PILLAR 3 DISCLOSURES

for the year ended 31 December 2020

COVENTRY Building Society

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

Summary of Key Metrics

This document presents the Pillar 3 disclosures of Coventry Building Society as at 31 December 2020. This report should be read in conjunction with the Coventry Building Society Annual Report & Accounts for the year ending 31 December 2020.

The Pillar 3 disclosure requirements apply to banks and building societies and require firms to publish key details regarding their capital and liquidity positions as well their risk management strategy.

The Pillar 3 disclosures provide information about risks and the risk management framework established to mitigate them as well as the regulatory key metrics of the Society.

The table below summaries the key metrics reported in this document.

Table 1: Key Metrics

	Transitional		End-point	
	2020 £m	2019 £m	**2020 £m**	2019 £m
Available own funds (amounts)				
Common Equity Tier 1 (CET 1) capital	**1,783.7**	1,691.0	**1,783.3**	1,691.0
Tier 1 capital	**2,230.7**	2,146.0	**2,198.3**	2,106.0
Total capital	**2,241.8**	2,162.6	**2,198.3**	2,106.0
Risk-weighted assets (amounts)				
Total risk-weighted assets	**5,410.9**	5,283.6	**5,410.6**	5,283.6
Risk- based capital ratios as a percentage of RWA				
Common Equity Tier 1 ratio (%)	**33.0%**	32.0%	**33.0%**	32.0%
Tier 1 ratio (%)	**41.2%**	40.6%	**40.6%**	33.9%
Total capital ratio (%)	**41.4%**	40.9%	**40.6%**	33.9%
Additional CET 1 buffer requirements as a percentage of RWA				
Capital conservation buffer (%)	**2.5%**	2.5%	**2.5%**	2.5%
Countercyclical capital buffer (%)	**0.0%**	1.0%	**0.0%**	1.0%
Total of CET 1 specific buffer requirements (%)	**2.5%**	3.5%	**2.5%**	3.5%
CET 1 available after meeting minimum capital requirements, but before buffer requirements (%)	**28.5%**	27.5%	**28.5%**	27.5%
UK Leverage ratio				
UK leverage ratio exposure measure	**46,480.0**	46,745.0	**46,480.0**	46,745.0
UK leverage ratio (%)[1]	**4.6%**	4.4%	**4.6%**	4.4%
CRR Leverage ratio				
CRR leverage ratio exposure measure	**51,688.2**	51,505.3	**51,688.2**	51,505.3
CRR leverage ratio (%)[2]	**4.3%**	4.1%	**4.3%**	4.1%
Liquidity coverage ratio				
Total HQLA[3]	**5,888.3**	5,562.0	**5,888.3**	5,562.0
Total net cash outflows[3]	**2,880.8**	2,641.0	**2,880.8**	2,641.0
Liquidity coverage ratio (%)[3]	**205.5%**	212.0%	**205.5%**	212.0%

1. During the period the Society has refined its calculation of this measure. Had this applied in 2019 the comparatives would be 4.6%.
2. During the period the Society has refined its calculation of this measure. Had this applied in 2019 the comparatives would be 4.2%.
3. The Liquidity Coverage data in the key metrics table is calculated on a 12-month average basis.

1. Overview

1.1 Background

This Pillar 3 document sets out disclosure requirements under the Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRD IV[1]). These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

The UK's membership of the EU came to an end on Friday 31 January 2020. The UK entered into a transition period lasting until 11pm on Thursday 31 December 2020, during which EU law continued to apply to the UK. The Pillar 3 disclosure aligns to the European and UK equivalent prevalent at that time in accordance with the Supervisory Statement 02/2019, and this will be expected to be further updated as the PRA guidance evolves.

CRD IV requires a concise risk statement approved by the management body which describes the institution's overall risk profile associated with its business strategy. The Society has a risk philosophy to be a below median risk building society. This is evidenced by its simple business model and prudent lending policy with a conservative balance weighted indexed loan to value of 52.8% (2019: 55.4%) and low levels of historic arrears. While arrears have been impacted by borrowers' ability to meet payments against the economic backdrop of Covid-19 and increased slightly in 2020, as at 31 December 2020 only 0.09% of mortgage balances were 2.5% or more in arrears (2019: 0.08%) compared to the latest available industry average of 0.69%[2]. The Society's Common Equity Tier 1 capital ratio was 33.0% at 31 December 2020 (2019: 32.0%), this is amongst the highest reported in the UK[3]. Additional information on the risks the Society is exposed to and how it manages these risks is included in this document and also within the Risk Management Report in the 2020 Annual Report & Accounts (Accounts) which is published on the Society's website (www.coventrybuildingsociety.co.uk).

1.2 Policy and frequency of disclosures

The CRR requires the Society to adopt a formal policy to comply with Pillar 3 disclosure requirements and the European Banking Authority has issued guidelines on materiality, proprietary and confidential information and on disclosure frequency. The Board has put in place such a policy and confirms that no disclosures have been omitted as either being proprietary or confidential. The only omissions on materiality grounds relate to those which would be disclosed under Article 447 'Exposures in equities not included in the trading book'. The fair value of these investments is £5.0 million (0.01% of the Society's total assets) and they are made up of shares in Visa Inc. and VocaLink Holdings Limited. Further information on these investments can be found in the Accounts.

Pillar 3 disclosures are published on an annual basis in accordance with regulatory guidelines. The Society closely monitors the regulatory environment to ensure continued compliance with upcoming changes including the on-going impact of Brexit.

1. On 28 December 2020 CRDV replaced CRD IV. However, some amendments to related UK regulation will only apply from 31 December 2021.
2. Source: Prudential Regulation Authority – latest available information at 30 September 2020.
3. Source: Common Equity Tier 1 ratio for the UK Finance 2019 top 20 mortgage lenders (balance outstanding) – latest published CET 1 data as at 30 March 2020.

1.3 Verification

These disclosures have been approved by the Board Audit Committee on behalf of the Board. These disclosures have not been, and are not required to be, subject to independent external audit, and do not constitute any part of the Society's financial statements.

1.4 Governance arrangements and remuneration

Disclosure requirements relating to governance arrangements under CRR Part Eight Article 435, and in particular the declaration approved by the Board of the adequacy of risk management arrangements, are included in the Directors' Report on Corporate Governance and Annual Business Statement within the 2020 Accounts published on the Society's website (www.coventrybuildingsociety.co.uk).

The disclosures required under CRR Part Eight Article 450 and the Prudential Regulation Authority's (PRA) Remuneration Code are included in the Directors' Remuneration Report within the 2020 Accounts.

1.5 Scope of disclosures

The Society is a UK parent institution that is regulated by the PRA and Financial Conduct Authority (FCA) and is not a Globally or Other Systemically Important Institution. The CRD IV framework applies to the Society and its subsidiary undertakings. Information on these subsidiaries is set out in note 16 to the 2020 Accounts. There are no differences between the basis of consolidation of the Group for accounting and CRD IV purposes in preparing the Pillar 3 disclosures.

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

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

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

1.6 New and amended IFRS in 2020 – Impact on regulatory capital

In the year ended 31 December 2020, the Society has early adopted Interest Rate Benchmark Reform phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16). Information on the impact of adoption of these amended accounting standards is in note 1 to the 2020 Accounts.

These changes did not have a material impact on the reserves of the Society and the impact on regulatory capital was negligible.

2. Risk management policies and objectives

2.1 Overview

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

2.2 The Society's Belief, Purpose, Values and Strategic Priorities

2.2.1 The Society's Belief

The Society believes in Putting Members First. The Society believes remaining an independent, customer owned mutual delivers the best outcomes for its savings and borrowing members and for wider society.

Putting Members First means considering the impact of its decisions and strategy on its current and future membership and has consistently led it to 'do the right thing' and outperform the markets in which it operates.

2.2.2 The Society's Purpose

Being purposeful recognises the business is made up of a network of relationships with multiple stakeholders. The Society needs to balance the interests of all stakeholders – giving them the power to be better off through life.

The Society's Purpose is at the core of all its decision making, and it aspires to live by it every day. Delivering on its purpose will empower its customers, colleagues and others to be better off through life and help to create a wider society that is fair, confident and resilient.

2.2.3 The Society's Values

The Society's CARES values have been updated in 2020 and they are to be **Caring**, **Ambitious**, **Responsible**, **Empowering** and **Straightforward** when dealing with each other, with members and customers and with other stakeholders as both a key driver of employee engagement and to sustain a strong culture.

2.2.4 The Society's Strategic Priorities

The Society's strategic priorities guide its activities and are aligned to performance measures and targets. They are:

- Having a Purpose led approach to business and the environment supporting sustainable growth and employment;
- Creating an inclusive and inspiring workplace which better reflects the diversity of its city and communities;
- Helping people to own homes and to save through simple mortgage and savings propositions that offer great long term value;
- Best in class customer service to allow its customers to feel confident they have chosen the right provider for their mortgage and savings;
- Digitising mortgages and savings, offering improved choice of products and improving the experience for customers and colleagues;
- Protecting members money, keeping it safe and accessible for its customers and their information secure through investment in resilient technology and infrastructure;
- Improved cost efficiency by spending its members' money wisely so that it can continue to offer great long term value, great service while investing for the future; and
- Sustainable capital, liquidity and profitability to be a responsible and resilient business supporting UK economic growth and employment and ensuring good outcomes for its customers. This responsibility extends to being open, honest and transparent in its dealings with its members, employees, partners, regulators and in reporting its performance.

More information on the Society's strategy, business model and values are in the Strategic Report in the 2020 Accounts.

2.3 Top and Emerging risks and Principal risks

As a building society, the Society is exposed to a number of risks both inherent within the market it operates in and top and emerging risks that could impact the Society's ability to achieve its strategic goals which vary over time. Information on these current risks and how they are mitigated is set out below.

Top and Emerging risks	Mitigation
Impact of Covid-19 Beyond the immediate consequences of the Covid-19 pandemic, government support to individuals through mortgage payment holidays makes the assessment of credit risk more uncertain. While payment holidays have brought a level of financial respite, certain features of the Scheme have obscured the full extent of the underlying credit risk.	The Society's simple, low risk, business model combined with its strong capital position means it remains resilient to both economic and credit downturns. The Society has undertaken extensive additional modelling of its credit exposures and performed additional analysis in order to make its assessment of future impairments and consequently its provisions.
Market environment The pandemic and post-Brexit trade friction could continue to increase pressure on the Society's financial position, with the potential to compress margins further. This includes the impact of persistently low or negative interest rates and new entrants to its core markets.	The Society's low cost operating model and strong capital position mean that it can operate effectively in a low margin environment while still returning value to its members and maintaining prudent capital ratios. Regular stress testing considers the impact of severe economic downturns and confirms that it expects to remain resilient to these factors.
Technology and innovation The Society continues to invest in significant levels of technology and business change and expects this to continue for a number of years. This activity increases operational risk and may result in requirements which are more costly or disruptive than expected.	The Society is building technology to increase flexibility and resilience. It has taken steps to enhance its change capability which improve its processes, capacity and governance around change programmes to mitigate the execution risks associated with change.
Changing customer behaviour Customer expectations and the increased use of technology are changing the way that savings and mortgage products are designed and delivered. The impact of social distancing measures could accelerate this trend further. There is a risk that the scale of change leaves the Society with insufficient capacity to develop new products and services in an increasingly digital world. Alternatively, change requirements could jeopardise the Society's low cost operating model.	The Society continues to focus on developing products and services to meet changing demands and engages with members to identify product and service enhancements that they need and value in order to do this. The Society's Strategic Plan balances short term change demands with longer term strategic investment requirements within its appetite for expenditure.
Operational resilience A major operational risk event could result in disruption to services leading to customer harm, financial or regulatory impacts or to reputational damage. Such events could include cyber attacks, loss of data or service outages.	The Society manages operational risk through its Enterprise Risk Management Framework and regularly tests its response to risk events. The Society models its important business services, analysing them and developing scenarios which it will use to assess, and enhance the resilience of each service, so that they do not fail when it has a major operational risk event.
Regulatory environment The regulatory environment continues to evolve, with increased focus in 2020 on responding to the challenges of the Covid-19 pandemic. There is a risk that the scope and complexity of regulatory changes could increase costs and funding requirements.	The Society closely monitors the regulatory environment to understand and model the impact of upcoming changes.

Climate change	
In recent years there has been increased focus and understanding of the impact of climate change. This could lead to increased credit risk if properties are impacted by flooding or other weather events or strategic risk as the economy transitions towards low carbon activities.	The Society's Strategic Plan outlines greater focus on social responsibility and contribution to society including addressing the impact of climate change.

As a UK building society there are a number of principal risks that the Society is inherently exposed to. These risk categories are summarised below, in addition to information on how the Society mitigates and manages them.

Principal risks	Mitigation
Credit risk The risk that borrowers or counterparties do not meet their financial obligations.	The Society operates robust underwriting and affordability assessments which, together with appropriate credit policies, results in the Society lending responsibly and remaining low risk.
Market risk The risk of a reduction in Society earnings and/or value as a result of financial market movements.	The Society operates within Board approved limits and uses interest rate swap agreements to mitigate the impact of changes in interest rates.
Liquidity and Funding risk The risk that the Society has insufficient funds to meet its obligations falling due or the inability to access funding at reasonable cost or risk.	The Society holds sufficient liquidity to withstand a severe but plausible stress and operate within limits set by the Board. It maintains a diversified funding base to avoid any overreliance on any funding source, type or term.
Conduct risk The risk that the Society's activities fail to deliver good customer outcomes.	The Society places good customer outcomes at the heart of its decision making. In line with Putting Members First, this reduces conduct risk. This ethos is embedded in product design, services, and people and communication strategies.
Operational risk The risk of loss arising from inadequate internal processes, people and systems, or from external events. This includes both legal and regulatory risk.	The Society actively identifies, assess and manages the operational risks to which the Society is exposed. During 2020 it has adapted and enhanced its operational risk management framework to enable the Society to react effectively to the demands of Covid-19. It has built in business continuity capability to ensure operational resilience. It closely monitors the regulatory environment to understand and model the impact of upcoming regulatory change.
Model risk The risk of an ineffective or incorrectly interpreted model leads to a loss, reputational damage or regulatory censure.	The Society operates robust model governance protocols including sensitivity analysis on key assumptions, independent model validation and regular model monitoring. It is enhancing its approach to data governance.
Strategic risk The risk that the business model or strategy becomes inappropriate given changes to macroeconomic, geopolitical, regulatory (including climate change) or other factors (including changing customer behaviour and expectations in an increasingly digital world).	The Society has a simple business model which focuses on well understood opportunities. It has a robust strategic planning process which includes capital and liquidity stress testing. The strategic planning assumptions are regularly reviewed to ensure these continue to focus on risks which could become threats to the business model over the medium to long term. The Society continues to focus on developing products and services to meet changing demands and engages with members to identify product and service enhancements that they need and value in order to do this.

