11

During the year, management concluded that the assumptions in relation to the valuation of level 3 derivatives were no longer significant. Further information on significant estimates and assumptions is included in the Board Audit Committee Report.

3. Interest receivable and similar income

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
On loans fully secured on residential property	958.4	972.4	563.9	573.9
On other loans				
Connected undertakings	–	–	320.5	313.0
Foreign currency gain	–	–	27.0	59.3
Other	1.9	2.2	1.3	1.5
	960.3	974.6	912.7	947.7
Interest and other income on debt securities	30.3	36.8	30.3	36.7
Interest and other income on other liquid assets	9.9	10.0	9.6	9.4
Net expense on financial instruments hedging assets	(106.7)	(113.0)	(106.7)	(113.0)
Foreign currency gains/(losses)	1.3	(1.1)	0.2	2.2
Total	895.1	907.3	846.1	883.0

Included within interest receivable and similar income is interest accrued of £1.7 million (2016: £2.6 million) for the Group and £1.0 million (2016: £1.5 million) for the Society on impaired loans and advances to customers. Interest receivable includes £12.6 million (2016: £nil) from the release of fair value adjustments for credit risk initially made on the merger with Stroud & Swindon Building Society which subsequent experience has indicated are now surplus to requirements.

Significant accounting estimates and judgements

The Group recognises interest on loans and advances to customers on the basis of their EIR (Effective Interest Rate). This is a constant rate that averages out the effect of fixed and variable rates of interest 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. An increase of 5% in the redemption rate of a loan for 12 months after the initial incentive period would result in a decrease in loans and advances to customers of £12.8 million, with a corresponding reduction to income in the Income Statement. Assumptions as to future market interest rates also affect the calculation. A relative decrease in the interest rate received by the Society of ten basis points would result in a decrease in loans and advances to customers of £4.6 million with a corresponding reduction to income in the Income Statement.

4. Interest payable and similar charges

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Bank and customer				
Subordinated liabilities	1.8	3.9	1.8	3.9
Other	14.1	21.2	14.1	21.2
Debt securities in issue	125.4	122.7	121.8	114.3
Other borrowed funds				
On shares held by individuals	410.4	444.1	410.4	444.1
On other shares	–	0.1	–	0.1
On subscribed capital	4.9	8.5	4.9	8.5
On loans from connected undertakings	–	–	–	3.2
Net income on financial instruments hedging liabilities	(73.7)	(76.8)	(57.8)	(57.8)
Foreign currency losses/(gains)	1.2	(1.4)	27.0	61.2
Total	484.1	522.3	522.2	598.7

5. Fees and commissions receivable

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Mortgage related fees	5.2	5.2	3.4	3.4
General insurance commissions	1.7	5.8	1.7	5.8
Other fees and commissions	2.2	2.3	2.2	2.3
Total	9.1	13.3	7.3	11.5

6. Fees and commissions payable

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Banking fees	2.6	2.7	2.6	2.6
Other fees and commissions	6.5	6.2	4.5	4.4
Total	9.1	8.9	7.1	7.0

7. Other operating income

Other operating income for the Group and Society includes £5.0 million relating to the gain on sale of the Society's equity investment in VocaLink Holdings Limited (VocaLink) to Mastercard. The Society has received upfront cash consideration in exchange for 90% of its VocaLink shares and put and call options exist over the remaining 10% of VocaLink shares with maturity dates in 2020 and 2022. Future deferred cash consideration, which is contingent on certain performance thresholds being met, has been valued at £nil in calculating the gain on sale (see note 15).

In 2016, other operating income for the Group and Society included £4.9 million relating to the gain on sale of Visa Europe Limited (Visa Europe) to Visa Inc.

8. Net losses from derivatives and hedge accounting

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Gains/(losses) on derivatives designated as fair value hedges	100.5	(52.9)	120.9	(44.6)
Movement in fair value of hedged items attributable to hedged risk	(103.0)	49.8	(123.3)	41.4
	(2.5)	(3.1)	(2.4)	(3.2)
Derivatives designated as cash flow hedges*	2.2	2.1	1.2	1.9
Losses on other derivatives	–	–	(0.6)	(0.6)
Total	(0.3)	(1.0)	(1.8)	(1.9)

* Represents ineffectiveness on cash flow hedge relationships which will mature over a period of seven years.

9. Administrative expenses

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Employee costs				
Wages and salaries	73.7	67.6	73.7	67.6
Social security costs	7.7	6.9	7.7	6.9
Pension costs				
Defined benefit plan (note 19)	(0.1)	(0.6)	(0.1)	(0.6)
Defined contribution plan	4.9	4.6	4.9	4.6
	86.2	78.5	86.2	78.5
Other expenses				
Loss on disposal of property, plant and equipment and intangibles	0.7	0.5	0.7	0.5
Premises and facilities	12.6	11.8	12.6	11.8
Project costs	12.6	8.9	12.6	8.9
Information systems	9.6	8.2	9.6	8.2
Other	27.2	26.6	19.1	17.3
Total	148.9	134.5	140.8	125.2

9. Administrative expenses continued

The remuneration of the auditor, Ernst & Young LLP, is set out below:

Group and Society	2017 £m	2016 £m
Audit of the annual accounts	0.2	0.2
Audit related assurance services - subsidiary audits	0.1	0.1
Other non-audit services	0.1	0.1
Total	0.4	0.4

The Group's policy in relation to its auditors providing non-audit engagements sets out the services they are generally precluded from performing. Further details are included in the Board Audit Committee Report in the Governance section. All non-audit engagements provided by the Group's auditor are subject to pre-approval by either the Board Audit Committee or the Chief Financial Officer (under delegation from the Board Audit Committee), depending upon the nature of the non-audit engagement.

10. Employee numbers

Group and Society	2017 Full time	2017 Part time	2016 Full time	2016 Part time
The average number of persons employed during the year (including executive directors) was:				
Head office and administrative centres	1,354	405	1,261	365
Branches	315	301	326	286
Total	1,669	706	1,587	651

The average number of employees on a full time equivalent basis was 2,088 (2016: 1,994) and all of these are employed within the United Kingdom.

11. Impairment provisions on loans and advances to customers

Impairment provisions have been deducted from the appropriate asset values on the Balance Sheet. The incurred loss element of the fair value adjustments arising from the merger with Stroud & Swindon Building Society in 2010 of £3.5 million (2016: £4.1 million) has been included within the opening and closing provisions in the tables below.

Group	Loans fully secured on residential property 2017 £m	Other loans 2017 £m	Total 2017 £m	Loans fully secured on residential property 2016 £m	Other loans 2016 £m	Total 2016 £m
At 1 January						
Individual impairment	6.4	4.2	10.6	9.4	4.3	13.7
Collective impairment	7.0	0.9	7.9	7.1	0.9	8.0
	13.4	5.1	18.5	16.5	5.2	21.7
Charge/(credit) for the year						
Individual impairment	2.1	–	2.1	(1.3)	(0.1)	(1.4)
Collective impairment	(1.6)	(0.3)	(1.9)	(0.1)	–	(0.1)
	0.5	(0.3)	0.2	(1.4)	(0.1)	(1.5)
(Credit)/charge set against fair value adjustment	(0.4)	–	(0.4)	0.2	–	0.2
Amounts written off	(1.0)	(0.2)	(1.2)	(1.9)	–	(1.9)
At 31 December						
Individual impairment	7.5	4.0	11.5	6.4	4.2	10.6
Collective impairment	5.0	0.6	5.6	7.0	0.9	7.9
Total	12.5	4.6	17.1	13.4	5.1	18.5

Society	Loans fully secured on residential property 2017 £m	Other loans 2017 £m	Total 2017 £m	Loans fully secured on residential property 2016 £m	Other loans 2016 £m	Total 2016 £m
At 1 January						
Individual impairment	2.9	3.9	6.8	4.8	3.8	8.6
Collective impairment	2.6	0.3	2.9	2.9	0.3	3.2
	5.5	4.2	9.7	7.7	4.1	11.8
Charge/(credit) for the year						
Individual impairment	0.4	(0.1)	0.3	(0.7)	(0.1)	(0.8)
Collective impairment	(0.2)	(0.2)	(0.4)	(0.3)	–	(0.3)
	0.2	(0.3)	(0.1)	(1.0)	(0.1)	(1.1)
Credit set against fair value adjustment	(0.4)	–	(0.4)	–	–	–
Amounts written off	(0.3)	(0.2)	(0.5)	(1.2)	0.2	(1.0)
At 31 December						
Individual impairment	2.6	3.6	6.2	2.9	3.9	6.8
Collective impairment	2.4	0.1	2.5	2.6	0.3	2.9
Total	5.0	3.7	8.7	5.5	4.2	9.7

11. Impairment provisions on loans and advances to customers continued

Significant 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 discounted expected future cash flows. Significant 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 to reflect current conditions as appropriate.