The Society also has a level of pension obligation risk (i.e. the risk that, as the sponsor of the Society's pension scheme, the Society is exposed to adverse movements in the actuarial valuation of the fund) in relation to the now closed defined benefit pension scheme. The Society continues to monitor the pension scheme to ensure that there is no scheme deficit over the medium term and details on the Society's management of pension obligation risk are provided in note 19 to the Accounts.

Disclosures relating to market, conduct, and strategic risks (including climate change) are included in the Risk Management Report in the 2020 Accounts and are not duplicated in this document. Disclosures for liquidity and funding, operational and model risk are included within this document with additional information included in the Accounts. The required Pillar 3 asset encumbrance disclosures are included in Appendix 3 and Pillar 3 Liquidity Coverage Ratio (LCR) disclosures in Appendix 7. This document does, however, include additional credit risk information to that in the 2020 Accounts given that credit risk is the principal driver of the Society's Pillar 1 capital requirement. In order to provide the reader with a comprehensive overview of credit risk, the 2020 Accounts disclosures on credit risk are also included in this document.

2.4 Controlling and managing risk - overview

The Society's Enterprise Risk Management Framework (ERMF) sets out the Society's approach to managing and overseeing risk by: defining risk strategy; risk appetite; governance and control; and risk management in light of the Society's strategy. The ERMF is approved annually by the Board and the Society will continue to enhance the ERMF, as required, to ensure it identifies and manages risk within its low risk tolerance.

The ERMF has continued to operate effectively during 2020.

2.5 Risk strategy

The Board sets the Society's risk strategy and risk management approach. The strategy includes establishing a robust risk culture, setting the Board's risk appetite and ensuring the 'three lines of defence' model operates effectively, in order to meet the Society's risk philosophy of being a below median risk building society.

Risk culture

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

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

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

The Society undertook a risk culture review during 2020 with the results reported to the Board Risk Committee. The review concluded there is a strong risk culture embedded across the Society.

Board risk appetite

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

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

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

Three lines of defence
The Society uses the ‘three lines of defence’ model which is recognised as an industry standard for risk management.

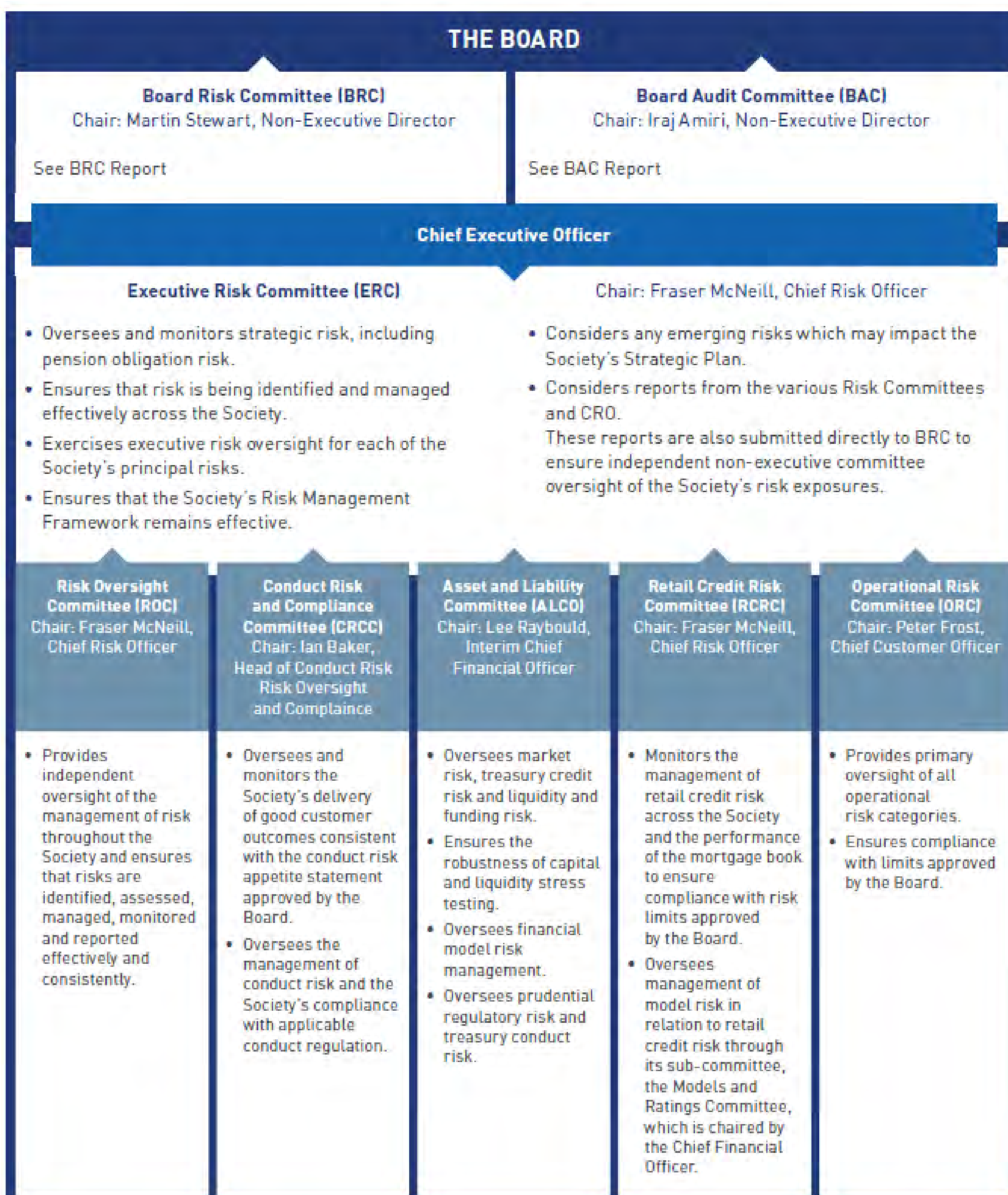
The key accountabilities of the three lines of defence within the Society are illustrated below.

2.6 Governance and control

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

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

Further information on the BRC and BAC is included in the Board Risk Committee Report and in the Board Audit Committee Report respectively in the Accounts.



2.7 Risk management

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

These processes deliver risk management objectives to:

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

Stress testing and planning

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

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

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

More detail on the Internal Liquidity Adequacy Assessment Process (ILAAP) together with reverse stress testing and the Society's Recovery Plan is set out in the Liquidity and funding risk section of this document (section 6).

3. Capital resources

3.1 Total available capital and compliance with capital requirements

As at 31 December 2020 and throughout the financial year, the Society complied with the capital requirements in force.

As explained in Section 1, the capital information in this section is set out on a Group basis only and the term 'Society' is used as a reference for the Group.

The Society uses the Internal Ratings Based (IRB) approach for most of its retail credit risk and capital management, following approval from the PRA in 2008. For all other lending exposures and for operational risk the Society follows the standardised approach. The standardised approach uses capital risk weighting percentages set by CRD IV[1] to calculate capital requirements.

IRB models are used to calculate capital requirements for prime owner-occupier and buy to let mortgage exposures which account for around 99% of lending exposures throughout 2020 (2019: 99%). The remaining retail credit risk exposures on legacy closed products are modelled using the standardised approach.

The Society implemented new IRB models in 2020 after receiving approval from the PRA to do so. The new models reflect current applicable guidance and embed hybrid PD modelling philosophy required by the PRA alongside a new definition of default that meets the latest guidance. Further updates of the IRB models will be required for the latest EBA roadmap guidance on LGD and quantifying Margins of Conservatism.

Use of the new models accounts for a 3.1% increase in risk weighted assets during the year and therefore a fall in the CET 1 ratio of 1.06%. This is because the new models assess the mortgage book across a wider distribution of risk grades and they are more sensitive to changes in variables such as house price inflation. The overall impact of the new models is relatively modest because the Society's previous models already assessed risks 'through the cycle' rather than solely on a 'point in time' basis.

Table 2 shows the composition of capital resources for the Society as at 31 December 2020 on a CRD IV basis on both a transitional and end-point basis (i.e. assuming all CRD IV requirements were in force with no transitional provisions permitted).

Transitional provisions apply to the Society's Common Equity Tier 1 (CET 1) capital and CET 1 ratio with a difference between the end-point and transitional disclosures for CET 1 of £0.4 million as at 31 December 2020 (2019: £nil) as a result of amendments to the CRR in response to Covid-19, with the transitional period ending 31 December 2024. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital ratios) include instruments that are grandfathered and are therefore disclosed on both a transitional and end-point basis with the transition period ending on 31 December 2021.

1. On 28 December 2020 CRDV replaced CRD IV. However, some amendments to related UK regulation will only apply from 31 December 2021.

Table 2: CRD IV – transitional and end-point analysis

	Notes	Transitional 2020 £m	Transitional 2019 £m	End-point 2020 £m	End-point 2019 £m
Common Equity Tier 1 (CET 1)					
General reserve		**1,835.1**	1,773.3	**1,835.1**	1,773.3
Fair value through other comprehensive income reserve		**2.3**	3.7	**2.3**	3.7
Cash flow hedge reserve		**(46.3)**	10.8	**(46.3)**	10.8
Common Equity Tier 1 prior to regulatory adjustments		**1,791.1**	1,787.8	**1,791.1**	1,787.8
Common Equity Tier 1 regulatory adjustments					
Prudent additional valuation adjustment	1	**(1.0)**	(1.3)	**(1.0)**	(1.3)
Intangible assets	2	**(31.0)**	(30.4)	**(31.0)**	(30.4)
Cash flow hedge reserve	2	**46.3**	(10.8)	**46.3**	(10.8)
Excess of expected loss over impairment	3	**(4.0)**	(24.5)	**(4.0)**	(24.5)
Pension fund surplus adjustment	2	**(7.7)**	(19.2)	**(7.7)**	(19.2)
Foreseeable distributions	4	**(10.4)**	(10.6)	**(10.4)**	(10.6)
IFRS 9 transitional arrangements	5	**0.4**	–	**–**	–
Common Equity Tier 1 capital		**1,783.7**	1,691.0	**1,783.3**	1,691.0
Additional Tier 1 capital (AT 1)					
Permanent Interest Bearing Shares (PIBS)		**32.0**	40.0	**–**	–
Additional Tier 1 - Perpetual Capital Securities (PCS)		**415.0**	415.0	**415.0**	415.0
Total Additional Tier 1 capital		**447.0**	455.0	**415.0**	415.0
Total Tier 1 capital		**2,230.7**	2,146.0	**2,198.3**	2,106.0
Tier 2					
Subordinated debt		**11.1**	16.6	**–**	–
Total Tier 2 capital		**11.1**	16.6	**–**	–
Total capital		**2,241.8**	2,162.6	**2,198.3**	2,106.0
Risk weighted assets					
IRB approach					
Credit risk - retail exposures		**4,375.7**	4,213.9	**4,375.7**	4,213.9
Standardised approach					
Credit risk - retail exposures		**138.4**	146.5	**138.1**	146.5
Credit risk - liquidity book		**141.9**	153.8	**141.9**	153.8
Credit risk - other		**102.0**	98.1	**102.0**	98.1
Credit valuation adjustment risk		**47.5**	60.8	**47.5**	60.8
Operational risk		**605.4**	610.5	**605.4**	610.5
Total risk weighted assets		**5,410.9**	5,283.6	**5,410.6**	5,283.6
Capital ratios (as a percentage of risk weighted assets)	6				
Common Equity Tier 1		**33.0%**	32.0%	**33.0%**	32.0%
Total Tier 1		**41.2%**	40.6%	**40.6%**	39.9%
Total capital		**41.4%**	40.9%	**40.6%**	39.9%

Notes
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 (Perpetual Capital Securities) are deducted, net of tax.
5. Following the implementation of IFRS 9, any increase in impairment provisions may be added back to CET 1 on a reducing basis, over five years. Currently 100% of the increase in provisions is added back to CET 1 as a result of measures bought in as a result of Covid-19.
6. CRD IV sets a minimum for Tier 1 capital of 6% of risk weighted assets (RWAs) of which CET 1 is required to be a minimum of 4.5% of RWAs. The total of Tier 1 and Tier 2 capital must be a minimum of 8% RWAs.

Appendix 1 sets out this information in the template format published by the EBA in 'Implementing Technical Standard (ITS) 2013/01'. CET 1 capital, Tier 1 capital and total capital have increased primarily as a result of addition to capital resources for the year of £92.3 million. Total risk weighted assets have increased by 2.4% reflecting growth in the mortgage book of 3% and a modest decrease in LTV of the mortgage book. As a result, the CET 1 ratio has increased to 33.0 % (2019: 32.0%).

The Individual Consolidated CET 1 ratio on an end-point basis at 31 December 2020 was 0.7% (2019: 0.8%) higher than the Group ratio due to assets held by entities that sit outside of the Individual Consolidation.

Table 3 shows the movement in capital during 2020. CET 1 capital is the same on an end-point and transitional basis. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital) are disclosed on a transitional basis.

Table 3: Regulatory capital flow statement

	Transitional £m
Common Equity Tier 1 capital at 1 January 2020	1,691.0
Retained profit for the year	101.4
Other changes to General reserves	(39.6)
Change in foreseeable distributions	0.2
Change in prudent valuation adjustments	0.3
Change in intangible assets	(0.6)
Change in Fair value through other comprehensive income reserve	(1.4)
Change in expected loss over impairment	20.5
Change in pension fund surplus adjustment	11.5
Change in IFRS 9 transitional arrangements	0.4
Common Equity Tier 1 capital at 31 December 2020	**1,783.7**
Additional Tier 1 capital at 1 January 2020	455.0
Repurchase / Issuance of AT 1 capital	–
Amortisation of PIBS	(8.0)
Additional Tier 1 capital at 31 December 2020	**447.0**
Total Tier 1 capital at 31 December 2020	**2,230.7**
Tier 2 capital at 1 January 2020	16.6
Amortisation of subordinated debt	(5.5)
Tier 2 capital at 31 December 2020	**11.1**
Total regulatory capital at 31 December 2020	**2,241.8**

3.2 Tier 1 capital

Tier 1 capital comprises:

- General reserve;
- Fair value through other comprehensive income reserve;
- AT 1 capital – Perpetual Capital Securities (PCS);
- AT 1 capital – Permanent Interest Bearing Shares (PIBS) on a transitional basis only; and
- Adjustments as set out by the regulatory requirements governing capital resources – see Table 2.

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

In April 2019, the Society issued £415.0 million of PCS capital. These PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum with an optional redemption in September 2024. The PCS are convertible into Core Capital Deferred Shares (the equivalent of common shares for a building society) if the Society's CET 1 capital ratio should fall below 7%. The combined cost of the tender and new issuance fees has been recognised within the Society's General reserves.

More information on the key features of these securities is included in Appendix 2.

3.3 Tier 2 capital

Tier 2 capital comprises Subordinated debt (transitional basis only).

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

Appendix 2 shows the key features of the Society's Tier 1 and Tier 2 capital instruments and more information can be found in notes 25, 26 and 27 to the 2020 Accounts.

3.4 Leverage ratio

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 is likely to be subject to the leverage ratio regime following the leverage review being undertaken by the FPC in 2021. The Society's focus on low risk assets means that the leverage requirement will be more onerous and likely become the binding capital requirement on the Society.

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

There are two additional buffers. These are a Supplementary Leverage Ratio Buffer (SLRB), which does not impact the Society, and a macro-prudential Countercyclical Leverage Buffer (CCLB). The levels of these buffers are set at 35% of the corresponding CET 1 buffers – see section 4.4.

The CCLB decreased to 0% in March 2020 in line with the CCyB, reducing the minimum UK Leverage requirement from 3.65% to 3.25% as a response to the Covid-19 pandemic. The Society's Strategic Plan ensures that it will continue to meet both UK and CRR leverage requirements on an ongoing basis.

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

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

Both the UK and CRR leverage ratios increased slightly to 4.6% and 4.3% respectively (2019: 4.4% and 4.1% respectively) as the increase in eligible Tier 1 capital was ahead of the increase in leverage ratio exposures. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Table 4: Leverage ratio

	Notes	**End-point 2020 £m**	End-point 2019 £m
Total Tier 1 capital – used in CRR calculation		**2,198.3**	2,106.0
Adjustment for AT 1 restriction		**(37.3)**	(35.2)
Total Tier 1 capital – used in UK calculation		**2,161.0**	2,070.8
Leverage ratio exposures			
Total balance sheet assets		**51,498.3**	49,530.8
Mortgage pipeline	1	**500.8**	328.3
Other committed facilities (undrawn lending)	1	**14.9**	17.1
Repurchase agreements	2	**76.1**	1,817.5
Netted derivative adjustments	3	**27.8**	51.6
Other adjustments	4	**(429.7)**	(240.0)
Total leverage ratio exposures – used in CRR calculation		**51,688.2**	51,505.3
Adjustment to exclude central bank reserves		**(5,208.2)**	(4,760.3)
Total leverage ratio exposures – used in UK calculation		**46,480.0**	46,745.0
CRR leverage ratio	5,6	**4.3%**	4.1%
UK leverage ratio	7	**4.6%**	4.4%

Notes
1. Mortgage pipeline are assessed at 20% and other commitments at 50% (2019: 20% and 50% respectively) as per the delegated regulation amending CRD IV.
2. Repurchase agreements represent the extent to which collateral provided on repurchase agreements exceeds the amount borrowed.
3. The netted derivative adjustment figure converts the accounting value of derivatives to an exposure measure.
4. Other adjustments predominantly relate to asset balances that have already been included in the capital calculation and these are therefore removed from the total Balance Sheet assets figure.
5. The CRR leverage ratio is calculated in accordance with the definition of CRD IV as amended by the European Commission delegated regulations.
6. During the period the Society has refined its calculation of this measure. Had this applied in 2019 the comparative would 31 December 2019 4.2%.
7. During the period the Society has refined its calculation of this measure. Had this applied in 2019 the comparative would 31 December 2019 4.6%.

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

4. Capital requirements

4.1 Pillar 1

4.1.1 Introduction

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

The Society manages its capital structure to ensure it continues to hold sufficient capital to meet its business objectives, regulatory requirements and the expectations of other key stakeholders.

The Society employs a number of tools to support the management of capital. The Board is responsible for setting risk appetite with respect to capital and defines minimum levels of capital, primarily by reference to capital ratios, leverage ratios and surplus over regulatory capital requirements. These minimum levels are translated into specific risk metrics which are monitored by the Board Risk Committee, Executive Risk Committee and the Asset and Liability Committee. Day to day capital management is delegated to the Chief Financial Officer and Treasurer and overseen by the Risk Function, ALCO, BRC and ultimately the Board.

The Society assesses its capital position and risks through an annual Internal Capital Adequacy Assessment Process (ICAAP). The ICAAP considers the key capital risks and the amount of capital the Society should retain to cover these risks. These requirements are assessed against the current position and throughout the five year Strategic Plan. Regular stress testing is undertaken to enhance the understanding of any potential vulnerabilities to stressed market conditions or tail-risks and management actions that could be deployed to manage these. The ICAAP and stress testing are considered further in section 4.2 below.

4.1.2 Minimum capital requirement – Pillar 1

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

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

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

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

Table 5: Minimum capital requirement – Pillar 1

	RWA		Minimum capital requirements	
	2020 £m	2019 £m	**2020 £m**	2019 £m
Credit risk (excluding counterparty credit risk (CCR))	**4,722.9**	4,550.2	**377.8**	364.0
Of which standardised approach	**347.2**	336.3	**27.7**	26.9
Of which the advanced IRB approach	**4,375.7**	4,213.9	**350.1**	337.1
Counterparty credit risk (CCR)	**69.4**	114.2	**5.6**	9.1
Of which mark to market	**2.5**	35.9	**0.2**	2.9
Of which the standardised approach	**19.4**	17.5	**1.6**	1.4
Of which credit valuation adjustment	**47.5**	60.8	**3.8**	4.8
Securitisation exposures	**3.3**	2.8	**0.3**	0.2
Of which standardised approach (SA)	**3.3**	2.8	**0.3**	0.2
Operational risk	**605.4**	610.5	**48.4**	48.9
Of which standardised approach	**605.4**	610.5	**48.4**	48.9
Amounts below the threshold for deduction (subject to 250%) risk weight	**9.9**	5.9	**0.8**	0.5
Total	**5,410.9**	5,283.6	**432.9**	422.7

4.1.3 Minimum capital requirement – credit risk

The following table shows the composition of the minimum capital required for credit risk (excluding credit valuation adjustment included in counterparty credit risk in Table 5) at 31 December 2020.

Table 6: Minimum capital requirement for credit risk

	Notes	**2020 £m**	2019 £m
Internal Ratings Based (IRB)			
Retail mortgages (prime secured against residential property)		**350.1**	337.1
Standardised exposure classes			
Mortgages and loans		**11.1**	11.7
Of which:			
Retail mortgages secured against residential property		**9.5**	9.9
Corporates (commercial lending)		**0.1**	0.1
Other retail (unsecured loans)		**1.0**	1.2
Past due		**0.5**	0.5
Treasury		**11.3**	12.3
Of which:			
Institutions	1	**11.1**	12.1
Securitisation positions		**0.2**	0.2
Other		**8.2**	7.9
Of which:			
Non-credit obligation assets (fixed assets and other)		**7.4**	7.4
Amounts below the threshold for deduction		**0.8**	0.5
Total minimum capital requirement Standardised		**30.6**	31.9
Total minimum capital requirement IRB and Standardised		**380.7**	369.0

Notes:
1. Other institutions includes minimum capital requirement of £1.5 million (2019: £1.9 million) for covered bonds, £0.2 million for central clearing counterparties (2019: £0.1 million) and £0.4 million (2019: £0.3 million) for equity.

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

The following table shows the movement in credit risk RWAs (excluding credit valuation adjustment) over 2020.The opening position has been adjusted to reflect Society's newly implemented IRB models in 2020 after receiving approval from the PRA to do so. The new models reflect current applicable guidance, which has changed since the previous models were developed.

Table 7: Risk Weighted Assets (RWA) flow statement

	IRB mortgages		Standardised mortgages and loans		Treasury		Other		Total	
	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m	RWA amount £m	Capital r'ment £m
RWAs at 31 December 2019	4,213.9	337.1	146.5	11.7	153.8	12.3	98.1	7.9	4,612.3	369.0
Impact of new IRB models	634.0	50.7	–	–	–	–	–	–	634.0	50.7
RWAs at 1 January 2020	4,847.9	387.8	146.5	11.7	153.8	12.3	98.1	7.9	5,246.3	419.7
Book size increase/(decrease)	469.6	37.6	(10.4)	(0.8)	(2.8)	(0.2)	3.9	0.3	460.3	36.9
Book quality (improvement)/ deterioration	(941.8)	(75.3)	2.3	0.2	(9.1)	(0.8)	–	–	(948.6)	(75.9)
RWAs at 31 December 2020	**4,375.7**	**350.1**	**138.4**	**11.1**	**141.9**	**11.3**	**102.0**	**8.2**	**4,758.0**	**380.7**

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

The majority of the treasury book is made up of exposures to central banks and sovereigns, which are zero risk weighted. The book quality improvement relates to movement in exposures to financial institutions subject to lower risk weightings and lower exposure to currency swaps.

4.2 Pillar 2

4.2.1 Introduction

The Pillar 2 capital requirement reflects the Society's ICAAP assessment and any capital add-ons from the supervisory review of those assessments. The Pillar 2 requirement is divided into capital held against risks not captured or not fully captured by Pillar 1 (Pillar 2A – see section 4.3) and risks to which a firm may become exposed under a severe but plausible stress (Pillar 2B).

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

The Board determines the level of capital required to support the Society's business objectives by undertaking an annual ICAAP in line with the PRA requirements. The ICAAP considers the key capital risks and the amount of capital the Society should retain to cover these risks. These requirements are assessed against the current position and throughout the five year Strategic Plan. The ICAAP includes consideration of Pillar 1 and Pillar 2 requirements.

The calculation of the Pillar 2 requirement examines the Society's business plans in detail, subjecting them to economic and operational stresses over a five year planning horizon. This stress testing is a major part of the ICAAP, it assesses whether capital requirements would be met under severe but plausible stress scenarios specified by the regulator and considers what management actions are available to mitigate the impacts of a stress. In 2020, these stresses incorporated the impact of the Covid-19 pandemic and included a high, low and negative Bank of England Base Rate scenario. In addition, the stress tests incorporate further negative trading assumptions to simulate a comprehensive stress on the Society's business model.

The ICAAP also incorporates alternative, more targeted, stress scenarios as part of the overall assessment of capital adequacy risks. Reverse stress testing is also performed to identify very extreme events that have the capacity to 'break' the Society to identify risks and control mechanisms which might otherwise be missed.

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

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

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

4.3 Pillar 2A

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

The Society is currently only formally bound by its Total Capital Requirement (TCR) which is set by the PRA. The TCR was last set in 2020 and equates to 10.6% of risk weighted assets or £573.5 million based on year end RWAs (2019: 11.2%, £590.2 million respectively) this includes Pillar 2A fixed requirement of £141.0 million. The Society comfortably meets this requirement out of its CET 1 capital resources. However, in anticipation of them becoming binding, the Society monitors and seeks to maintain capital sufficient to meet both the non-risk based leverage ratio (both under CRR and UK leverage definitions) and standardised risk weighted floors that are part of the Basel IV reforms package.

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

1. Source: Common Equity Tier 1 ratio for the UK Finance 2019 top 20 mortgage lenders (balance outstanding) – latest published CET 1 data as at 30 March 2020.

4.4 Regulatory capital buffers

CRD IV requires lenders, to hold supplementary capital buffers. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB). At 31 December 2020 the CCoB was set at 2.5 % and the CCyB was 0% (having decreased to 0% from March 2020 following measures announced by the Bank of England in response to Covid-19). The SRB, which came into force from 1 January 2019, does not impact the Society as it has total assets of less than £175 billion.

Appendix 5 discloses information relevant for the calculation of the CCyB as at 31 December 2020 in accordance with Regulation (EU) 2015/1555.

4.5 Minimum Requirement for Own Funds and Eligible Liabilities (MREL)

Minimum Requirement for own funds and Eligible Liabilities (MREL) requirements are being introduced by regulators to ensure that taxpayers no longer absorb losses when a bank or building society fails. MREL requirements are set to reflect how complex or important to the wider economy an institution is.

The Society has met an MREL requirement of 18% of RWAs. From 1 January 2023 this will increase to twice the binding capital requirement (or two times Pillar 1 plus Pillar 2a), currently this equates to 21.2% of RWAs. The calibration of end-state MREL requirements is currently the subject of a Bank of England Discussion Paper to which the Society has contributed. A consultation on the MREL calibration is anticipated to follow concluding, alongside the Bank of England's review of Leverage, by the end of 2021.

On a TCR based approach, the Society anticipates its MREL requirements will increase following changes proposed in CP14/20 and also with the introduction of the Basel IV floors. If leverage becomes a binding constraint this will substantially increase the level of MREL required and the Society will need to issue MREL eligible debt. The Society's financial plan provides for these outcomes.

4.6 Future regulatory developments

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

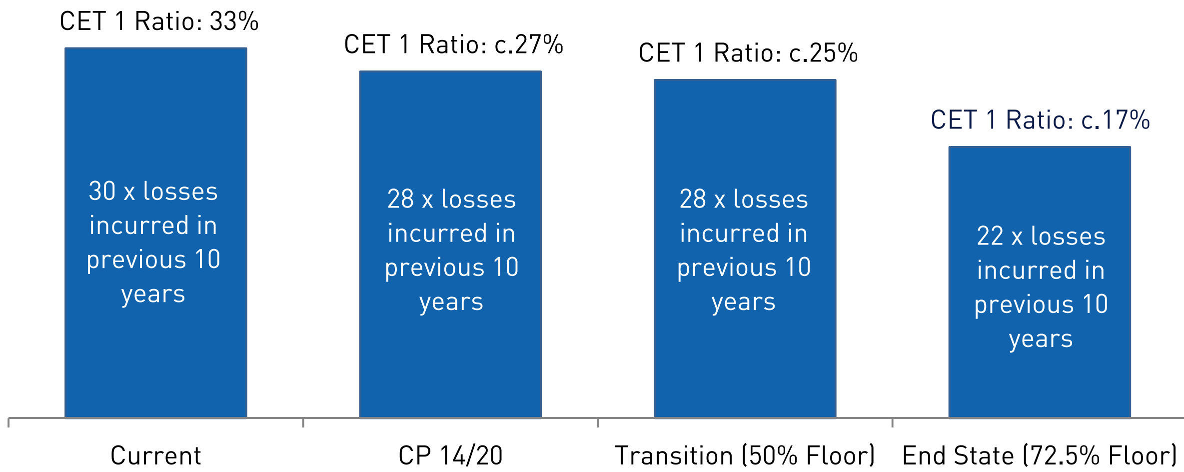
The PRA published Consultation Paper 14/20 in September 2020, which proposed introducing risk weight floors of 7% for each individual IRB mortgage exposure and 10% for the average risk weight of all IRB mortgage exposures. Additionally, the Basel Committee published their final reforms to the Basel III framework in December 2017. The amendments include changes to the standardised approaches for credit and operational risks and the introduction of a new RWA output floor. The rules are subject to a transitional period from 2023 to 2028. The Bank of England has published CP5/21 which looks to implement Basel III standards through a new PRA Capital Requirements Regulation (CRR) rule incorporating a significant number of changes to the PRA's rulebook and reporting templates.