If average regional house prices were to fall by 10%, the estimated impact on the impairment provision would be an increase of £0.9 million, with a corresponding charge in the Income Statement. If the probability of defaulting accounts progressing to possession increased by 5%, the estimated impact on the impairment provision would be an increase of £0.2 million, with a corresponding charge in the Income Statement.

12. Taxation

	Group 2017 £m	Group 2016 £m	**Society 2017 £m**	Society 2016 £m
Current tax				
UK corporation tax	**55.4**	56.1	**42.4**	37.4
UK corporation tax – adjustment in respect of prior years	**0.1**	–	**0.1**	–
Total current tax	**55.5**	56.1	**42.5**	37.4
Deferred tax				
Current year	**2.8**	1.7	**0.9**	1.6
Adjustment in respect of prior years	**(0.4)**	(1.1)	**(0.4)**	(1.1)
Total deferred tax	**2.4**	0.6	**0.5**	0.5
Total	**57.9**	56.7	**43.0**	37.9

A reconciliation between the actual tax expense and tax that would be due if the UK standard corporation tax rate of 19.25% (2016: 20.0%) was applied to the profit before tax without adjustment is as follows:

	Group 2017 £m	Group 2016 £m	**Society 2017 £m**	Society 2016 £m
Profit before tax (PBT)	**242.7**	239.1	**162.7**	146.1
Tax at UK standard rate of corporation tax on PBT of 19.25% (2016: 20.0%)	**46.7**	47.8	**31.3**	29.2
Recurring items				
Surcharge on banking profits	**11.1**	9.4	**11.1**	9.4
Expenses not deductible for tax purposes – compensation payments	**0.2**	0.4	**0.2**	0.4
Effect of tax rate change	**(0.3)**	0.1	**(0.3)**	–
Non-recurring items				
Adjustments in respect of prior years	**(0.3)**	(1.1)	**(0.3)**	(1.1)
Other	**0.5**	0.1	**1.0**	–
Total	**57.9**	56.7	**43.0**	37.9

Since 1 January 2016 the Society, but not other group companies, has been subject to a surcharge of 8% on taxable profits in excess of £25 million in line with other banking companies, including building societies.

The effective tax rate for the year is 23.9% (2016: 23.7%) for the Group and 26.4% (2016: 25.9%) for the Society. Effective tax rates are significantly above the UK standard corporation tax rate, because of the £11.1 million surcharge.

The Finance Act 2016 introduced legislation requiring the Society to publish its tax strategy. This was published on the Society's website during 2017 and covers the tax risks faced by the Society and how these risks are managed.

Tax on items reported through the Statements of Comprehensive Income is as follows:

Statements of Comprehensive Income	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Tax charge/(credit) on remeasurement of defined benefit pension plan	3.9	(3.8)	3.9	(3.8)
Tax (credit)/charge on Available-for-sale movements	(0.4)	2.8	(0.4)	2.8
Tax (credit)/charge on cash flow hedges	(7.9)	4.3	(4.2)	1.4
Effect of change in corporation tax rate	0.1	(0.6)	–	(0.2)
Total	(4.3)	2.7	(0.7)	0.2

Tax on other items reported through the Statements of Changes in Members' Interests and Equity is as follows:

Statements of Changes in Members' Interests and Equity	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Tax credit on Additional Tier 1 capital distribution	(7.0)	(7.2)	(7.0)	(7.2)
Total	(7.0)	(7.2)	(7.0)	(7.2)

Further information relating to deferred tax is presented in note 20.

13. Debt securities

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Available-for-sale:				
UK Government investment securities	990.3	1,328.9	960.3	1,328.9
Other listed transferable debt securities	22.0	25.4	22.0	25.4
Total	1,012.3	1,354.3	982.3	1,354.3
Movements during the year are analysed below:				
At 1 January	1,354.3	1,551.7	1,354.3	1,477.7
Additions	65.2	143.6	35.2	43.5
Maturities and disposals	(351.9)	(368.3)	(351.9)	(194.2)
Changes in fair value	(55.3)	27.3	(55.3)	27.3
At 31 December	1,012.3	1,354.3	982.3	1,354.3

A maturity analysis of the Group debt securities is included in the Liquidity and Funding section of the Risk Management Report.

At the year end £300.4 million (2016: £1,328.9 million) of debt securities had been sold under sale and repurchase agreements. The cash received and accrued interest in relation to these agreements of £300.1 million (2016: £1,320.8 million) was included within deposits from banks (see note 21). The Group was unable to use, sell or pledge the transferred assets for the duration of the transactions and remained exposed to any associated interest rate and credit risk of the assets.

Although not included on the Balance Sheet, at 31 December 2016 the Group had received FLS Treasury bills with a market value of £2,398.6 million. At this same date, Treasury bills with a market value of £1,255.8 million were pledged as part of sale and repurchase agreements for proceeds of £1,249.2 million included in deposits from banks (see note 21). At 31 December 2017, no FLS Treasury bills were held.

At the 2016 year end, the Group held UK Government investment securities with a market value of £19.2 million pledged by counterparties under interest rate swaps that were not included in the Balance Sheet. At the 2017 year end, no such securities were held.

14. Loans and advances to customers

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Residential				
Owner-occupier mortgages	21,710.6	20,089.4	21,195.4	19,505.9
Buy to let mortgages	13,899.0	12,416.7	1,735.7	1,723.3
Near-prime mortgages	76.8	87.5	4.3	4.9
Self-certification mortgages	214.5	252.0	109.7	128.2
Other				
Commercial mortgages	2.0	2.8	0.5	0.6
Unsecured personal loans	28.0	33.2	18.7	21.9
Total	35,930.9	32,881.6	23,064.3	21,384.8

Maturity analysis

The remaining contractual maturity of loans and advances to customers at the Balance Sheet date is as follows:

	Note	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Repayable in not more than one year		2,670.4	2,493.3	1,636.1	1,553.9
Repayable in more than one year		33,277.6	30,406.8	21,436.9	19,840.6
		35,948.0	32,900.1	23,073.0	21,394.5
Impairment provision	11	(17.1)	(18.5)	(8.7)	(9.7)
Total		35,930.9	32,881.6	23,064.3	21,384.8

Actual redemption levels experienced by the Group or Society may differ from the contractual analysis.

Pledged assets – Loans and advances to customers

Certain loans and advances to customers have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools with the Bank of England to enable the Group to obtain secured funding.

Loans and advances to customers pledged to support secured funding and the notes in issue are as follows:

		Notes in issue*			
2017	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	4,887.3	2,311.2	1,400.0	–	3,711.2
Securitisation programme – Mercia No.1 plc	1,089.4	–	973.6	–	973.6
Securitisation programme – Offa No.1 plc	331.6	192.9	–	107.3	300.2
Whole mortgage loan pools**	3,573.9	–	1,498.0	2,075.9	3,573.9
Total	9,882.2	2,504.1	3,871.6	2,183.2	8,558.9

* Notes in issue exclude Class Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.
** The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under TFS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

2016	Mortgages pledged £m	Notes in issue* 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	4,872.7	1,847.8	1,400.0	–	3,247.8
Securitisation programme – Mercia No.1 plc	1,084.0	–	973.6	–	973.6
Securitisation programme – Offa No.1 plc	390.6	231.2	–	128.7	359.9
Whole mortgage loan pools**	3,602.1	–	1,010.1	2,592.1	3,602.2
Total	9,949.4	2,079.0	3,383.7	2,720.8	8,183.5

* Notes in issue exclude Class Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.
** 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 FLS and TFS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

Mortgages pledged are not derecognised from the Group or Society Balance Sheets as the Group has retained substantially all the risks and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue and held by third parties are included within debt securities in issue (note 22).

Notes in issue, held by the Group drawn, include debt securities issued by the covered bond programme to the Society and those issued by the Mercia and Offa securitisation programmes pledged as collateral.

Notes in issue, held by the Group and undrawn, are other debt securities issued by the programmes to the Society, and mortgage loan pools that have been pre-positioned at the Bank of England but not utilised. These are held to provide collateral for potential future use in sale and repurchase agreements or central bank operations.

Notes in issue, and held by the Group, are not recognised on the Group or Society Balance Sheets, thus preventing inappropriate grossing up of the Group and Society Balance Sheets.

Since the year end, the Group increased the amount of whole mortgage loan pools pre-positioned at the Bank of England by £5.1 billion as part of its liquidity risk management strategy. No additional funding has been drawn against this.

Covered bonds

Coventry Building Society Covered Bonds LLP (LLP) provides security for issues of self-issued covered bonds and for external issuances. As at 31 December 2017, the Society had £2,800.0 million (2016: £2,800.0 million) and €1,000.0 million (2016: €500.0 million) of covered bonds in issue; of which £1,400.0 million (2016: £1,400.0 million) was retained by the Group. At the reporting date, the Society has overcollateralised the LLP as set out in the table above to secure the ratings of the covered bonds and to provide operational flexibility. From time to time, the obligation of the Society to provide collateral may increase due to the formal requirements of the covered bonds programme and the value of the collateral would depend upon conditions at that time. The Society may also voluntarily contribute collateral to support the covered bond ratings; no such contributions were made during 2017 or 2016.

During the period, the Society voluntarily repurchased £115.2 million (2016: £283.4 million) of mortgages from the LLP to maintain the quality of the pool and minimise the overcollateralisation requirement.

14. Loans and advances to customers continued

Securitisation – Mercia No.1 plc

Mercia No.1 plc (Mercia) was incorporated in October 2012 and in December 2012 Mercia issued £1,436.4 million of listed debt securities, all of which were retained by the Group. The Group's obligations in respect of the Mercia securitisation vehicle are limited to transferring cash flows from the underlying assets.

In March 2016, Godiva Mortgages Limited repurchased £462.8 million of the mortgages from Mercia and Mercia used the proceeds to reduce notes in issue by this same amount.

Securitisation – Offa No. 1 plc

Offa No. 1 plc (Offa) was incorporated in February 2016 and in March 2016 Offa issued £427.5 million of listed debt securities secured against certain loans of Godiva Mortgages Limited, of which £152.5 million was held by the Group. The Group's obligations in respect of the Offa securitisation vehicle are limited to transferring cash flows from the underlying assets.

Under the terms of the securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme.

The fair value of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset are presented in the table below:

	Fair value assets pledged 2017 £m	Fair value liabilities 2017 £m	Fair value net position 2017 £m	Fair value assets pledged 2016 £m	Fair value liabilities 2016 £m	Fair value net position 2016 £m
Securitisation programme – Offa No.1 plc	331.6	195.2	136.4	390.6	233.4	157.2

The above table excludes the Mercia securitisation programme as all the notes issued were retained by the Society.

During the year Leofric No.1 plc (Leofric), a former consolidated securitisation structured entity was liquidated. Leofric was incorporated in November 2011 and fully paid down in November 2016. Further information is included on page 124 of the 2016 Annual Report & Accounts.

15. Investments in equity shares

The investments in equity shares are in respect of Visa Inc. preference shares and VocaLink ordinary shares.

The Visa Inc. preference shares were received as part of the consideration for the sale of the Society's share in Visa Europe in June 2016. At 31 December 2017 the preference shares have been recognised at a fair value of £1.9 million (2016: £1.4 million). The Society may receive additional deferred cash consideration in 2019, which has been ascribed a fair value of nil at 31 December 2017.

The VocaLink ordinary shares represent the remaining 10% holding retained by the Society following the sale of VocaLink to MasterCard in 2017 (see note 7). At 31 December 2017 the ordinary shares have been recognised at a fair value of £0.6 million (2016: £4.5 million for 100% then held). The retained shares are subject to a put option for the Society at 2020 or 2022 and the Society may receive deferred cash consideration in 2020. At 31 December 2017 a fair value of £nil has been ascribed to both the put options and deferred cash consideration.

16. Investments in Group undertakings

Society	Shares £m	Loans £m	Total £m
At 1 January 2017	8.0	11,174.6	11,182.6
Additions	–	1,374.9	1,374.9
At 31 December 2017	8.0	12,549.5	12,557.5

The Society has the following consolidated subsidiary undertakings, all of which operate in the United Kingdom and are wholly owned by Coventry Building Society:

Subsidiary undertakings	Principal activity
Godiva Mortgages Limited	Mortgage lending
ITL Mortgages Limited	Mortgage lending and mortgage acquisition vehicle
Five Valleys Property Company Limited	Non-trading (formerly 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

During the year, the remaining investment properties held by Five Valleys Property Company Limited were sold and the company ceased to trade.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control in accordance with the accounting policy set out in note 1. The following structured entities are consolidated:

Consolidated structured entities	Principal activity
Coventry Building Society Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds
Mercia No.1 plc	Funding vehicle
Offa No. 1 plc	Funding vehicle

The nature and risks associated with the Society's investments in these entities (including obligations of financial support) are disclosed in note 14. A former consolidated structured entity, Leofric No.1 plc, was liquidated during the year.

The registered office for Mercia No. 1 plc and Offa No. 1 plc is 35 Great St. Helens, London EC3A 6AP, for Godiva Mortgages Limited and Five Valleys Property Company Limited is Oakfield House, Binley Business Park, Binley, Coventry CV3 2TQ and for all of the others is Oakfield House, PO Box 600, Binley Business Park, Coventry, West Midlands CV3 9YR.

17. Intangible assets

Group and Society	Externally acquired 2017 £m	Internally developed 2017 £m	Total 2017 £m	Externally acquired 2016 £m	Internally developed 2016 £m	Total 2016 £m
Cost						
At 1 January	12.1	42.5	54.6	9.3	22.6	31.9
Additions	3.1	17.6	20.7	3.5	22.0	25.5
Retirements	(0.2)	(1.1)	(1.3)	(0.7)	(2.1)	(2.8)
At 31 December	15.0	59.0	74.0	12.1	42.5	54.6
Amortisation						
At 1 January	6.5	15.6	22.1	4.7	10.9	15.6
Charge for the year	2.6	9.7	12.3	2.5	6.6	9.1
Retirements	(0.1)	(1.1)	(1.2)	(0.7)	(1.9)	(2.6)
At 31 December	9.0	24.2	33.2	6.5	15.6	22.1
Net book value at 31 December	6.0	34.8	40.8	5.6	26.9	32.5

Intangible assets primarily consist of externally acquired and internally developed software that is not an integral part of a related hardware purchase.

Internally developed assets at 31 December 2017 include £9.8 million (2016: £12.1 million) of assets in course of construction. These assets relate mainly to the Society's investment in new systems platforms to meet the future needs of the business. To the extent that these new systems platforms are not yet ready for use by the business, no amortisation has been charged against these assets.

18. Property, plant and equipment

	Land and buildings				
Group and Society	Freehold £m	Long leasehold £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost					
At 1 January 2017	9.3	6.1	3.2	44.9	63.5
Additions	–	–	–	8.0	8.0
Disposals	–	–	–	(3.9)	(3.9)
At 31 December 2017	9.3	6.1	3.2	49.0	67.6
Depreciation					
At 1 January 2017	1.9	1.1	2.1	22.7	27.8
Charge for the year	0.1	0.3	–	6.3	6.7
Depreciation on disposals	–	–	–	(3.1)	(3.1)
At 31 December 2017	2.0	1.4	2.1	25.9	31.4
Net book value at 31 December 2017	7.3	4.7	1.1	23.1	36.2

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 2016	9.3	6.1	3.4	39.1	57.9
Additions	–	–	–	9.1	9.1
Disposals	–	–	(0.2)	(3.3)	(3.5)
At 31 December 2016	9.3	6.1	3.2	44.9	63.5
Depreciation					
At 1 January 2016	1.8	0.8	2.3	20.1	25.0
Charge for the year	0.1	0.3	–	5.5	5.9
Depreciation on disposals	–	–	(0.2)	(2.9)	(3.1)
At 31 December 2016	1.9	1.1	2.1	22.7	27.8
Net book value at 31 December 2016	7.4	5.0	1.1	22.2	35.7

Disposals relate to assets that were retired during the year.

Equipment, fixtures, fittings and vehicles includes assets held under finance leases as follows:

Group and Society	2017 £m	2016 £m
Net book value	2.2	2.6
Accumulated depreciation	1.3	1.2

The net book value of land and buildings occupied by the Group for its own activities is as follows:

Group and Society	2017 £m	2016 £m
At 31 December	13.1	13.2

Investment properties

During 2017 Five Valleys Property Company Limited disposed of two investment properties with a carrying value of £0.2 million for proceeds of £0.2 million. The net gain of £0.1 million is disclosed in other operating income. The Group holds no investment properties at 31 December 2017 (2016: two properties with a carrying and fair value of £0.2 million).

19. Pension scheme

The Society operates both a funded defined benefit and a defined contribution pension scheme.

The Coventry Building Society defined benefit pension scheme (the Fund) is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are required to act in the best interest of the Fund members. The appointment of the trustees is determined by the Fund's trust documentation and one third of trustees are nominated by the members of the pension fund. As at 31 December 2014, the date of the last full actuarial valuation, 1,833 current employees, former employees and former executive directors were members of the Fund.

The Fund is subject to the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, set out the framework for funding defined benefit occupational pension plans in the UK.