These reforms represent a re-calibration of regulatory requirements with no underlying change in the capital resources the Society holds or the risk profile of its assets. The final impacts are subject to uncertainty for future balance sheet size and mix, and because the final detail of some elements of the regulatory changes remain at the PRA's discretion.

The Society currently expects that introduction of these RWA floors and IRB calibration changes will result in a significant reduction of its capital ratios as compared to its reported ratios as at 31 December 2020. On an indicative basis and for illustrative purposes only, the Society anticipates that if these amendments (as the Society understands them) had been applied as at 31 December 2020 (i) with the CP14/20 risk weight floors, its reported CET 1 ratio as at that date would have reduced to approximately 27% (ii) with the initial Basel IV transitional 50% floor, its reported CET 1 ratio as at that date would have reduced to approximately 25%; or (iii) on an end-point basis (i.e. ignoring the transitional provisions through to 2028), its reported CET 1 ratio as at that date would have reduced to approximately 17%. On such end-state basis, the Society's surplus over the revised CET 1 ratio would have remained over 22 times the aggregate credit losses incurred in the last ten years (or, if applying the initial

transitional floor of 50%, would have remained over 28 times the aggregate credit losses incurred in the last ten years).

Indication of Surplus over Regulatory Requirements



5. Credit risk

5.1 Overview

5.1.1 Credit risk overview and exposures

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

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

5.1.2 Credit risk exposures

The exposures presented below relate to on balance sheet exposures only. Exposures are presented net of impairment provisions. The limited number of classes disclosed illustrates the Society's very simple business model. All retail credit risk exposures are in the United Kingdom. A distribution of this lending by region is provided in Table 14.

Table 8: Credit risk exposure

	Notes	**Average during 2020 £m**	**As at 31 December 2020 £m**	Average during 2019 £m	As at 31 December 2019 £m
Residential mortgages	1	**42,764.5**	**43,393.3**	40,645.6	42,135.7
Unsecured and other lending	1	**19.5**	**17.7**	23.0	21.3
Total retail credit risk exposures		**42,784.0**	**43,411.0**	40,668.6	42,157.0
Treasury:					
Central banks and sovereigns	1,2	**5,857.7**	**5,979.2**	5,811.0	5,736.1
Multilateral development banks (supranational bonds)	2	**166.5**	**167.5**	120.3	165.5
Financial institutions	1,2	**1,037.6**	**1,142.4**	682.7	932.8
Residential Mortgage Backed Securities (RMBS)	1,2	**22.8**	**25.4**	14.3	20.3
Total treasury credit risk exposures		**7,084.6**	**7,314.5**	6,628.3	6,854.7
Total credit risk exposures		**49,868.6**	**50,725.5**	47,296.9	49,011.7

Table 9a: Geographical distribution of credit risk 2020

As at 31 December 2020	Notes	**United Kingdom £m**	**Rest of Europe £m**	**Rest of the World £m**	**Total £m**
Residential mortgages	1	**43,393.3**	**–**	**–**	**43,393.3**
Unsecured and other lending	1	**17.7**	**–**	**–**	**17.7**
Total retail credit risk exposures		**43,411.0**	**–**	**–**	**43,411.0**
Treasury:					
Central banks and sovereigns	1,2	**5,979.2**	**–**	**–**	**5,979.2**
Multilateral development banks (supranational bonds)	2	**–**	**117.4**	**50.1**	**167.5**
Financial institutions	1,2	**1,024.0**	**108.5**	**9.9**	**1,142.4**
Residential Mortgage Backed Securities (RMBS)	1	**25.4**	**–**	**–**	**25.4**
Total treasury credit risk exposures		**7,028.6**	**225.9**	**60.0**	**7,314.5**
Total credit risk exposures		**50,439.6**	**225.9**	**60.0**	**50,725.5**

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

Table 9b: Geographical distribution of credit risk 2019

As at 31 December 2019	Notes	United Kingdom £m	Rest of Europe £m	Rest of the World £m	Total £m
Residential mortgages	1	42,135.7	–	–	42,135.7
Unsecured and other lending	1	21.3	–	–	21.3
Total retail credit risk exposures		42,157.0	–	–	42,157.0
Treasury:					
Central banks and sovereigns	1,2	5,736.1	–	–	5,736.1
Multilateral development banks (supranational bonds)	2	–	115.4	50.1	165.5
Financial institutions	1,2	839.1	90.2	3.5	932.8
Residential Mortgage Backed Securities (RMBS)	1	20.3	–	–	20.3
Total treasury credit risk exposures		6,595.5	205.6	53.6	6,854.7
Total credit risk exposures		48,752.5	205.6	53.6	49,011.7

The maturity of exposures is shown on a contractual basis:

Table 10a: Residual maturity of credit risk 2020

As at 31 December 2020	**Notes**	**Up to 12 months £m**	**1-5 years £m**	**5-10 years £m**	**More than 10 years £m**	**Total £m**
Residential mortgages	1	**3,167.8**	**11,124.2**	**11,406.8**	**17,694.5**	**43,393.3**
Unsecured and other lending	1	**2.0**	**5.3**	**5.7**	**4.7**	**17.7**
Total retail credit risk exposures		**3,169.8**	**11,129.5**	**11,412.5**	**17,699.2**	**43,411.0**
Treasury:						
Central banks and sovereigns	1,2	**5,510.3**	**50.2**	**368.9**	**49.8**	**5,979.2**
Multilateral development banks (supranational bonds)	2	**25.3**	**142.2**	**–**	**–**	**167.5**
Financial institutions	1,2	**1,015.5**	**123.8**	**3.1**	**–**	**1,142.4**
Residential Mortgage Backed Securities (RMBS)	1	**–**	**18.2**	**–**	**7.2**	**25.4**
Total treasury risk credit exposures		**6,551.1**	**334.4**	**372.0**	**57.0**	**7,314.5**
Total credit risk exposures		**9,720.9**	**11,463.9**	**11,784.5**	**17,756.2**	**50,725.5**

Table 10b: Residual maturity of credit risk 2019

As at 31 December 2019	Notes	Up to 12 months £m	1-5 years £m	5-10 years £m	More than 10 years £m	Total £m
Residential mortgages	1	3,032.6	10,724.0	11,071.3	17,307.8	42,135.7
Unsecured and other lending	1	1.9	6.1	6.7	6.6	21.3
Total retail credit risk exposures		3,034.5	10,730.1	11,078.0	17,314.4	42,157.0
Treasury:						
Central banks and sovereigns	1,2	5,421.7	50.8	263.6	–	5,736.1
Multilateral development banks (supranational bonds)	2	0.2	165.3	–	–	165.5
Financial institutions	1,2	534.2	395.6	3.0	–	932.8
Residential Mortgage Backed Securities (RMBS)	1	0.1	7.5	12.7	–	20.3
Total treasury risk credit exposures		5,956.2	619.2	279.3	–	6,854.7
Total credit risk exposures		8,990.7	11,349.3	11,357.3	17,314.4	49,011.7

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

5.2 Retail credit risk

5.2.1 Management of retail credit risk

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

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

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

All mortgage applications are assessed against the Society's lending policy criteria to ensure consistent credit decision making, and lending within the Society's credit risk appetite. This assessment uses stressed interest rates to ensure affordability even if interest rates increase. Assurance that lending decisions are robust and within the Society's policy is provided through the three lines of defence model.

All underwriting is done by the Society and its key lending criteria include:

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

The lending criteria have been updated in 2020 in order to reduce retail credit risk during the Covid-19 pandemic. The updates include:

- Lending restricted to 90% LTV for owner-occupier mortgages.
- Limits on the type of income which can be used to assess affordability, including reductions in overtime, shift allowance, commissions and bonuses.
- Capital raising loans are only permitted for owner-occupier loans up to 65% LTV for self-employed applicants, and limited to a maximum of 75% LTV where the funds are to be used for debt consolidation.

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

5.2.2 The Society's approach to payment difficulties

Inevitably, despite the Society's prudent lending approach, on occasion members experience financial difficulty. This section explains the support the Society has offered to those members and customers in need.

Covid-19 payment holidays

The Society has worked to support customers who have experienced payment difficulties during 2020 as a result of the Covid-19 pandemic 39,336 payment holidays have been granted during the year, of which 2,565 were active at 31 December 2020.

The table below shows the active payment holidays by product type.

Table 11a: Analysis of Covid-19 payment holidays

31 December 2020	No. of active payment holidays[1]	% of total mortgage accounts	Gross balance £m	% of gross mortgage balance	Balance weighted average LTV %
Residential					
Owner-occupier mortgages	**1,779**	**1.0**	**317.3**	**1.2**	**57.7**
Buy to let mortgages	**717**	**0.6**	**133.5**	**0.8**	**57.7**
Near-prime mortgages	**23**	**3.5**	**3.3**	**6.1**	**54.0**
Self-certification mortgages	**38**	**2.3**	**6.0**	**4.4**	**53.9**
Other					
Commercial mortgages	**–**	**–**	**–**	**–**	**–**
Unsecured	**8**	**0.4**	**0.1**	**0.6**	**–**
Total	**2,565**	**0.9**	**460.2**	**1.1**	**57.6**

1. Payment holidays where mortgage payments are due to resume on or after 1 January 2021.

Of the accounts with payment holidays which had expired at 31 December 2020, 98.3% had commenced repayments.

A further 1.7% had not resumed payments – these accounts had balances of £87.6 million and a balance weighted LTV of 56.4%. The Society is working with these customers to assess their future affordability. In these cases, the Society seeks to reach a sustainable and fair arrangement to regularise the position in a timeframe which is acceptable to both the Society and the borrower.

Accounts which have had a Covid-19 payment holiday for longer than three months or had a Covid-19 payment holiday of any length and are also showing other signs of credit deterioration are assessed as stage 2 under IFRS 9. The vast majority of accounts subject to non-Covid related forbearance are assessed as either stage 2 or 3 under IFRS 9 and the Society recognises a lifetime expected credit loss for these as an impairment provision.

Arrears performance

In 2020, arrears of three months or more have increased albeit from historical low levels seen previously. This position has been supported by the application of Covid-19 mortgage payment holidays for customers who have experienced financial difficulty during 2020. The overall credit quality of the book remains high and arrears levels compare favourably to the UK Finance average.

The Society will only seek repossession of a property when all reasonable efforts have failed or where the mortgage is unsustainable in the longer term. There has been a moratorium on house repossessions since March 2020 which is expected to remain in place until 1 April 2021. This has led to an increase in balances which are six months or more in arrears as shown in the table below. As at 31 December 2020 there have been 66 accounts which have been prevented from moving into possession proceedings which may have otherwise have done so during the year if not for the possession moratorium.

Table 11b: Analysis of Society arrears

	2020		2019	
	Gross balance £m	**Arrears balance £m**	Gross balance £m	Arrears balance £m
Greater than three months	**69.3**	**2.7**	54.0	1.7
Greater than six months	**38.7**	**2.1**	22.3	1.0
Greater than one year	**12.5**	**1.1**	5.1	0.4
In possession	**3.1**	**0.2**	4.6	0.2

The accounts in arrears as a percentage of loans and advances to customers has also increased during the year due to the worsening environment however remains significantly lower than the UK Finance average, as shown below:

Table 11c: Analysis of Society arrears compared with UK Finance

	2020		2019	
	Society %	**UK Finance[1] %**	Society %	UK Finance[1] %
Greater than three months	**0.18**	**0.83**	0.16	0.72
Greater than six months	**0.10**	**0.56**	0.06	0.43
Greater than one year	**0.03**	**0.31**	0.01	0.22
In possession	**0.01**	**0.01**	0.01	0.02

1. UK Finance data as at 31 December 2020 (31 December 2019).

Extent and use of forbearance

The Society exercises forbearance if it is in the best interests of the borrower. Forbearance measures that the Society may offer are:

- 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.
- A change of product which results in more sustainable monthly payments.

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

Where a loan is up to date, the Society may agree a short-term payment holiday as a way of allowing borrowers to resolve financial difficulties, in which case this is treated as a forbearance measure rather than as one where the borrower is using a product feature. Forbearance payment holidays are for a maximum of three months and are only given where the borrower can afford the post-holiday monthly repayments.

Details of loans which have had forbearance measures granted in the last 12 months are shown below. This does not include Covid-19 payment holidays which are reported separately above.

Table 12: Forbearance

	2020		2019	
	No. of accounts	**Carrying value £m**	No. of accounts	Carrying value £m
Forbearance: Accounts past due				
Arrangements	**402**	**43.9**	542	58.0
Concessions	**42**	**7.5**	20	3.7
Term extensions	**3**	**0.4**	6	0.9
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department	**54**	**5.7**	191	22.7
Term extensions	**139**	**24.8**	154	30.0
Capitalisation of arrears	**–**	**–**	5	0.6

The number of loans in forbearance has decreased compared with 2019 reflecting the impact of the Government support schemes in combating Covid-19. This table includes customers who have previously had Covid-19 payment holidays and then moved onto forbearance measures as a result of entering financial difficulty.

5.2.3 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 those acquired as a result of the merger with Stroud & Swindon Building Society in 2010, continue to fall, comprising just 0.4% (2019: 0.6%) of total gross balances at 31 December 2020.

Buy to let lending continues to be provided mainly on an interest only basis reflecting the underlying investment nature of buy to let properties which can be sold to repay the capital amount. Interest only lending was 4.9% of the owner-occupier portfolio at 31 December 2020 (2019: 5.4%) with an average loan to value of 37.6% (2019: 39.4%).

During 2020, the credit risk profile of the Society's mortgage book has been significantly impacted by the emergence of the Covid-19 pandemic and government measures to control it. The Society has worked to support customers who have experienced payment difficulties throughout the year. The Society has granted 39,336 payment holidays to customers, of which 2,565 were active at the year end.