The Fund typically exposes the Society to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the Balance Sheet and may give rise to increased charges in future periods. This effect would be partially offset by an increase in the value of the plan's bond and liability matching holdings. Caps on inflationary increases are in place to protect the plan against extreme inflation.

The pension scheme assets are predominantly invested in Liability Matching Funds (LMFs) being leveraged pooled funds used to help manage interest rate and inflation risk. The investment policy of the LMFs is summarised as follows:

- Each LMF relates to a single named benchmark gilt – the Fund holds units in the 2027, 2032, 2040, 2050 and 2062 index-linked gilt LMFs, the 2040, 2052 and 2060 fixed interest gilt LMFs and the LMF real 2020-2024 swap.
- The LMFs holds a combination of gilt sale and repurchase agreements (repos), gilt total return swaps and physical gilts.
- The fund manager manages the amount of underlying cash and gilt collateral held to support the derivative exposure within the funds (known as leverage) to keep the leverage of each individual fund within a particular range. If leverage increases too much then the manager will ask the Fund to pay in additional capital, and if leverage falls too low the manager will return capital to the Fund in order to increase the leverage.
- The fund manager aims to limit the exposure to each counterparty to 20% of each LMF's overall exposure.

For the purposes of IAS 19 *Employee Benefits (Revised)* the actuarial valuation as at 31 December 2014, which was carried out by a qualified independent actuary, has been updated on an approximate basis to 31 December 2017. There have been no changes in the valuation methodology adopted for this period's disclosures although assumptions have been updated on actuarial advice.

The cost of the Fund was assessed in accordance with the advice of a qualified actuary on the basis of valuations using the projected unit method. The main assumptions used in the valuations were:

i. An investment return pre-retirement of 0.5% (2016: 0.45%) per annum in excess of projected pre-retirement benefit increase.
ii. An investment return post-retirement of -0.4% (2016: -0.4%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 0.5% (2016: 0.6%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

The 31 December 2014 actuarial valuation showed a deficit of £11.5 million. The Society agreed with the trustees that it would aim to eliminate the deficit by 30 September 2019 by the payment of annual contributions of £1.4 million in respect of the deficit.

Since the Fund is closed to future service accrual no contributions were made in respect of members' pensionable salaries during 2017 (2016: £nil); 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 2018 is £1.4 million. The Society met and continues to meet the Fund's expenses including levies to the Pension Protection Fund.

The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is then deducted from the fair value of plan assets and the net surplus is presented on the Balance Sheet as shown below:

Group and Society	2017 £m	2016 £m
Present value of funded obligation	(203.2)	(211.9)
Fair value of plan assets	221.7	214.4
Funded status/Pension benefit surplus	18.5	2.5

	2017			2016		
	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	(211.9)	214.4	2.5	(169.1)	183.3	14.2
Included within administrative expenses:						
Interest (expense)/income	(5.6)	5.7	0.1	(6.4)	7.0	0.6
Included within other comprehensive income:						
Remeasurements:						
Return on plan assets (excluding amounts in the Income Statement)	–	7.0	7.0	–	28.2	28.2
Gains/(losses) from changes in financial assumptions	7.5	–	7.5	(41.9)	–	(41.9)
	7.5	7.0	14.5	(41.9)	28.2	(13.7)
Other contributions and payments:						
Employer contributions	–	1.4	1.4	–	1.4	1.4
Benefit payments	6.8	(6.8)	–	5.5	(5.5)	–
	6.8	(5.4)	1.4	5.5	(4.1)	1.4
As at 31 December	(203.2)	221.7	18.5	(211.9)	214.4	2.5

The surplus reflects the Society's ability to recover a surplus either through reduced contributions in the future or through refunds from the Fund after the last benefit has been paid in line with IAS 19.

The major categories of plan assets are:

	Plan assets at 31.12.2017 £m	Plan assets at 31.12.2016 £m
Quoted		
Corporate bonds and liability matching	113.2	139.2
Diversified growth funds	18.7	24.5
Direct lending	12.9	7.2
Cash	0.9	1.7
Unquoted		
Corporate bonds and liability matching	56.8	23.2
Property	19.2	18.6
Total	221.7	214.4

19. Pension scheme continued

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligation at	31.12.2017 %	31.12.2016 %
Discount rate	2.60	2.70
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	3.10	3.25
Rates of inflation (Consumer Prices Index)	2.10	2.25

Weighted average assumptions used to determine net pension cost for the year ended	31.12.2017 %	31.12.2016 %
Discount rate	2.70	3.85
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	3.25	3.10
Rates of inflation (Consumer Prices Index)	2.25	2.10

Weighted average life expectancy for mortality tables used to determine benefit obligation at	31.12.2017		31.12.2016	
	Male	Female	Male	Female
Member age 60 (current life expectancy)	26.5	28.4	26.9	29.0
Member age 45 (life expectancy at age 60)	26.9	28.9	28.2	30.5

The Group has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension fund surplus and changes in these assumptions could affect the reported surplus. The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is indicated below for isolated changes in assumptions; in reality it is likely that assumptions will be related to each other and impact simultaneously:

Impact on present value of obligation:	Change in assumption	Increase in assumption %	Decrease in assumption %
Discount rate	0.25%	(4.6)	4.9
Rates of inflation (Retail Prices Index and Consumer Prices Index)	0.25%	4.0	(3.8)
Life expectancy	1 year	3.2	(3.2)

The average duration of the defined benefit obligation at the period ending 31 December 2017 is 22 years.

20. Deferred tax

Deferred tax assets and liabilities are attributable to the following items:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Deferred tax assets				
Transfer of engagements – fair value adjustments	–	1.9	–	–
Total	–	1.9	–	–
Deferred tax liabilities				
Cash flow hedges	7.3	14.2	6.4	9.7
Defined benefit pension plan surplus	4.4	0.6	4.4	0.6
Transfer of engagements – fair value adjustments	0.1	0.2	0.1	0.2
Investment in equity shares	0.2	1.5	0.2	1.5
Available-for-sale	1.9	1.3	1.9	1.3
Excess of depreciation over capital allowances	(3.0)	(3.1)	(3.0)	(3.1)
Provisions	(0.5)	(0.6)	(0.5)	(0.6)
IFRS transitional fair value adjustments	–	(0.1)	–	–
Deferred consideration on the sale of equity shares	(0.1)	–	(0.1)	–
Capital losses	–	(0.3)	–	(0.3)
Total	10.3	13.7	9.4	9.3

Deferred tax assets are recognised where they have arisen on the basis that sufficient future taxable trading profits will be available to utilise the deferred tax assets.

The deferred tax carried forward in respect of capital losses of £0.3 million in 2016 was recognised because the Group expected that the losses would be offset against future capital gains. The capital losses were offset against gains during 2017 and at 31 December 2017 there were no deferred tax assets in respect of capital losses.

The deferred tax balances at 31 December 2017 reflect future reductions in the standard rate of corporation tax, as introduced by the Finance (No. 2) Act 2015 and the Finance Act 2016, to 17% from 1 April 2020.

21. Deposits from banks

A maturity analysis for the Group's deposits from banks is included in the Risk Management Report Liquidity and Funding section.

For the Group and Society, deposits from banks include £3,000.0 million (2016: £nil) drawn down against the Bank of England Term Funding Scheme (TFS).

Deposits from banks also includes £300.1 million (2016: £1,320.8 million) in respect of sale and repurchase agreements (repos) of on-balance sheet debt securities (see note 13).

At the 2016 year end, deposits from banks included £1,249.2 million for sale and repurchase of off-balance sheet Treasury bills (see note 13). No FLS Treasury bills were held at the 2017 year end.

22. Debt securities in issue

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Certificates of deposit	251.3	156.5	251.3	156.5
Medium-term notes	2,135.2	1,742.6	2,135.2	1,742.6
Covered bonds	2,309.4	1,847.8	2,309.4	1,847.8
Residential Mortgage Backed Securities	192.9	231.2	–	–
Total	4,888.8	3,978.1	4,695.9	3,746.9

The change in debt securities issued by the Group from financing activities arises as follows:

			Non-cash flows			
2017	2016 £m	Cash flows £m	Foreign exchange movements £m	Change in accrued interest £m	Amortisation £m	2017 £m
Certificates of deposit	156.5	94.3*	–	0.5	–	251.3
Medium-term notes	1,742.6	354.7	35.3	1.2	1.4	2,135.2
Covered bonds	1,847.8	430.8	27.1	2.1	1.6	2,309.4
Residential Mortgage Backed Securities	231.2	(38.5)	–	–	0.2	192.9
Total	3,978.1	841.3	62.4	3.8	3.2	4,888.8

* Cash flows relating to certificates of deposits are included within changes in operating liabilities in the Statements of Cash Flows.