Loans and advances to customers are shown below. The effective interest rate (EIR) asset and fair value and other adjustments have been presented separately from gross balances in order to aid understanding.

Table 13: Credit risk profile

Loans and advances to customers	2020 £m	2020 %	2019 £m	2019 %
Residential mortgages: owner-occupier	**25,508.7**	**58.7**	25,198.9	59.7
Residential mortgages: buy to let	**17,740.7**	**40.8**	16,732.6	39.6
Total traditional residential mortgages	**43,249.4**	**99.5**	41,931.5	99.3
Residential near-prime mortgages	**53.8**	**0.1**	59.2	0.1
Residential self-certification mortgages	**136.9**	**0.3**	156.3	0.4
Commercial mortgages[1]	**1.8**	**–**	2.0	–
Total non-traditional mortgages	**192.5**	**0.4**	217.5	0.5
Unsecured personal loans[1]	**17.2**	**–**	20.0	–
Total gross balance	**43,459.1**	**99.9**	42,169.0	99.8
Impairment	**(48.1)**	**(0.1)**	(12.0)	–
EIR asset	**71.1**	**0.2**	75.8	0.2
Fair value and other adjustments	**0.7**	**–**	1.9	–
Total net balance	**43,482.8**	**100.0**	42,234.7	100.0

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

Residential mortgages: owner-occupier includes £210.2 million (2019: £223.9 million), less than 1% of the total gross balances, of 'equity-release mortgages', where the borrower is guaranteed that the amount recoverable by the Society at the end of the mortgage will not exceed the value of the property. The Society is therefore exposed to the risk that the value of the property at the time of redemption is lower than the loan including accumulated interest. The Society mitigated this risk by granting loans at a relatively low loan to value and has not offered new mortgages on this basis since 2009. The weighted average loan to value of the equity release book is 40.0% (2019: 40.0 %).

Geographical concentration

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

Table 14: Geographical distribution of residential mortgages

Region	**2020 %**	2019 %
London	**27.9**	27.6
South East England	**18.7**	18.7
Central England	**14.1**	14.2
Northern England	**13.1**	13.1
East of England	**11.7**	11.7
South West England	**8.8**	8.9
Scotland	**3.4**	3.4
Wales and Northern Ireland	**2.3**	2.4
Total	**100.0**	100.0

Loan to value and income multiples

The low loan to value (LTV) profile of the mortgage book, as shown in the following tables, is a reflection of the Society's low risk approach to lending. The Society updates the estimated value of the properties securing the mortgage portfolio on a quarterly basis using Nationwide regional house price indices and all tables within this report are prepared using these valuations.

The standard maximum income multiple for owner-occupier mortgages is 4.5. The Society lends on multiples of up to 5.0 for very low (65% or lower) LTV cases. Any lending at or above 4.5 times income is closely monitored and 5.9% (2019: 3.4%) of advances were made at or above this level in 2020, which is well below the maximum limit of 15% set by the Bank of England's Financial Policy Committee (FPC). The Society reduces maximum income multiples permitted if the loan term extends significantly into retirement to ensure it remains affordable.

The Society is a responsible lender and operates robust affordability checks before advancing any loans. For owner- occupier mortgages, ensuring a borrower has sufficient net income, both at the time of application and in a future higher interest rate environment, is a key part of this. For buy to let loans the Society sets minimum interest coverage ratios which reflect among other things the tax status of borrowers.

The Society's actual average interest coverage ratio at the end of the year using a stressed 5% interest rate was 175.4% (2019: 175.4%), significantly above its minimum lending criteria. The Society also lends to portfolio landlords within the buy to let segment and takes a prudent approach to assessing portfolio LTV and income coverage ratios. There are also limits on the number of properties in the portfolio both in total and those which the Society will lend on. Each loan in a portfolio is assessed on a standalone basis and no allowance is made in the affordability assessment for other income of the borrower.

The loan to value distribution of the mortgage book as at 31 December 2020 has remained broadly stable as shown below. The following tables and disclosures calculate LTV based on the weighted average loan balances unless stated otherwise:

Table 15: Total mortgage book loan to value (number of accounts)

Total mortgage book profile	**2020 %**	2019 %
Indexed loan to value:		
< 50%	**53.4**	49.7
50% to 65%	**26.4**	25.0
65% to 75%	**13.6**	14.7
75% to 85%	**5.8**	7.4
85% to 95%	**0.8**	3.1
> 95%	**0.0**	0.1
Total	**100.0**	100.0
Average indexed loan to value of stock (balance weighted)	**52.8**	55.4

The average indexed LTV of loan stock in London has decreased to 51.7% (2019: 54.1%) as a result of increases in house prices during the year. The rest of the portfolio has also seen indexed LTV fall to 53.3% (2019: 55.9%).

The average LTV of gross new lending in 2020 is shown below. In 2020 the percentage of new buy to let lending increased during the year particularly for remortgages. Owner-occupier purchases also increased which reflects the active house purchase market in the second half of the year. The average LTV of the new lending book has been maintained during the year.

Table 16: Gross lending new business profile

Gross lending	2020 %	2019 %
Owner-occupier purchase	**34.9**	33.9
Owner-occupier remortgages	**23.1**	30.7
Owner-occupier further advances	**2.1**	2.0
Buy to let purchase	**8.1**	7.7
Buy to let remortgages	**31.1**	25.0
Buy to let further advances	**0.7**	0.7
Total	**100.0**	100.0
Average loan to value (balance weighted)	**63.7**	63.7

5.2.4 IRB rating system

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

IRB models are used to calculate capital requirements for prime owner-occupier and buy to let mortgage exposures which account for around 99% of lending exposures throughout 2020 (2019: 99%). The remaining retail credit risk exposures on legacy closed products are modelled using the standardised approach.

The Society implemented new IRB models in 2020 after receiving approval from the PRA to do so. The new models reflect current applicable guidance and embed hybrid PD modelling philosophy required by the PRA alongside a new definition of default that meets the latest guidance. Further updates of the IRB models will be required for the latest EBA roadmap guidance on LGD and quantifying Margins of Conservatism.

Use of the new models accounts for a 3.1% increase in risk weighted assets during the year and therefore a fall in the CET 1 ratio of 1.06%. This is because the new models assess the mortgage book across a wider distribution of risk grades and they are more sensitive to changes in variables such as house price inflation. The overall impact of the new models is relatively modest because the Society's previous models already assess risks 'through the cycle' rather than solely on a 'point in time' basis. The impact of this change of model on the Society's RWAs can be seen in Table 7.

Capital is calculated using the Standardised approach on certain small legacy portfolios and uses capital risk weighting percentages set by CRD IV[1]. No new lending has been originated on these products for a number of years (a drawdown facility is available for a small element of existing equity release customers).

The internal rating model and process

Three models provide the rating of credit risk:

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

1. On 28 December 2020 CRD V replaced CRD IV. However, some amendments to related UK regulation will only apply from 31 December 2021.

Probability of default model

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

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

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

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

Loss given default model

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

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

Exposure at default (EAD) model

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

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

Comparison of impairment provisions with regulatory expected losses

The £43.9 million IFRS 9 impairment provision on IRB loans recognised in the financial statements at 31 December 2020 differs from the £47.9 million determined from the IRB regulatory expected loss models due to the methodology differences set out below.

The IFRS 9 / IRB methodology differences are as follows:

- The IFRS 9 PD is an estimate of the residual lifetime probability of default based on expectations for future economic conditions at the balance sheet date. The first 12 months of the residual lifetime PD estimate is utilised for accounts in Stage 1 whilst the full residual lifetime PD is used for accounts in Stages 2 and 3. The regulatory PD is a long run average throughout a full economic cycle;
- The IFRS 9 EAD has been modelled based on expected payments over the term up to the point of default. The regulatory EAD cannot be lower than the current balance;
- The IFRS 9 LGD includes the impact of future economic conditions such as changes in value of collateral and does not include any floors. Only costs associated with obtaining/selling the collateral are included and the discounting of the expected cash flows is performed using the effective interest rate of the loan. The regulatory LGD is based on downturn conditions and includes all collection costs, is subject to regulatory floors and is discounted using a stressed measure of the cost of capital; and

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

Allocation of exposures to risk grades by the IRB rating system

The following table shows the Society's retail exposures under IRB using the new model approved for use in the year. For comparative purposes the 2019 balances have been updated to reflect the position as at 31 December 2019 if under the current IRB model.

Table 17: Allocation of exposures (including undrawn) to IRB risk band

PD bands up to and including:	Exposure at default estimate 2020 £m	Average loss given default 2020 %	Average risk weight 2020 %	RWAs 2020 £m	Updated Exposure at default estimate 2019 £m	Updated Average loss given default 2019 %	Updated Average risk weight 2019 %	Updated RWAs 2019 £m
0.10	**6,014.1**	**8.2**	**1.2**	**73.0**	5,398.8	8.2	1.2	65.0
0.20	**20,409.0**	**12.8**	**4.0**	**818.9**	18,186.4	13.1	4.1	745.7
0.30	**11,103.8**	**16.6**	**8.9**	**987.9**	10,977.4	17.8	9.6	1,050.1
0.50	**5,293.4**	**19.7**	**16.1**	**849.7**	5,562.2	21.6	17.6	980.1
1.00	**110.4**	**7.6**	**8.2**	**9.0**	129.6	8.2	8.6	11.2
3.00	**2,045.9**	**20.5**	**34.0**	**694.9**	2,253.1	23.4	38.9	876.8
9.99	**921.5**	**20.3**	**64.5**	**594.5**	1,015.1	23.1	73.2	743.1
99.99	**291.9**	**13.8**	**71.2**	**207.9**	300.9	14.1	72.1	217.0
In Default	**188.5**	**8.3**	**74.2**	**139.9**	177.9	9.0	89.3	158.9
Total	**46,378.5**			**4,375.7**	44,001.4			4,847.9

The PDs disclosed in the table above are on long run basis. The average loss given default and the average risk weights decreased during 2020 as a result of defaults reducing due to Government support schemes in combating Covid-19 and the reduction in average Loan to Value of the mortgage book with HPI increases in the year.

Treatment of undrawn exposures

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

At 31 December 2020, the value of undrawn exposures being rated under the IRB approach was £2,534.0 million (2019: £1,675.9 million).

5.2.5 Controls and governance

Management of model risk

Model risk is managed by the Chief Financial Officer and oversight is provided by the Chief Risk Officer. It has been governed through Retail Credit Risk Committee (RCRC) and Asset and Liability Committee (ALCO). During the year the RCRC oversees management of model risk through its sub-committee Model and Ratings Committee (MRC) which is chaired by the CFO and includes in its membership the CRO and senior managers from the Prudential & Enterprise Risk and Retail Credit Risk functions with Internal Audit also in attendance.

The Society has a Board approved policy on model risk which sets out the minimum standards to be applied to mitigate risk. These standards are supported by controls and model requirements within a comprehensive Model Risk Framework which is reviewed by BRC annually and are designed to conform to the regulatory expectations

for model risk management practices. Within this, the Society has a comprehensive model governance framework which sets out policies and statements that govern all models including the IRB models throughout their life cycle.

Techniques employed to manage model risk include:

- Independent model validation.
- Governance around model assumptions and data.
- Model overview statements which identify conditions when the models may fail.
- Requirements on model development and documentation.
- Sensitivity analysis of key assumptions.

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

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

The first line undertakes an annual detailed review of the regulatory requirements over IRB models, which includes assessment against the EU Capital Requirements Regulations and the PRA's supervisory statements and guidance, in accordance with its Model Risk Framework. The second line risk function independently reviews this work, and both the annual review and the second line opinion is presented to MRC.

MRC's responsibilities in relation to IRB models included:

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

As part of its third line responsibilities, Internal Audit undertakes an annual review of the effectiveness of the controls governing the use of IRB models. Following this self-assessment, the Chief Risk Officer attests compliance with IRB regulatory requirements. During 2020, the Society obtained approval from the PRA to adopt a new suite of IRB models. The new IRB models were implemented by the year end.

Governance over the IFRS 9 ECL calculation is the responsibility of the Expected Credit Loss Group (ECLG). This group is chaired by the Chief Financial Officer and attendees include the Chief Risk Officer, Chief Internal Auditor and other senior managers from the Finance, Credit Risk and Risk functions. ECLG monitors the adequacy of historic ECL projections, comparing actual losses as they emerge with the estimated losses that were set aside as provisions. Detailed model performance monitoring as well as oversight and approval of the IFRS 9 models is the responsibility of the Models & Ratings Committee.

ECLG also proposes the economic scenarios and weightings used to determine the forward looking views that are required by IFRS 9, as well as the key judgments and assumptions supporting the calculation. These scenarios, weightings and judgements are approved by the Society's Board Audit Committee.

Model risk outlook

IRB models have been and will continue to be subject to significant regulatory reform with regulations published by UK and global bodies. The Society will continue to update its suite of IRB models to reflect future changes in regulatory requirements.

The Society anticipates that usage of models within the business will continue to increase. As a result the Society has continued to develop its controls over and oversight of models and complex calculators and the data that populates them. To this aim from 2021 the Society has set up a specific Model Risk Committee to manage model risk across all functions of the Society which creates stronger alignment with the ERMF principles. This principal risk committee reports directly into ERC and consider financial and product based models as well as credit risk models.

See additional information on Model risk within the Risk Management Report in the 2020 Accounts.

5.2.6 IRB model performance over time

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

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

The new IRB models that were implemented at the 2020 year end are built on a revised definition of default that, unlike with previous models, are calibrated to 90 days past due (previously 180 days) together with expanded unlikeliness-to-pay indicators.

The PD model has been directly calibrated to the long run average PD rather than on a point-in-time basis. The assessment of performance that has been made therefore compares actual default rates with the long run PD estimate. For comparison the prior year's performance on the same basis has been updated within the table below.

The LGD model has also been rebuilt, given that the new definition of default impacts all areas of loss given default. The table below compares the predicted LGD of accounts that defaulted in 2019 with the actual loss for those accounts that then went on to sell from possession in 2020. The prior year's performance has also been shown (i.e. defaulted in 2018, sold in 2019). Cases which gave rise to a special provision i.e. on which the loss was the result of circumstances that could not be modelled (e.g. a boundary dispute where a large loss was incurred when a property was partly built on neighbouring land) have been excluded from the analysis. The LGD models slightly over-predicted losses on 2020 sales and slightly under-predicted on 2019 sales but the small number of sales causes some volatility in the results.

The EAD model has also been rebuilt to reflect the new definition of default. The ratio of estimated to actual EAD is also shown (a ratio of greater than 1 indicates that estimated EAD was greater than actual EAD). The new EAD model slightly over-predicts the actual exposure at default.

Long run PD and LGD predictions against actual results are shown below, this includes updated positions for 2019 using the new IRB models to aid comparability. The ratio of estimated to actual EAD is also shown (a ratio of greater than 1 indicates that estimated EAD was greater than actual EAD).

Table 18: Actual Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD) against predicted

IRB retail mortgages	Actual 2020 %	Predicted 2020 %	Updated[1] Actual 2019 %	Updated[1] Predicted 2019 %
PD	**0.24**	**0.74**	0.26	0.75
LGD	**17.6**	**18.9**	16.2	15.3
EAD (Estimated to actual)	**1.03**	**N/A**	1.05	N/A

1. Updated positions for 2019 using the new IRB models to aid comparability.

5.2.7 Credit risk mitigation

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

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

The initial valuations of properties are determined by the Credit Risk function using a variety of techniques. These techniques include internal physical inspection with written reports by a qualified Royal Institutions of Chartered Surveyors (RICS) surveyor as well as Automated Valuation Models or drive by valuations. The credit risk function oversees the techniques used, and independently assesses the accuracy of valuations which are performed.

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

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

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

5.2.8 Identifying impaired loans

Under IFRS 9 the Society calculates impairment provisions on loans and advances to customers on an expected credit loss (ECL) basis and not on an incurred loss basis. ECL provisions are based on an assessment of probability of default, loss given default and exposure at default in a range of forward-looking scenarios.

IFRS 9 requires the Society to categorise customer loans into one of three stages at the balance sheet date. Assets that are ‘performing’ are shown in stage 1; assets where there has been a significant increase in credit risk since initial recognition or ‘deteriorating’ assets are in stage 2; and accounts which are credit impaired or in ‘default’ are in stage 3. Under IFRS 9, loans are generally treated as being in ‘default’ if they are three or more months in arrears, have been three or more months in arrears in the last 12 months or have other specific unlikeliness to pay indicators. Equity release loans are treated as being in default once the loan is 12 months past the contractual trigger event. IFRS 9 requires a 12 month ECL provision on all stage 1 assets and a lifetime ECL provision on all stage 2 and 3 assets.

The impact of Covid-19 has increased uncertainty in relation to identifying a significant increase in credit risk. More information on the accounting judgements which have been applied are included in note 1 and 12 to the Accounts. Note 12 to the Accounts also provides further information on the forward looking information used in the ECL calculations and sensitivities.

At 31 December 2020, 91.3% of loans are in stage 1 with 8.2% in stage 2 and 0.5% in stage 3 (2019: 97.0%, 2.5% and 0.5%). The proportion in Stage 1 has decreased during 2020 as a result of the worsened credit environment driven by the Covid-19 pandemic. Cure periods are applied to accounts in stages 2 and 3 which have had a Covid-19 payment holiday in addition to accounts which have hit certain quantitative triggers such as arrears. These cure periods delay transition of loans to a lower credit risk classification (i.e. from stage 3 to

stage 2 or from stage 2 to stage 1) by requiring 12 months of sustained performance before a loan is reassessed. As a result, loans can be recorded in stage 2 or stage 3 despite otherwise performing at the reporting date.

Stage 2 balances were £3,549.1 million (2019: £1,078.6 million) and of these £81.3 million or 2.3% (2019: £94.4 million, 8.8%) are in arrears by 30 days or more. A total of £2,604.1 million are present within stage 2 as a result of the new SICR criteria established for the Covid-19 pandemic of which £324.9 million or 9.2% have an active Covid-19 payment holiday at 31 December 2020. Of these balances £2,561.5 million or 98.4% of accounts are up to date as at 31 December 2020 and remain in stage 2 as a result of cure rules or other indicators of increased risk. The significant increase in stage 2 balances has been driven by the impact of Covid-19 and all accounts which have either had a payment holiday of more than three months or have had a payment holiday of any length but are also showing signs of credit deterioration have been assessed as stage 2.

Of the £206.6 million (2019: £197.3 million) of loans which are classified as stage 3 at the reporting date, 35.0% or £72.4 million were greater than three months in arrears (2019: 29.8%, £58.7 million), and 44.0% (£90.9 million) were paid up to date (2019: 40.2%, £80.2 million). This position has deteriorated slightly since 2019 as a result of the worsened economic environment and the moratoria on repossessions which means that loans which have defaulted are not moving through to possession. At the 31 December there are 66 properties with a property value of £18.0 million and a loan balance of £8.5 million to which possession proceedings may have started had the moratoria not been in place.

The number of properties which are in possession remains low and a total of £3.1 million of stage 3 loans are in possession (2019: £4.6 million), representing 22 individual properties (2019: 33 properties).

The table below shows gross loans and advances to customers split by IFRS 9 stage at 31 December 2020 and at 31 December 2019. For loans in stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

Table 19a: Gross loans and advances to customers split by IFRS 9 stage 2020

			Of which			Of which		
2020	**Stage 1 'Performing' £m**	**Stage 2 'Deteriorating' £m**	**Not past due £m**	**Past due £m**	**Stage 3 'Default' £m**	**Not past due £m**	**Past due £m**	**Total £m**
Residential mortgages:								
Owner-occupier	23,089.8	2,300.3	2,252.4	47.9	118.6	54.7	63.9	25,508.7
Buy to let	16,532.8	1,152.3	1,122.1	30.2	55.6	21.7	33.9	17,740.7
Total traditional residential mortgages	**39,622.6**	**3,452.6**	**3,374.5**	**78.1**	**174.2**	**76.4**	**97.8**	**43,249.4**
Non-traditional mortgages:								
Residential near-prime	21.1	18.7	17.3	1.4	14.0	5.6	8.4	53.8
Residential self-certified	45.6	73.6	72.1	1.5	17.7	8.3	9.4	136.9
Commercial lending	–	1.4	1.4	–	0.4	0.4	–	1.8
Total non-traditional mortgages	**66.7**	**93.7**	**90.8**	**2.9**	**32.1**	**14.3**	**17.8**	**192.5**
Unsecured loans	**14.1**	**2.8**	**2.5**	**0.3**	**0.3**	**0.2**	**0.1**	**17.2**
Total gross loans	**39,703.4**	**3,549.1**	**3,467.8**	**81.3**	**206.6**	**90.9**	**115.7**	**43,459.1**
	%	**%**	**%**	**%**	**%**	**%**	**%**	**%**
% Total gross loans	**91.3**	**8.2**	**8.0**	**0.2**	**0.5**	**0.2**	**0.3**	**100.0**

Table 19b: Gross loans and advances to customers split by IFRS 9 stage 2019

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

The table below shows total impairment provision split by IFRS 9 stage at 31 December 2020 and the previous year. For stages 2 and 3, further analysis of accounts which are past due and not past due is also shown.

Table 20a: Impairment on loans and advances to customers split by IFRS 9 stage 2020

Impairment provision as at 31 December 2020	**Stage 1 12 month ECL £m**	**Stage 2 lifetime ECL £m**	**Of which: Not past due £m**	**Of which: Past due £m**	**Stage 3 lifetime ECL £m**	**Of which: Not past due £m**	**Of which: Past due £m**	**Total £m**
Residential mortgages:								
Owner-occupier	4.8	16.5	16.4	0.1	5.2	3.7	1.5	26.5
Buy to let	3.5	10.3	10.2	0.1	4.7	2.7	2.0	18.5
Total traditional residential mortgages	**8.3**	**26.8**	**26.6**	**0.2**	**9.9**	**6.4**	**3.5**	**45.0**
Non-traditional mortgages:								
Residential near-prime	0.1	0.2	0.2	–	0.2	0.1	0.1	0.5
Residential self-certified	–	0.5	0.5	–	0.7	0.4	0.3	1.2
Commercial lending	–	0.2	0.2	–	0.2	0.2	–	0.4
Total non-traditional mortgages	**0.1**	**0.9**	**0.9**	**–**	**1.1**	**0.7**	**0.4**	**2.1**
Unsecured loans	**0.1**	**0.7**	**0.6**	**0.1**	**0.1**	**0.1**	**–**	**0.9**
Mortgage pipeline	**0.1**	**–**	**–**	**–**	**–**	**–**	**–**	**0.1**
Total impairment provision	**8.6**	**28.4**	**28.1**	**0.3**	**11.1**	**7.2**	**3.9**	**48.1**
	%	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Total impairment provision	**17.9**	**59.0**	**58.4**	**0.6**	**23.1**	**15.0**	**8.1**	**100.0**

Table 20b: Impairment on loans and advances to customers split by IFRS 9 stage 2019

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

Included within the ECL provision of £48.1 million (2019: £12.0 million) is £37.6 million (2019: £4.0 million) relating to post model adjustments (PMAs). Of the total increase in the year of £33.6 million, £32.5 million relates to a PMA for potential further credit losses as a result of the impact of Covid-19 which has not yet been reflected in the Society's impairment models. More information on the accounting judgements and estimates applied in calculation of the PMAs are included in note 12 to the Accounts.

A reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage from 1 January to 31 December 2020 is as follows:

Table 21a: Reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage 2020

	Stage 1		Stage 2		Stage 3		Total	
	Gross balance 12 month ECL £m	Provision 12 month ECL £m	Gross balance lifetime ECL £m	Provision lifetime ECL £m	Gross balance lifetime ECL £m	Provision lifetime ECL £m	Gross balance £m	Provision £m
At 1 January 2020	**40,893.1**	**1.0**	**1,078.6**	**3.2**	**197.3**	**7.8**	**42,169.0**	**12.0**
Movements with Income Statement impact:								
Transfer from stage 1 to stage 2	(3,104.2)	(0.1)	3,104.2	0.5	–	–	–	0.4
Transfer from stage 1 to stage 3	(39.1)	–	–	–	39.1	0.9	–	0.9
Transfer from stage 2 to stage 3	–	–	(57.5)	(0.2)	57.5	0.2	–	–
Transfer from stage 3 to stage 2	–	–	36.9	0.9	(36.9)	(0.9)	–	–
Transfer from stage 3 to stage 1	10.8	0.1	–	–	(10.8)	(0.1)	–	–
Transfer from stage 2 to stage 1	303.0	–	(303.0)	(0.4)	–	–	–	(0.4)
Net movement arising from transfer of stages	**(2,829.5)**	**–**	**2,780.6**	**0.8**	**48.9**	**0.1**	**–**	**0.9**
New loans originated[1]	6,981.1	0.5	2.5	–	–	–	6,983.6	0.5
Remeasurement of ECL due to changes in risk parameters	–	(4.7)	–	4.5	–	1.7	–	1.5
Increase/(decrease) in post model adjustments	–	12.0	–	19.4	–	2.2	–	33.6
Remeasurement of ECL due to model refinements[2]	–	0.1	–	0.9	–	1.0	–	2.0
Loans derecognised in the period	(3,698.9)	(0.3)	(233.3)	(0.4)	(32.1)	(0.7)	(3,964.3)	(1.4)
Other items impacting income statement charge/(reversal)	–	–	–	–	–	(0.3)	–	(0.3)
Net write offs directly to Income Statement	–	–	–	–	–	(0.4)	–	(0.4)
Income Statement charge for the period		**7.6**		**25.2**		**3.6**		**36.4**
Repayment and charges	(1,642.4)	–	(79.3)	–	(6.4)	–	(1,728.1)	–
Net write offs	–	–	–	–	(1.1)	(0.3)	(1.1)	(0.3)
At 31 December 2020	**39,703.4**	**8.6**	**3,549.1**	**28.4**	**206.6**	**11.1**	**43,459.1**	**48.1**

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

2. A number of refinements to the Society's ECL models have been made during 2020. These include an update to the calculation of the probability of default for interest rate shock, enhancements to staging methodology for UPLs, time to modelled possession of properties in default, and lag of unemployment to credit deterioration in Buy to let properties. In the period these refinements increased ECLs by £2.0 million at Group and £1.2 million within the Society.

Table 21b: Reconciliation of movements in gross exposures and impairment provision by IFRS 9 stage 2019

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

1. New mortgages originated in stages 2 and 3 relate to further advances on accounts which are performing at the date of origination but are in the 12 month cure period for IFRS 9 staging.
2. A number of refinements to the Society's ECL models have been made during 2019. These include an update to the calculation of the Probability of Default and an enhancement to the regional house price index modelling capability. In the year these refinements decreased ECLs by £1.1 million at Group and £0.4 million within the Society.

The LTV distribution of the mortgage book by IFRS 9 stage has remained broadly stable during 2020 with 89% of the mortgage book having an LTV of 75% or lower (2019: 85%).

The Society updates its security values using the Nationwide Building Society quarterly regional HPI. Part of the risk assessment of the portfolio also includes an initial individual revaluation of security using automated valuation model (AVM) values, and following model build and testing it is expected that the Society will use AVM values more widely in future. Initial indications suggest that this assessment will reduce the weighted average ILTV of both the owner occupier and buy to let portfolios. Notwithstanding the anticipated reduced ILTV across the portfolios, an estimate of approximately £80 million of additional negative equity balances over and above the current methodology and reported figure has been used when considering expected credit losses.

Table 22a: Loan to value distribution by IFRS 9 stage 2020

As at 31 December 2020 Indexed loan to value	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
< 50%	**16,802.1**	**1,187.7**	**86.8**	**(1.3)**	**18,075.3**
50% to 65%	**12,595.2**	**1,130.7**	**62.8**	**(8.0)**	**13,780.7**
65% to 75%	**6,354.8**	**764.7**	**32.5**	**(14.4)**	**7,137.6**
75% to 85%	**3,465.7**	**435.3**	**17.4**	**(14.5)**	**3,903.9**
85% to 90%	**402.2**	**22.0**	**2.6**	**(1.6)**	**425.2**
90% to 95%	**67.1**	**3.7**	**0.6**	**(0.4)**	**71.0**
95% to 100%	**1.1**	**1.3**	**0.6**	**(0.3)**	**2.7**
> 100%	**1.1**	**0.9**	**3.0**	**(1.4)**	**3.6**
Unsecured loans	**14.1**	**2.8**	**0.3**	**(1.0)**	**16.2**
Mortgage pipeline	**–**	**–**	**–**	**(0.1)**	**(0.1)**
Other[1]	**–**	**–**	**–**	**(5.1)**	**(5.1)**
Total	**39,703.4**	**3,549.1**	**206.6**	**(48.1)**	**43,411.0**

1. Other includes expected credit losses which are not directly attributable to underlying accounts and therefore are not allocated across loan to value bandings.