During the period, a €500.0 million covered bond and £800.0 million medium term notes were issued. The Society change in liabilities from financing activities is the same as the Group, other than they exclude Residential Mortgage Backed Securities (issued by Offa No.1 plc; a consolidated structured entity).

Debt securities in issue are repayable in the ordinary course of business as follows:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Accrued interest	42.6	38.5	42.5	38.3
Other debt securities in issue with residual maturity repayable:				
In not more than one year	1,000.3	573.2	1,000.3	573.2
In more than one year	3,845.9	3,366.4	3,653.1	3,135.4
Total	4,888.8	3,978.1	4,695.9	3,746.9

23. Derivative financial instruments

Derivative financial instruments are held solely 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 for IAS 39 and those which, whilst in economic hedging relationships, are not. Contractual/notional amounts indicate the amount on which payment flows are derived at the Balance Sheet date and do not represent amounts at risk.

Foreign exchange losses of £61.8 million have been recognised in the Income Statement relating to the principal amount of financial instruments held at amortised cost. This is offset by £61.8 million of foreign exchange gains on derivative financial instruments held at fair value.

	2017			2016		
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	24,890.7	185.0	212.8	22,818.0	226.8	363.1
Derivatives designated as cash flow hedges:						
Interest rate swaps	445.0	–	1.2	764.0	–	3.6
Cross currency swaps*	1,363.4	121.5	–	1,340.4	127.4	–
Total derivatives	26,699.1	306.5	214.0	24,922.4	354.2	366.7
Derivatives have remaining maturities as follows:						
In not more than one year	7,192.5	42.1	12.1	8,382.6	39.0	18.4
In more than one year	19,506.6	264.4	201.9	16,539.8	315.2	348.3
Total derivatives	26,699.1	306.5	214.0	24,922.4	354.2	366.7

* Cash flows are expected to occur over a seven year period (2016: five).

	2017			2016		
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	24,140.7	154.3	212.8	22,068.0	175.9	363.1
Derivatives designated as cash flow hedges:						
Interest rate swaps	445.0	–	1.2	764.0	–	3.6
Cross currency swaps*	541.1	59.6	–	946.1	78.2	–
Other derivatives:						
Interest rate basis swaps	650.0	1.3	–	650.0	1.9	–
Total derivatives	25,776.8	215.2	214.0	24,428.1	256.0	366.7
Derivatives have remaining maturities as follows:						
In not more than one year	6,442.5	11.4	12.1	8,382.6	39.0	18.4
In more than one year	19,334.3	203.8	201.9	16,045.5	217.0	348.3
Total derivatives	25,776.8	215.2	214.0	24,428.1	256.0	366.7

* Cash flows are expected to occur over a three year period (2016: four).

Collateralised derivatives are valued using discount curves based on OIS rates, whilst non-collateralised derivatives are valued using discount curves based on term LIBOR rates.

The Society also has intra-group interest rate swaps with the subsidiaries that operate the Group's covered bond programme. Under these agreements, the Society receives the interest income of the subsidiaries' mortgage books and pays LIBOR on the same basis as the subsidiaries' interest expense. These swaps have a nominal principal amount of £4,951.7 million (2016: £4,307.2 million) and are accounted for on an accruals basis in accordance with IAS 39.

24. Provisions for liabilities and charges

Group	FSCS 2017 £m	Other provisions 2017 £m	Total 2017 £m	FSCS 2016 £m	Other provisions 2016 £m	Total 2016 £m
At 1 January	4.4	3.1	7.5	7.0	1.8	8.8
Charge for the year	2.5	1.0	3.5	4.3	1.8	6.1
Provisions utilised	(4.4)	(0.9)	(5.3)	(6.9)	(0.5)	(7.4)
At 31 December	2.5	3.2	5.7	4.4	3.1	7.5

The Society position differs by £0.2 million (2016: £0.2 million) to the Group in relation to other provisions which are held in subsidiaries of the Society.

FSCS levy provision

The Society is a member of the Financial Services Compensation Scheme (FSCS) and along with all deposit-taking institutions that are members is required to contribute to the costs of the FSCS to safeguard the deposits of savers in financial institutions. Contributions to the FSCS are based on the retail savings balances of all members of the FSCS. As at 31 December 2017, the Group held a provision of £2.5 million with respect to the estimated FSCS levy for the period 2017/18, which is expected to be utilised in August 2018.

Other provisions

Other provisions have also been recognised in respect of potential customer claims, including Payment Protection Insurance (PPI) redress. The charge in the year includes a further £1.0 million provision reflecting an increase in the number of claims received in the period, the estimated impact of the finalised rules from the Financial Conduct Authority and the deadline for PPI claims.

The Group has no contingent liabilities.

25. Subordinated liabilities

Group and Society	2017 £m	2016 £m
Subordinated liabilities owed to note holders are as follows:		
Fixed rate subordinated notes 2026 – 6.327%	10.2	10.2
Fixed rate subordinated notes 2032 – 7.54%	15.3	15.3
Total	25.5	25.5

All the subordinated liabilities are denominated in sterling and are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, subject to prior consent of the Prudential Regulation Authority (PRA).

The subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members, other than holders of Permanent Interest Bearing Shares and Perpetual Capital Securities (PCS), for both principal and interest.

26. Subscribed capital

Group and Society	Call date	2017 £m	2016 £m
Subscribed capital owed to permanent interest holding members is as follows:			
Permanent Interest Bearing Shares 1992 – 12 1/8%	n/a	41.6	41.6
Total		41.6	41.6

Subscribed capital comprises the Permanent Interest Bearing Shares (PIBS) issued in 1992 that are only repayable in the event of the winding up of the Society. Interest is paid in arrears in half yearly instalments at 12 1/8% per annum.

PIBS rank equally with each other and Perpetual Capital Securities (PCS). They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than holders of PCS) for both principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

27. Other equity instruments

In June 2014, the Society issued £400.0 million of new PCS capital raising £396.9 million (net of issuance costs and associated tax). These instruments rank equally with each other and PIBS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS), for both principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.375% per annum. The rate will reset on 1 November 2019 and every five years thereafter to the five year mid swap rate plus 4.113%. Coupons are paid semi-annually in May and November.

The returns paid to holders of PCS are treated as an appropriation of profit after tax, reflecting their categorisation as equity instruments, distributed directly from the general reserve. During 2017, coupon payments of £25.6 million (2016: £25.6 million), were approved and have been recognised (net of tax) in the Statement of Change in Members' Interests and Equity.

The instruments have no maturity date. They are repayable at the option of the Society in 2019 and on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an individual consolidated or a consolidated basis, falls below 7% they convert to Core Capital Deferred Shares (CCDS) at the rate of one CCDS for every £67 PCS held.

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 £26.4 million loss (2016: £21.8 million gain) was transferred to net losses from derivatives and hedge accounting in the Income Statement with respect to hedge accounting adjustments relating to Available-for-sale debt securities in fair value hedge accounting relationships. A £1.3 million gain (2016: £nil) was also transferred to interest receivable and similar income in respect of the disposal of Available-for-sale debt securities.

During the year a gain of £5.0 million was transferred to other operating income (see note 7) in respect of the disposal of 90% of the equity investment in VocaLink (2016: £nil). In 2016, a gain of £4.9 million was transferred to other operating income in respect of the disposal of the equity investment in Visa Europe Limited.

29. Financial commitments

The Group and Society are committed to the following undrawn mortgage loan facilities relating to equity release and flexible mortgage products, which are subject to the satisfaction of previously agreed loan to value ratios:

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Undrawn mortgage loan facilities	55.4	66.5	45.4	54.2

In addition, the Group has also committed to advance £1,425.3 million (2016: £1,623.2 million) in respect of loans and advances to customers.

30. Capital and leasing commitments

Capital commitments

Group and Society	2017 £m	2016 £m
Capital expenditure contracted for but not provided for in the accounts	2.6	7.9

Leasing commitments

Future minimum lease payments under non-cancellable operating leases relating to land and buildings were as follows:

Group and Society	2017 £m	2016 £m
Amounts falling due:		
Within one year	3.3	3.0
Between one and five years	10.5	9.5
After five years	5.2	5.8
Total	19.0	18.3
Lease payments recognised as an expense in the period	4.5	4.4

31. Financial instruments – classification and fair value measurement

For the purpose of calculating fair values, fair value is assessed as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: unadjusted quoted prices in active markets for identical instruments.
- Level 2: valuation techniques for which all significant inputs are based on observable market data.
- Level 3: valuation techniques for which significant inputs are not based on observable market data.

Where applicable, the Group measures fair value using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Where this is not applicable, the Group determines fair values using other valuation techniques.

The following table summarises the fair value of the Group's financial assets and liabilities measured at amortised cost on the face of the Group's Balance Sheet by the fair value hierarchy.