Table 22b: Loan to value distribution by IFRS 9 stage 2019

As at 31 December 2019 Indexed loan to value	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
< 50%	15,352.0	403.7	70.7	(0.3)	15,826.1
50% to 65%	12,112.9	326.1	61.9	(0.8)	12,500.1
65% to 75%	7,272.0	195.5	29.2	(1.1)	7,495.6
75% to 85%	4,098.4	102.2	21.0	(2.2)	4,219.4
85% to 90%	1,720.2	39.9	7.2	(1.0)	1,766.3
90% to 95%	309.5	7.0	1.4	(0.3)	317.6
95% to 100%	5.9	1.9	1.7	(0.2)	9.3
> 100%	2.6	2.0	4.0	(1.6)	7.0
Unsecured loans	19.6	0.3	0.2	(0.4)	19.7
Mortgage pipeline	–	–	–	(0.1)	(0.1)
Other[1]	–	–	–	(4.0)	(4.0)
Total	40,893.1	1,078.6	197.3	(12.0)	42,157.0

1. Comparative information has been updated to include 'Other'. Other includes expected credit losses which are not directly attributable to underlying accounts which were previously apportioned based on gross balances.

The credit quality of the mortgage book has been impacted by Covid-19 and payment holidays and other support measures may mean that indicators of deterioration may not be reflected in credit scores. Notwithstanding this, the credit quality of the mortgage book remained high during 2020.

The table below shows the PD of the Society's loans over their life (e.g. PD of less than or equal to 0.25 indicates a 0.25% chance of default over the life of the loan). Default includes cases which are three or more months in arrears or have been three or more months in arrears at some point in the last 12 months in addition to cases which have a specified unlikeliness to pay indicator.

Loan balances are reflected in the respective PD bands of the account as modelled through the Society's standard IFRS 9 impairment models. This has led to an increase of impairment reflected in the lower PD bands as a result of the post model adjustments (PMAs) applied as a result of the Covid-19 pandemic. For more information on PMAs see note 12 to the 2020 Accounts.

Table 23a: Lifetime probability of default by IFRS 9 stage 2020

As at 31 December 2020 Probability of default (%)	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Modelled ECL and non Covid-19 PMAs £m	Covid-19 PMA	Total £m
<=0.25	**37,800.0**	**254.8**	**–**	**(0.4)**	**(11.2)**	**38,043.2**
0.26 to 0.50	**1,151.3**	**552.3**	**–**	**(0.1)**	**(4.0)**	**1,699.5**
0.51 to 1.50	**367.3**	**1,187.4**	**–**	**(0.1)**	**(7.7)**	**1,546.9**
1.51 to 5.00	**79.8**	**811.3**	**–**	**(0.2)**	**(5.0)**	**885.9**
5.01 to 20.00	**52.3**	**536.8**	**–**	**(0.5)**	**(2.6)**	**586.0**
20.01 to 100.00	**36.7**	**198.9**	**–**	**(0.7)**	**(0.8)**	**234.1**
Other[1]	**216.0**	**7.6**	**4.5**	**(7.2)**	**–**	**220.9**
Default	**–**	**–**	**202.1**	**(6.3)**	**(1.2)**	**194.6**
Mortgage pipeline	**–**	**–**	**–**	**(0.1)**	**–**	**(0.1)**
Total	**39,703.4**	**3,549.1**	**206.6**	**(15.6)**	**(32.5)**	**43,411.0**

1. Other includes gross loans for equity release mortgages and other loans where credit risk is assessed using alternative calculation methods and their respective ECLs or where ECLs are not directly attributable to underlying accounts and therefore are not allocated across PDs bandings or to Default.

Table 23b: Lifetime probability of default by IFRS 9 stage 2019

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

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

Credit risk outlook

The impact of the pandemic and lockdown measures both in the UK and around the world are expected to result in a continued economic downturn. The Society expects to maintain support for customers who are experiencing payment difficulties with mortgage payment holidays and other forbearance measures in 2021. This is expected to increase once measures such as the furlough scheme remove support for those impacted by lockdowns.

While the Society acknowledges the continued uncertainty associated with Covid-19 both in terms of future house price and unemployment movements following the planned removal of government support schemes, the Society's focus on low risk lending, which is geographically spread across the UK, offers protection against future house price falls and affordability pressures.

5.3 Treasury credit risk

5.3.1 Management of treasury credit risk

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

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

Treasury exposure to financial institutions are predominantly with highly rated UK banks, with additional credit limits extended to a small number of highly rated and systemically important institutions in Europe, Australia, Canada and the United States and multilateral development banks (MDBs). In addition, the Society invests in covered bonds and Residential Mortgage Backed Securities (RMBS). The treasury credit framework is reviewed annually by BRC and the Board and reflect internal analysis, external credit ratings and any other relevant factors. There is a maximum permitted exposure set for each category of investments in addition to country and regional limits.

Within the risk framework, detailed limit setting is delegated to the Asset and Liability Committee (ALCO) with oversight from the Risk function. The Treasury Credit Committee monitors and allocates limits within the ALCO approved level.

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

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities. The majority of liquidity continues to be held in UK central bank reserves and Government securities.

All of the Society's treasury exposures remain at investment grade as set out below:

Table 24a: Treasury exposure value by rating 2020

As at 31 December 2020	Aaa–Aa3 £m	A1–A3 £m	Baa1–Baa3 £m	Unrated £m	Total £m
Central banks and sovereigns	5,979.2	–	–	–	5,979.2
Multilateral development banks (supranational bonds)	167.5	–	–	–	167.5
Financial institutions	619.3	523.1	–	–	1,142.4
Residential mortgage-backed securities	25.4	–	–	–	25.4
Total	**6,791.4**	**523.1**	–	–	**7,314.5**

Table 24b: Treasury exposure value by rating 2019

As at 31 December 2019	Aaa–Aa3 £m	A1–A3 £m	Baa1–Baa3 £m	Unrated £m	Total £m
Central banks and sovereigns	5,736.1	–	–	–	5,736.1
Multilateral development banks (supranational bonds)	165.5	–	–	–	165.5
Financial institutions	678.9	197.0	56.9[1]	–	932.8
Residential mortgage-backed securities	20.3	–	–	–	20.3
Total	6,600.8	197.0	56.9	–	6,854.7

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

Capital for credit risk within the liquidity book is calculated using the Standardised approach. For central banks, sovereigns, and UK Financial Institutions with a residual maturity of less than three months, risk weights prescribed in CRD IV are used. At 31 December 2020, the exposure for UK Financial Institutions with a residual maturity of less than three months was £372.4 million (2019: £336.2 million) with a capital requirement of £6.0 million (2019: £5.4 million).

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

Table 25: ECAI exposure values and ratings

	Moody's rating	Risk weight %	Exposure value 2020 £m	Minimum capital requirement 2020 £m	Exposure value 2019 £m	Minimum capital requirement 2019 £m
Retail Mortgage Backed Securities (RMBS)						
Credit quality step 1	Aaa-Aa3	10	**18.2**	**0.2**	12.5	0.1
Credit quality step 1	Aaa-Aa3	20	**7.2**	**0.1**	7.8	0.1
Total RMBS			**25.4**	**0.3**	20.3	0.2
Covered bonds						
Credit quality step 1	Aaa-Aa3	10	**137.4**	**1.1**	242.8	1.9
Credit quality step 2	A1-A3	20	**24.5**	**0.4**		
Total covered bonds			**161.9**	**1.5**	242.8	1.9
Financial institutions						
Credit quality step 1	Aaa-Aa3	20	**87.9**	**1.4**	164.3	2.6
Credit quality step 2	A1-A3	50	**96.6**	**1.6**	39.7	1.6
Credit quality step 3	Baa1	50	**–**	**–**	1.6	0.1
Total financial institutions			**184.5**	**3.0**	205.6	4.3
Total			**371.8**	**4.8**	468.7	6.4

5.3.2 Counterparty credit risk mitigation

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

The Society manages this risk by undertaking credit assessments of all counterparties and by exchanging collateral to mitigate any exposure. Daily collateralisation of repo transactions is carried out in accordance with the Global Master Repurchase Agreements to mitigate net exposure arising from changes in market value. Similarly, all derivatives have Credit Support Annexes (CSAs) in place to ensure they are collateralised to mitigate net mark-to-market credit exposures.

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

The Society is subject to mandatory central clearing of derivatives through a third party regulated central clearing counterparty to reduce systemic and operating risk. Under this, collateral is exchanged on a daily basis. Where the Society enters into 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.

The Society's Covered Bond programmes (Coventry Building Society Covered Bonds LLP and Coventry Godiva Covered Bonds LLP) and Economic Master Issuer plc enter into swaps under separate ISDA agreements. Each agreement includes a CSA which provides for full collateralisation of the swap exposure with exposure thresholds in place for a single agreement before collateral is exchanged. The £7.5 million (2019: £6.6 million) net derivative credit exposure in the table below includes £7.5 million (2019: £3.6 million) in respect of this arrangement which will only be fully collateralised if the counterparty is downgraded to below a specified credit rating.

5.3.3 Counterparty credit risk - derivatives

The balance sheet exposure values of derivative instruments are as follows. The net derivative credit exposure has reduced as a result of changes in the underlying derivative fair values during the year.

Table 26: Derivative counterparty credit exposure

	Exposure value As at 31 December 2020 £m	Exposure value As at 31 December 2019 £m
Gross positive fair value of contracts	**173.5**	137.9
Netting benefits	**(108.9)**	(66.5)
Net credit exposure	**64.6**	71.4
Collateral held	**(57.1)**	(64.8)
Net derivative credit exposure	**7.5**	6.6

As at 31 December 2020, all of the £7.5 million exposure is to Aa3 rated institutions.

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

For regulatory capital purposes, the Society measures derivative counterparty credit exposure values using the counterparty credit risk mark to market method. The net exposure value of derivatives at 31 December 2020, which includes uplifts for Potential Future Credit Exposure (PFCE) under this method, totalled £156.6 million (2019: £163.8 million).

5.3.4 Analysis of treasury assets by IFRS stage and impairment

Under IFRS 9 the calculation of impairment on treasury assets is performed on an Expected Credit Loss (ECL) basis.

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

Given their low risk nature, all of the Society's treasury assets are stage 1 'performing' assets at both 1 January and 31 December 2020. Impairment is calculated applying an externally published probability of default for the applicable credit risk rating to the treasury exposure value. The resulting ECL remains immaterial at 31 December 2020 as it was at 31 December 2019. As at 31 December 2020, no treasury assets were past due.

More information on the impact of IFRS 9 on classification and measurement of the Society's treasury assets is included in note 1 to the 2020 Accounts.

5.3.5 Securitisation

Purchased securitisation positions

The exposure values relating to the Society's ownership of Residential Mortgage Backed Securities (RMBS) and their associated risk weightings for capital purposes are included in Table 25 in section 5.3.1. All exposures comprise senior tranche RMBS.

Purchases and retention of RMBS are undertaken within a clearly defined credit risk policy. RMBS are predominantly held at Fair Value through Other Comprehensive Income (FVOCI) on the Society's balance sheet. Movement on the assets value is reflected in the Society reserves and if the assets are sold before maturity, a gain or loss would be transferred to the Income Statement. RMBS are regularly reviewed in line with article 406 of the Capital Requirements Regulations, with pricing and credit conditions reviewed by the Society's Treasury Credit Committee.

As at 31 December 2020, no purchased securitisation positions were past due or impaired (2019: none). The Society uses the Standardised approach for calculating capital requirements on its purchased securitisation positions.

Originated securitisations and Covered bonds

The Society has securitised certain mortgage loans by transferring the loans to structured entities under the Mercia, Offa and Economic Master Issuer (EMI) securitisation programmes and Coventry Building Society Covered Bonds LLP and Coventry Godiva Covered Bonds LLP covered bond programmes. These programmes enable the Society to obtain secured funding or to create collateral which can be used to source funding.

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

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

The Society's obligations in respect of these securitisation vehicles and programmes are limited to transferring cash flows from the underlying assets and for the covered bonds or EMI maintaining its required overcollateralisation or minimum sellers share in accordance with the rules of the programmes. The Society and its subsidiaries are under no obligation to support any losses that may be incurred by the securitisation programmes or holders of the issued notes. The parties holding the notes in issue are therefore only entitled to obtain payment to the extent of the resources in the securitisation and covered bond programmes respectively.

The three securitisation vehicles and two covered bond programmes create a potential liquidity requirement for the Society due to legal covenants within the swap documentation which require the Society to post collateral with the entities under certain circumstances. The cash flows under these legal covenants are considered in the Society's internal assessment of its liquidity requirements.

The Society is required to post collateral under the Mercia and Offa transactions, and if credit ratings were downgraded may need to post additional collateral and to post collateral under the Economic Master Issuer programme. Collateral postings totalled £62.1 million at 31 December 2020 (2019: £88.8 million). At 31 December

2020, the impact of a one notch credit rating downgrade would increase the required collateral to be posted by £39.0 million (2019: £23.1 million), with no further requirement for a two notch downgrade.

The Society's covered bond programmes gives rise to a similar requirement, and the Society posted collateral of £50.0 million with the Coventry Building Society Covered Bonds LLP at 31 December 2020 (2019: £124.9 million). At this point, no additional collateral would be required under a one notch or two notch downgrade, such a requirement may arise in the future dependent on the valuation of the underlying swaps.

The Society provides bank account facilities to Economic Master Issuer plc and Coventry Godiva Covered Bonds LLP. Upon a one notch ratings downgrade, these facilities would need to move to a third party.

Additional information on the securitisation vehicles and covered bond programmes of the Society is contained in note 15 to the 2020 Accounts.

6. Liquidity and funding risk

Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as they fall due. Funding risk is the risk of the inability to access funding markets or to do so only at excessive cost. Liquidity risk is difficult to eliminate, with the Society's business model transforming on-demand and relatively short-dated retail deposits to contractually much longer-term mortgage lending (maturity transformation).

6.1 Liquidity Management structure

Both risks are managed on a Group basis (including all subsidiary entities) with day-to-day responsibility delegated to the Chief Financial Officer and Treasurer with oversight by ALCO, BRC and the Board. A sub-committee of ALCO called Balance Sheet Management Committee (BSMC) acts as a conduit for analysis and proposals to promote detailed challenge at working level prior to any progression to ALCO. The Prudential and Enterprise Risk function is responsible for oversight and provides insight into key capital, liquidity and interest rate risk in the banking book (IRRBB).