The Society position is not materially different to that of the Group except that it excludes £12,866.6 million (2016: £11,496.8 million) of loans and advances to customers with a fair value of £12,863.1 million (2016: £11,468.3 million) and £58.7 million (2016: £49.8 million) of deposits from banks with a fair value of £58.7 million (2016: £49.8 million) which are held in subsidiaries of the Society.

2017 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	202.0	–	202.0	–	202.0
Loans and advances to customers	35,930.9	–	–	35,824.6	35,824.6
Financial liabilities					
Shares	31,035.7	–	–	31,158.8	31,158.8
Deposits from banks	3,499.0	–	3,499.0	–	3,499.0
Other deposits	4.0	–	4.0	–	4.0
Amounts owed to other customers	735.5	–	735.8	–	735.8
Debt securities in issue	4,888.8	4,991.0	39.2	–	5,030.2
Subordinated liabilities	25.5	–	28.6	–	28.6
Subscribed capital	41.6	90.1	–	–	90.1

2016 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	213.5	–	213.5	–	213.5
Loans and advances to customers	32,881.6	–	–	32,751.5	32,751.5
Financial liabilities					
Shares	28,054.3	–	–	28,257.3	28,257.3
Deposits from banks	2,937.5	–	2,936.4	–	2,936.4
Other deposits	7.0	–	7.0	–	7.0
Amounts owed to other customers	819.4	–	818.0	–	818.0
Debt securities in issue	3,978.1	4,173.8	13.8	–	4,187.6
Subordinated liabilities	25.5	–	29.2	–	29.2
Subscribed capital	41.6	79.4	–	–	79.4

Loans and advances to customers

The fair value of loans and advances to customers is assessed as the value of the expected future cash flows, projected using contractual interest payments and repayments and the expected prepayment behaviour of borrowers. Conservative assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The estimated future cash flows are discounted at current market rates for the loan types and adjusted where necessary to reflect any observable market conditions.

Shares and deposits

The fair value of shares available on demand approximates to the carrying value. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows discounted at the current market rates for those types of deposit.

31. Financial instruments – classification and fair value measurement continued

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer-dated liabilities is calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those liabilities where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate to the remaining term to maturity.

The following table summarises the fair value of the Group's financial assets and liabilities measured at fair value on the face of the Group's Balance Sheet by fair value hierarchy and product type.

The Society position is not materially different to that of the Group except that it excludes £30.7 million (2016: £50.9 million) of Level 2 interest rate swap assets and £61.9 million (2016: £49.2 million) of Level 2 cross currency swap liabilities, which are held in subsidiaries of the Society, and includes a fair value asset of £1.3 million (2016: £1.9 million fair value asset) relating to Level 2 intercompany interest rate basis swaps.

2017 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	185.0	–	185.0
Cross currency swaps	–	121.5	–	121.5
Total	–	306.5	–	306.5
Debt securities				
UK Government investment securities	990.3	–	–	990.3
Other listed transferable debt securities	14.2	0.3	7.5	22.0
Total	1,004.5	0.3	7.5	1,012.3
Investment in equity shares				
Investment in equity shares	–	–	2.5	2.5
Total	–	–	2.5	2.5
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	150.5	63.5	214.0
Total	–	150.5	63.5	214.0

2016 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	226.8	–	226.8
Cross currency swaps	–	127.4	–	127.4
Total	–	354.2	–	354.2
Debt securities				
UK Government investment securities	1,328.9	–	–	1,328.9
Other listed transferable debt securities	15.8	3.6	6.0	25.4
Total	1,344.7	3.6	6.0	1,354.3
Investment in equity shares				
Investment in equity shares	–	–	5.9	5.9
Total	–	–	5.9	5.9
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	298.1	68.6	366.7
Total	–	298.1	68.6	366.7

Financial instruments recorded at fair value

The determination of fair value for financial instruments which are recorded at fair value using valuation techniques is described below, including the assumptions that a market participant would be expected to make when valuing the instruments:

Level 1: Debt securities – Available-for-sale – Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2: Derivatives

Derivative products utilise observable market inputs for interest rate swaps and cross currency swaps. Valuations are generated by swap models which use present value calculations and incorporate assumptions for interest rate curves and foreign exchange spot and forward rates.

Level 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 valuation. Otherwise, a security is valued based on its relative value to comparable bonds.

Level 3: Debt securities – Available-for-sale – Listed

The item included within Level 3 is a mortgage backed security. This is valued 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 10 basis points, which is representative of repayment commencing (if positive) or being set back further (if negative), would change the value of the security by £0.8 million.

Level 3: Investment in equity shares – Available-for-sale – Unlisted

Details of the Level 3 Investment in equity shares are set out in note 15 and represent the Group's holding in Visa Inc. preference and VocaLink Holdings Limited shares. These shares are valued based on future cash consideration which the Group expects to receive on sale of these instruments, or the underlying market value. Currently deferred cash consideration has been assigned a value of £nil.

Where appropriate, a discount is applied to the valuation to reflect marketability and other risks in relation to the instruments. A change in discount of 10% would result in the change in the carrying value of the investment of £0.4 million.

Level 3: Derivatives

The items included within Level 3 are balance tracking swaps, which have remained in place during the year. These are valued using present value calculations based on market interest rate curves. The unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. Projected mortgage prepayment amounts are used in the modelling of the mortgage portfolio profile. A change of 10% in the prepayment rates used results in a £0.6 million change in the value of the swaps. However, changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact the swap and hedged item equally so that the net Income Statement and Balance Sheet impact would be negligible.

31. Financial instruments – classification and fair value measurement continued

The following table analyses movements in the Level 3 portfolio for both the Group and the Society.

Group and Society	Investment in equity share 2017 £m	Debt securities 2017 £m	Derivative financial instruments 2017 £m	Investment in equity share 2016 £m	Debt securities 2016 £m	Derivative financial instruments 2016 £m
As at 1 January	5.9	6.0	(68.6)	3.3	7.0	(55.5)
(Losses)/gains recognised in the Income Statement						
Interest receivable and similar income	–	–	–	–	0.1	–
Interest payable and similar expense	–	–	(6.4)	–	–	(6.3)
Net unrealised (losses)/gains	(0.1)	–	5.0	–	–	(13.1)
Gains/(losses) recognised in the Statement of Comprehensive Income						
Available-for-sale reserve fair value movement	1.8	1.5	–	1.9	(1.0)	–
Settlements	(5.1)	–	6.5	(4.9)	(0.1)	6.3
Transfers into Level 3 portfolio	–	–	–	5.6	–	–
As at 31 December	2.5	7.5	(63.5)	5.9	6.0	(68.6)

Transfers between fair value levels

Transfers between fair value levels occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. Transfers are considered to occur at the end of the reporting period for the purposes of this disclosure.

During 2017, one debt securities valued at £2.9 million was transferred from Level 2 to Level 1.

32. Offsetting financial assets and liabilities

The Group and Society do not have any financial assets or financial liabilities that are offset with the net amount presented in the Balance Sheets. IAS 32 *Financial Instruments: Presentation* states that there should be both an enforceable right to set-off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously to apply this treatment and neither of these conditions is met.

The Group has entered into master netting arrangements such as International Swaps and Derivatives Association (ISDA) master agreements for its derivatives, other than derivatives held by Coventry Building Society Covered Bonds LLP. Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements, which typically provide for the exchange of collateral to mitigate net mark to market credit exposure.

The Group has also entered into Global Master Repurchase Agreements, including margin collateralisation arrangements, whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event.

Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the covered bonds programme. However, it has entered into a separate ISDA agreement in respect of each of the derivatives it has transacted with external counterparties. Each agreement includes a CSA which provides for full collateralization of the swap exposure with exposure thresholds in place for two agreements before collateral is exchanged. The £45.2 million net derivative credit exposure in the table below includes £34.5 million in respect of these two arrangements which will only be fully collateralized if the counterparties are downgraded to below specified credit ratings.

The table below shows the net exposure for sale and repurchase agreements or derivative contracts after any netting benefits and collateral. The Group did not enter into securities lending or reverse sale and repurchase agreements during 2017.

2017 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	306.5	(95.1)	(166.2)	45.2
Total financial assets	306.5	(95.1)	(166.2)	45.2
Financial liabilities				
Derivative financial instruments	214.0	(95.1)	(115.4)	3.5
Sale and repurchase agreements	300.1	–	(300.1)	–
Total financial liabilities	514.1	(95.1)	(415.5)	3.5

2016 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	354.2	(185.2)	(124.0)	45.0
Total financial assets	354.2	(185.2)	(124.0)	45.0
Financial liabilities				
Derivative financial instruments	366.7	(185.2)	(171.8)	9.7
Sale and repurchase agreements	1,320.7	–	(1,320.7)	–
Total financial liabilities	1,687.4	(185.2)	(1,492.5)	9.7

* As reported on the Balance Sheet.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

As at 31 December 2017, £39.8 million of the £45.2 million exposure is to Aa3 rated institutions with a further £5.4 million to A2 or above rated financial institutions.

32. Offsetting financial assets and liabilities continued

2017 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	215.2	(95.1)	(108.2)	11.9
Total financial assets	215.2	(95.1)	(108.2)	11.9
Financial liabilities				
Derivative financial instruments	214.0	(95.1)	(115.4)	3.5
Sale and repurchase agreements	300.1	–	(300.1)	–
Total financial liabilities	514.1	(95.1)	(415.5)	3.5

2016 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	256.0	(185.2)	(55.6)	15.2
Total financial assets	256.0	(185.2)	(55.6)	15.2
Financial liabilities				
Derivative financial instruments	366.7	(185.2)	(171.8)	9.7
Sale and repurchase agreements	1,320.7	–	(1,320.7)	–
Total financial liabilities	1,687.4	(185.2)	(1,492.5)	9.7

* As reported on the Balance Sheet.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

For derivative financial assets, collateral received can be in the form of cash and UK Government investment securities. Where cash is received it is included as a liability within deposits from banks (see note 21). Where UK Government investment securities are received, these are not recognised on the Balance Sheet, as the Group does not obtain the risks and rewards of ownership.

For derivative financial liabilities, collateral paid is in the form of cash and is included as an asset in loans and advances to credit institutions.

For sale and repurchase agreements (repos), collateral provided is predominantly in UK Government investment securities with the remainder in cash. Again, cash paid is included as an asset in loans and advances to credit institutions. UK Government investment securities are not derecognised as the Group retains substantially all the risks and rewards of ownership.

Cash collateral held and cash collateral pledged are not restricted and are returned at the end of the contract.

33. Capital management

As at 31 December 2017, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on the Group's capital resources and capital management can be found in the Capital section of the Risk Management Report.

34. Related party transactions

The Group is controlled by Coventry Building Society registered in England and Wales, which is also considered to be the ultimate parent.

	Group undertakings		Key management	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Loans payable to the Society				
Loans outstanding as at 1 January	**11,174.6**	9,637.0	**–**	0.2
Loans issued during the year	**1,374.9**	1,537.2	**1.1**	–
Impairment credit	**–**	0.4	**–**	–
Repayments during the year*	**–**	–	**(0.3)**	(0.2)
Loans outstanding as at 31 December	**12,549.5**	11,174.6	**0.8**	–
Deposits payable by the Society				
Deposits outstanding at 1 January	**–**	109.0	**2.6**	3.0
Deposits received during the year**	**–**	–	**1.3**	0.6
Repayments during the year*	**–**	(109.0)	**(1.4)**	(1.0)
Deposits outstanding at 31 December	**–**	–	**2.5**	2.6
Net interest income/(expense)				
Interest receivable	**320.5**	313.0	**–**	–
Interest payable	**–**	(3.2)	**–**	–
Foreign currency gains/(losses)	**27.0**	59.3	**–**	–
Total	**347.5**	369.1	**–**	–
Other income and expenses				
Fees and expenses paid to the Society	**7.7**	8.8	**–**	–

* 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 rate agreed between the Society and its subsidiaries.

Deposits payable by the Society to Group undertakings relate to amounts owing to the Society's structured entities, in accordance with the accounting policy set out in note 1. These intercompany balances have been presented within other liabilities on the Society Balance Sheet.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The Board of directors are considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24 *Related Party Disclosures*. No director has any interest in the shares or debentures of any connected undertaking of the Society. See the Directors' Remuneration Report in the Governance section for information on Directors' remuneration for 2017.

In accordance with Section 68 of the Building Societies Act 1986, the Society maintains a register of loans falling within Section 65 made to directors and connected persons. A statement containing requisite particulars of such transactions may be inspected by members at the Society's Annual General Meeting (AGM) or at the Principal Office of the Society during the period 15 days prior to the AGM.

Transactions with related undertakings

Transactions are entered into with related parties in the normal course of business. These include loans, deposits, and the payment and recharge of interest and administrative expenses.

Other Information

Annual Business Statement

For the year ended 31 December 2017

1. Statutory percentages

	2017 %	Statutory limits %
Lending limit	1.3	25.0
Funding limit	22.7	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of the business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus loan impairment less liquid assets, intangible assets and property, plant and equipment. The value of X used is the value at 31 December 2017.

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 2017.

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 2017.

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 2017.

2. Other percentages

	2017 %	2016 %
As a percentage of shares and borrowings:		
Gross capital	5.09	5.28
Free capital	4.91	5.11
Liquid assets	15.5	13.5
As a percentage of mean total assets:		
Profit for the financial year	0.46	0.50
Management expenses	0.42	0.41
Net profit as a percentage of total balance sheet	0.43	0.48

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
Peter Ayliffe, BA (Hons), FCIBS, CMgr (05.03.1953)	Company Director	TruRating Limited The Pennies Foundation	01.05.2013
Roger Burnell, BSc, FCA (08.04.1950)	Company Director	Clarence Mansions Management Company Limited	01.09.2008
Catherine Doran, BA (11.09.1956)	Company Director	Department for Environment, Food & Rural Affairs	01.08.2016
Andy Deeks, BA (Hons), MBA (18.03.1981)	Building Society Product, Marketing and Strategy Director	None	27.04.2017
Michele Faull, FCCA (24.11.1960)	Building Society Chief Financial Officer	Arkose Funding Limited Bow Arts Trust Coventry Financial Services Limited Coventry Property Services Limited Five Valleys Property Company Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Mortgages Limited Godiva Savings Limited Godiva Securities and Investments Limited ITL Mortgages Limited	27.04.2017
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer	Five Valleys Property Company Limited	01.11.2012
Ian Geden, BSc (Hons), FCII (08.07.1953)	Company Director	Faraday Underwriting Limited	01.09.2008
Joanne Kenrick, LLB (21.09.1966)	Company Director	BACS Payment Schemes Limited Dŵr Cymru Cyfyngedig Glas Cymru Holdings Cyfyngedig Global Charities Global Charities (Trading) Limited Lynmouth Colossus Way Management Limited Rhapsody Court Freehold Limited Safestore Holdings plc	06.11.2017
Mark Parsons, BA (Hons), FCMA (24.10.1961)	Building Society Chief Executive	Godiva Mortgages Limited ITL Mortgages Limited	01.07.2014

Documents may be served on the above named directors at: Coventry Building Society, c/o Ernst & Young LLP, 1 Bridgewater Place, Leeds LS11 5QR.

The Society has entered into service contracts with the following directors: Peter Frost (Chief Operating Officer); Mark Parsons (Chief Executive); Andrew Deeks (Product, Marketing and Strategy Director) and Michele Faull (Chief Financial Officer). These are terminable by the individual on six months' notice and by the Society on one year's notice.

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:

Term	Definition
Additional Tier 1 (AT 1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to a form of Common Equity Tier 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Available-for-sale reserve (AFS)	The Available-for-sale reserve 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	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'.
Bank surcharge	An 8% surcharge on the profits of banking companies which was introduced from 1 January 2016 by the Finance (No.2) Act 2015.
Basel 4	The Basel Committee on Banking Supervision reforms published in December 2017 addressing credit risk (standardised approach with floors, and IRB), operational risk, and the leverage ratio. They are applicable from Jan 2022 and are phased in over five years.
Basis point	One hundredth of a percent (0.01 percent). Used when quoting movements in interest rates and yields on securities.
Brexit	The process of the UK leaving the European Union decided by the UK referendum on 23 June 2016.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital Conservation Buffer (CCoB)	A buffer for all banks that can be used to absorb losses while avoiding breaching minimum capital requirements. Phased in from January 2016 (0.625% from 1 January 2016, increasing to 2.5% by 1 January 2019).
Capital requirements	Amount of capital required to be held by the Group to cover the risk of losses and to protect against excessive leverage. The level is set by regulators and the firm's own assessment of its risk profile.
Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)	CRD IV is the European Union legislation (part regulation and part directive) which came into force from 1 January 2014 to implement Basel III, revising the capital requirements framework and introducing liquidity requirements, which regulators use when supervising firms.
Capital resources	Capital comprising the general reserve, Available-for-sale reserve, eligible Additional Tier 1 capital less all required regulatory adjustments.
Central clearing	The process by which parties to an OTC derivative contract replace this with a separate contract with a central counterparty, which takes over each party's positions under the original contract.
Certificates of deposit	Bearer-negotiable instruments issued on the receipt of a fixed term deposit at a specified interest rate.
Collateral	Security pledged by the borrower to the lender in case of default.
Collective assessment of impairments	Where impairment is identified within a portfolio that comprises assets with similar characteristics, but such impairment cannot be individually identified, a collective impairment assessment takes place using appropriate statistical techniques.
Common Equity Tier 1 (CET 1) capital	Common Equity Tier 1 capital comprises general reserves and 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	The risk that the Society's behaviour and decision making, at all levels, fails to deliver good customer outcomes
Contractual maturity	The date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.
Core Capital Deferred Shares (CCDS)	A form of Common Equity Tier 1 (CET 1) capital. The Society's Perpetual Capital Securities (PCS) convert into CCDS at the rate of one CCDS for every £67 PCS held if the end-point CET 1 ratio, calculated on either an individual or consolidated basis, falls below 7%.
Countercyclical Buffer (CCyB)	A buffer that can be varied over the financial cycle to match the resilience of the banking system to the scale of risk it faces. Individual banks' buffers will depend on the geographical composition of their exposures. Applies now but currently set at 0%, rising to 0.5% from 27 June 2018 and rising further to 1.00% from 28 November 2018.

Countercyclical Leverage Buffer (CCLB)	As a guiding principle, the Financial Policy Committee sets the CCLB rate at 35% of the risk weighted CCyB (ranges from 0% to 0.9%). This applies now but is currently set at 0%, rising to 0.175% from 27 June 2018 and then to 0.35% from 28 November 2018.
Covered bonds	Debt securities that are backed by both the resources of the issuer and a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual Principal risk categories.
Currency swap	An arrangement in which two parties exchange equivalent principal amounts of different currencies at inception and subsequently exchange interest payments on the principal amounts. At the maturity of the swap, the principal amounts are re-exchanged at the original rates, protecting the participants from changes in exchange rates.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	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 as a result of the carry-forward of tax losses or unused tax credits, or from deductible (or taxable) temporary differences between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit pension plan resulting from past employee service.
Defined benefit pension scheme	A pension or other post-retirement benefit plan offering guaranteed benefits, usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
Effective Interest Rate (EIR)	The rate of interest 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 regulation (for example, CRD IV) with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A Board approved framework which provides the context, guidance and principles needed for cohesive risk management activity across the Society and its subsidiaries.
European Banking Authority	An independent European Union authority which works to ensure effective and consistent 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.

Term	Definition
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every deposit taking firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Fitch	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
Foreign currency risk	The risk of loss arising as a result of movements in exchange rates on investments, obligations or derivatives in foreign currencies.
Free capital	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 historical and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Government investment securities (gilts)	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
Gross capital	The aggregate of reserves, other equity instruments, subscribed capital and subordinated liabilities.
IFRIC	The International Financial Reporting Interpretations Committee. IFRIC interprets the application of IAS and IFRS and provides timely guidance on financial reporting issues not specifically addressed in IAS and IFRS, in the context of the International Accounting Standards Board framework.
IFRS/IAS	International Financial Reporting Standards/International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are 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 Balance Sheet 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 assessment of impairment	Impairment is measured specifically for assets that are individually identified as being impaired at the Balance Sheet date.
Individual Capital Guidance (ICG)	The minimum amount of capital the Society should hold as set by the PRA under Pillar 1 and Pillar 2A and informed by the Internal Capital Adequacy Assessment Process (ICAAP).
Individual Liquidity Guidance (ILG)	Guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.
Interest rate risk	Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of differences between interest rates received and paid on mortgages, deposits and financial instruments.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.

Term	Definition
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment of the liquidity resources that are required to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on regulatory benchmarks and on Society-specific tests.
Internal Ratings Based 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. The Society's calculation reflects constraints on the inclusion of AT 1 capital under the FPC's UK leverage ratio framework.
LIBOR	London Inter-Bank Offer Rate. A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquid assets	An amount as defined by the Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including Government investment securities (gilts)), loans to credit institutions and other liquid assets.
Liquidity and funding risk	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Liquidity and Funding risks are principal risks of the Society.
Liquidity Coverage Ratio (LCR)	A measure brought in as part of CRD IV which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions. A binding minimum LCR of 80% applied to the Society from 1 October 2015, rising to 90% from 1 January 2017.
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	Market risk is defined as the risk of a reduction in Society earnings and/or value resulting from adverse movements in financial markets.
Medium-term notes	Securities offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.
Minimum Requirement for own funds and Eligible Liabilities (MREL)	A requirement under the Bank Recovery and Resolution Directive (BRRD) which requires deposit takers to hold minimum levels of capital plus debt eligible for bail-in.
Moody's	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of average total assets.
Net Stable Funding Ratio (NSFR)	A ratio which assesses the amount of stable funding in place as a proportion of the on and off-balance sheet funding requirements of an institution. A minimum requirement for the NSFR is due to be set by 1 January 2018.

Term	Definition
Open banking	The term used to describe activity mandated by the Competition and Markets Authority through the Retail Banking Market Investigation Order 2015. This requires the 9 largest UK banks and building societies to develop and use open standards to enable the sharing of customer payment account data. The term "open banking" is also used to refer to the elements of Payment Services Directive II (PSD2) that oblige financial institutions such as the Society, to provide authorised third party organisations with payment account transactional data, or the ability for them to initiate a payment, where the Member has requested this and provided consent.
Operational risk	Operational risk is the risk of loss arising from inadequate internal processes, systems or people, or from external events. Operational risk is a principal risk category.
Output floor	Basel 4 proposal that will prevent IRB risk-weightings falling below a certain level.
Overnight indexed swap (OIS) rate	A rate reflecting the overnight interest earned or paid in respect of overnight interbank loans, being typically SONIA for sterling loans. OIS is used to value collateralised interest rate derivatives.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Pension fund surplus	The assets in a pension fund that are in excess of its liabilities.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. Under Basel III, PIBS are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Pillar 1/2/2A/3	Components of the Basel capital framework. Pillar 1 covers the minimum requirement, Pillar 2 covers supervisory review and Pillar 3 covers disclosures.
PRA Buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
PRA Remuneration Code	The aim of the Financial Conduct Authority's (FCA) Remuneration Codes is to: ensure greater alignment between risk and individual reward, discourage excessive risk taking and short-termism, encourage more effective risk management and support positive behaviours and a strong and appropriate conduct culture within firms.
Principal risk	Principal risk is an inherent risk exposure that could materially compromise the Society's ability to grow and provide attractive products to savings and borrowing members.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
PV200	Present Value 200. A calculation of the theoretical change in the net present value of financial instruments for a 200 basis point (2%) parallel shift in yield curves.
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.
Residual maturity	The remaining period to the contractual maturity date of a financial asset or financial liability.
Retail deposits	See Shares.
Reverse stress test	Regulatory stress test that requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.
Ring fencing	The Financial Services Banking Reform Act 2012 required banks to separate or ring-fence their retail and commercial banking operations from their investment banking activities. Building societies do not fall within the scope of these ring-fencing requirements as they do not undertake investment banking activities.
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.

Term	Definition
Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a structured entity which then issues securities (RMBS) backed by the assets. The Group has used residential mortgages as the loan pool for securitisation purposes.
Self-certified mortgage	An owner-occupier mortgage where the lending decision has been based on the borrower's declaration of their income and the applicant has been suitably verified.
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.
Standardised approach	The basic method used to calculate capital requirements for credit and operational risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
Strategic risk	Strategic 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 a principal risk.
Stress testing	Testing undertaken to provide an understanding of the Society's resilience to internal and external shocks.
Structured entity	An entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.
Subordinated liabilities	A form of Tier 2 capital that is unsecured. Subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members (other than holders of Permanent Interest Bearing Shares and Perpetual Capital Securities) as to principal and interest. Under Basel III are included as Tier 2 under transitional rules only.
Subscribed capital	See Permanent Interest Bearing Shares.
Supplementary Leverage Ratio Buffer (SLRB)	Applied to systemically important banks and building societies. As a guiding principle, the FPC sets the buffer at 35% of the risk weighted Systemic Risk Buffers.
Systemic risk buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.
Term Funding Scheme (TFS)	The Term Funding Scheme (TFS) is a tool of the Monetary Policy Committee designed to reinforce the transmission of Bank of England Base Rate cuts to those interest rates actually faced by households and businesses by providing term funding to banks and building societies at rates close to Bank of England Base Rate.
Tier 1 capital	A component of regulatory capital comprising Common Equity Tier 1 and Additional Tier 1 capital.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances.
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with an intention to trade. The Society does not have a trading book.
UK Corporate Governance Code (the Code)	The code (formerly known as the Combined Code), issued by the Financial Reporting Council, that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.
UK Finance	A trade association that incorporates residential mortgage lending (formerly the Council of Mortgage Lenders – CML).
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 external counterparties that operate within the global financial markets (for example, insurance companies, pension funds, large businesses, financial institutions and sovereign entities.

Notes

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