6.2 Strategies and Policies

The Society has articulated its strategy for managing liquidity risk as:

- A clear and appropriate internally defined liquidity risk appetite which is prudent and ensures the Society remains a going concern post stress;
- A diversified funding model maintaining active retail and wholesale franchises within regulatory constraints;
- Ensuring adequate liquidity is maintained across the strategic plan;
- Maintaining a High Quality Liquid Asset portfolio, with constituent portfolios aligned to risk appetite; and
- Utilising an operational liquidity buffer to provide adequate coverage for forecasting uncertainties, with the ability to fund short-term liquidity gaps through retail acquisition or the Bank of England Open Market Operations Repo.

This strategy is deployed primarily via the use of stress testing and a range of preventative and detective controls to manage liquidity and funding, plus associated risks through a range of limits and triggers. These include controls for concentration risk in wholesale funding (in total and by sector and single depositor, plus maturity structure), retail funding activation (including fixed and bonus maturities plus unilateral rate cuts), and encumbrance and over-collateralisation restrictions. In addition, a series of early warning indicators are reviewed as part of the Recovery Plan and a suite of triggers monitored for use in calibrating the severity of the Society binding internal 30-day stress scenario.

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

6.3 Risk Appetite and Planning

The Society has established stress tests to quantify the level of liquidity risk it is exposed to in pursuit of its business objectives and ensuring compliance with its regulatory obligations. The key expression of the liquidity risk is via stress tests and is measured with reference to the liquidity available compared to anticipated net stressed outflows for three stress scenarios. Liquidity risk appetite is monitored daily and reported monthly to ALCO and is subject to formal review at least annually as part of the Internal Liquidity Adequacy Assessment Process (ILAAP).

The Society has chosen, through its risk appetite, to hold sufficient liquidity resources to survive a 90-day combined stress (which combines elements of a firm-specific and market-wide stress) and enough liquid assets to survive a 30-day severe but plausible stress, with 7 days of the 30-day stress covered by cash at the Bank of England. At the end of each stress, the Society is required to have sufficient liquidity to meet its survival point.

This survival point is calibrated as a percentage of LCR. In addition, the Society maintains retail and secured funding capacity to generate enough liquidity to recover from this stress.

6.4 Stress Testing

The Society's Liquidity Risk Appetite uses stress testing to measure the adequacy of liquidity levels and to evidence compliance with the Overall Liquidity Adequacy Rule. A fundamental pillar to this is an assessment of a suitably plausible stress test for survival over a 30-day period and its use of the combined stress test for survival over a 90 day period; indicative of the Society's low appetite for risk.

The Society applies assumptions to each of the sources of liquidity risk to quantify the total stress outflows. These assumptions are made at a granular level to reflect the estimated market and consumer behaviour.

To support this stress testing, the Society undertakes periodic Alternative Stress Tests, which take the form of specifically defined scenarios or more detailed portfolio stress tests to provide further insight into the drivers, exposures and impacts of liquidity risk.

The Society also conducts reverse stress testing to inform the risk management process.

6.5 Recovery planning

ALCO operates with a liquidity buffer above its prudent liquidity risk appetite with protocols in place to deal with 'actual' or 'projected' liquidity below the ALCO buffer in business as usual conditions. The Recovery Plan covers management of liquidity events beyond this.

The Society assesses the full range of Recovery Options available to raise incremental liquidity. The Recovery Plan considers the timeframe for these and the governance framework to manage a liquidity stress event, should the need arise.

The Recovery Plan specifies Recovery Early Warning Indicators and Recovery Invocation Trigger Points that capture both internal and external events that could result in a future liquidity stress. These measures provide the Society with advance warning of events that could lead to a liquidity stress for the Society. The Recovery Plan also provides a framework for the options to be deployed where an Early Warning Indicator or Invocation Trigger Point is breached.

The Recovery Options contained within the Recovery Plan are updated at least annually, in addition to annual Board approval for the entire Recovery Plan. Furthermore, the plan is tested annually to ensure it is operationally robust.

See additional information on Liquidity and Funding risk within the Risk Management Report in the 2020 Accounts.

7. Operational risk

7.1 Operational risk profile

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

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

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

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

7.2 Management of operational risk

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

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

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

Following the emergence of the Covid-19 pandemic, the Society responded quickly by invoking its Serious Incident Management Framework and actively managed the impacts to the Society under two key workstreams: people and business continuity. The Society's business continuity arrangements proved effective and service levels were maintained across all channels.

7.3 Operational risk measurement

The Society uses the standardised approach for calculating its Pillar 1 capital requirement for operational risk. The calculation uses total income averaged over a three year period. The reduction to the risk weighted assets for operational risk in the year to £605.4 million (2019: £610.5 million) is as a result of continuation of low mortgage pricing combined with the Society's strategy of paying the best possible interest rates to its saving members.

7.4 Operational risk outlook

The Society continues to develop its approach to operational resilience in line with regulatory expectations which are expected to be confirmed by the regulator in the first half of 2021. The Society expects to finalise its Operational Risk and Resilience Framework in 2021 and will continue to work on defining important business services, setting impact tolerance, mapping end to end services and scenario testing to better understand where the Society can improve its resilience.

See additional information on Operational risk within the Risk Management Report in the 2020 Accounts.

Appendix 1: EBA Own Funds Disclosure Template

Any blank lines in the template have been removed.

		Transitional CRD IV		End-point CRD IV	
		2020 £m	2019 £m	**2020** £m	2019 £m
Common Equity Tier 1 (CET 1) Capital: instruments and reserves					
2	Retained earnings	**1,835.1**	1,773.3	**1,835.1**	1,773.3
3	Accumulated other comprehensive income (and other reserves)	**(44.0)**	14.5	**(44.0)**	14.5
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(10.4)**	(10.6)	**(10.4)**	(10.6)
6	Common Equity Tier 1 (CET 1) capital before regulatory adjustments	**1,780.7**	1,777.2	**1,780.7**	1,777.2
Common Equity Tier 1 (CET 1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	**(1.0)**	(1.3)	**(1.0)**	(1.3)
8	Intangible assets (net of related deferred tax liability (negative amount)	**(31.0)**	(30.4)	**(31.0)**	(30.4)
11	Fair value reserves related to gains or losses on cash flow hedges	**46.3**	(10.8)	**46.3**	(10.8)
12	Negative amounts resulting from the calculation of expected loss amounts	**(4.0)**	(24.5)	**(4.0)**	(24.5)
15	Defined-benefit pension fund assets (negative amount)	**(7.7)**	(19.2)	**(7.7)**	(19.2)
27a	Other regulatory adjustments to CET 1 capital (including IFRS 9 transitional adjustments when relevant)	**0.4**	–	**–**	–
28	Total regulatory adjustments to Common Equity Tier 1 (CET 1)	**3.0**	(86.2)	**2.6**	(86.2)
29	Common Equity Tier 1 (CET 1) capital	**1,783.7**	1,691.0	**1,783.3**	1,691.0
Additional Tier 1 (AT 1) capital: instruments					
30	Capital instruments and the related share premium accounts	**415.0**	415.0	**415.0**	415.0
31	of which: classified as equity under applicable accounting standards	**415.0**	415.0	**415.0**	415.0
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT 1	**32.0**	40.0	**–**	–
36	Additional Tier 1 (AT 1) capital before regulatory adjustments	**447.0**	455.0	**415.0**	415.0
44	Additional Tier 1 (AT 1) capital	**447.0**	455.0	**415.0**	415.0
45	Tier 1 capital (T1 = CET 1 + AT 1)	**2,230.7**	2,146.0	**2,198.3**	2,106.0
Tier 2 (T2) capital: instruments and provisions					
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	**11.1**	16.6	**–**	–
51	Tier 2 (T2) capital before regulatory adjustments	**11.1**	16.6	**–**	–
58	Tier 2 (T2) capital	**11.1**	16.6	**–**	–
59	Total capital (TC = T1 + T2)	**2,241.8**	2,162.6	**2,198.3**	2,106.0
60	Total risk weighted assets	**5,410.9**	5,283.6	**5,410.6**	5,283.6

		Transitional CRD IV		End-point CRD IV	
		2020 £m	2019 £m	**2020 £m**	2019 £m
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	**33.0%**	32.0%	**33.0%**	32.0%
62	Tier 1 (as a percentage of total risk exposure amount)	**41.2%**	40.6%	**40.6%**	39.9%
63	Total capital (as a percentage of total risk exposure amount)	**41.4%**	40.9%	**40.6%**	39.9%
64	Institution specific buffer requirement (CET 1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	**7.0%**	8.0%	**7.0%**	8.0%
65	of which: capital conservation buffer requirement	**2.5%**	2.5%	**2.5%**	2.5%
66	of which: countercyclical buffer requirement	**0.0%**	1.0%	**0.0%**	1.0%
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**28.5%**	27.5%	**28.5%**	27.5%
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)					
82	Current cap on AT 1 instruments subject to phase out arrangements	**32.0**	48.0	**–**	–
83	Amount excluded from AT 1 due to cap (excess over cap after redemptions and maturities)	**8.0**	–	**–**	–
84	Current cap on T2 instruments subject to phase out arrangements	**11.1**	16.6	**–**	–
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities	**13.9**	8.4	**–**	–

Appendix 2: Capital Instruments Key Features

1	Issuer	Coventry	Coventry	Coventry (Stroud & Swindon)	Coventry (Stroud & Swindon)
2	ISIN	XS1961836712	GB0002290764	N/a	N/a
3	Gov. law (sub)	English	English	English	English
	Regulatory treatment				
4	Trans. CRR rules	AT 1	AT 1	T2	T2
5	Post-transitional CRR rules	AT 1	Ineligible	Ineligible	Ineligible
6	Eligible at Group (G), Individual Consolidated (IC) or Society (S)	G; IC; S	G; IC; S	G; IC; S	G; IC; S
7	Instrument type (types to be specified by each jurisdiction)	Perpetual Capital Security	PIBS	Sub Debt	Sub Debt
8	Regulatory capital value (£m)	415,000,000	32,000,000	6,657,960	4,438,640
9	Nominal amount of instrument	415,000,000	40,000,000	15,000,000	10,000,000
9a	Issue price	100	100.749	100	100
9b	Redemption price	100	100	100	100
10	Accounting classification	Shareholders' equity	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost
11	Date of issue	02-Apr-19	28-May-92	23-Aug-01	29-Aug-03
12	Perpetual or dated	Perpetual	Perpetual	Dated	Dated
13	Original maturity	No maturity	No maturity	23-Aug-32	29-Aug-26
14	Issuer call	Yes	No	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	18-Sep-24; par regulatory/tax call	N/a	23-Aug-27	29-Aug-21
16	Subsequent call dates, if applicable	5 yearly	N/a	N/a	N/a
	Coupons / dividends				
17	Fixed or floating dividend/coupon	Fixed to fixed	Fixed	Fixed to fixed	Fixed to fixed
18	Coupon rate and any related index	6.875%	12.125%	7.540%	6.327%
19	Existence of a dividend stopper	No	No	No	No
20a/b	Fully discretionary, partially or mandatory (in terms of timing)	Fully discretionary	Partially discretionary	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	No	No	Yes	Yes
22	Non-cumulative or cumulative	Non-cumulative	Non-cumulative	N/a	N/a
23	Convertible or non-convertible	Convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	Contractual – CET 1 <7%	N/a	N/a	N/a
25	If convertible, fully or partially	Fully	N/a	N/a	N/a
26	If convertible, conversion rate	One for every £67 held	N/a	N/a	N/a
27	If convertible, mandatory or optional	Mandatory	N/a	N/a	N/a

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

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

Appendix 3: Asset Encumbrance Disclosure Template

The templates below are as prescribed in updated EBA Guideline EBA/RTS/2017/03 on disclosure of encumbered and unencumbered assets.

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

Template A – Encumbered and unencumbered assets

2020		Carrying amount of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Carrying amount of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m
010	Assets of the reporting institution	**14,337.8**	**105.9**			**36,056.9**	**5,459.5**		
030	Equity instruments	**–**	**–**			**4.1**	**–**		
040	Debt securities	**105.9**	**105.9**	**105.9**	**105.9**	**898.3**	**890.9**	**898.6**	**891.7**
050	of which: covered bonds	**–**	**–**	**–**	**–**	**187.2**	**187.2**	**188.1**	**188.1**
060	of which: asset backed securities	**–**	**–**	**–**	**–**	**26.2**	**18.8**	**25.5**	**18.8**
070	of which: issued by general government	**105.9**	**105.9**	**105.9**	**105.9**	**528.7**	**528.7**	**528.7**	**528.7**
080	of which: issued by financial corporations	**–**	**–**	**–**	**–**	**26.2**	**18.8**	**25.5**	**18.8**
120	Other assets[1]	**14,100.3**	**–**			**35,075.9**	**4,511.8**		

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

2019		Carrying amount of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Carrying amount of unencumbered assets £m	of which notionally eligible EHQLA and HQLA £m	Fair value of encumbered assets £m	of which notionally eligible EHQLA and HQLA £m
		010	030	040	050	060	080	090	100
010	Assets of the reporting institution	12,018.2	316.5			36,714.0	5,719.5		
030	Equity instruments	–	–			4.0	–		
040	Debt securities	316.5	316.5	316.5	–	804.0	793.5	803.5	793.5
050	of which: covered bonds	–	–	–	–	166.1	166.1	166.1	166.1
060	of which: asset backed securities	–	–	–	–	10.5	–	9.5	–
070	of which: issued by general government	316.5	316.5	316.5	–	479.4	479.4	479.4	479.4
080	of which: issued by financial corporations	–	–	–	–	10.5	–	9.5	–
120	Other assets[1]	11,607.6	–			35,773.5	4,816.5		

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

Template B - Collateral received

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

Template C – Encumbered assets/collateral received and associated liabilities

2020		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
		010	030
010	Carrying amount of selected financial liabilities	**9,420.9**	**13,751.8**
2019			
010	Carrying amount of selected financial liabilities	7,716.1	11,405.6

Template D – Information on importance of encumbrance

The most material sources of encumbrance for the Society are secured funding via the Society's covered bond and securitisation programmes which are supported by pledging mortgage assets. The Society has also utilised whole mortgage pools with the Bank of England to secure amounts drawn down under the Term Funding Scheme (TFS) and the Term Funding Scheme with additional incentives for SMEs (TFSME). Further detail on these activities is set out in note 15 to the 2020 Accounts. Assets are encumbered in accordance with the contractual requirements of these programmes. Furthermore, these programmes are continually assessed and a prudent buffer of over-collateralisation is voluntarily maintained for operational efficiency. The underlying assets and cover pool assets related to any securities retained by the Society are treated as unencumbered in both this disclosure and in the Accounts.

The Society also pledges debt securities as collateral in sale and repurchase transactions – see note 14 to the 2020 Accounts.

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

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

At the year end encumbered assets are predominantly all on the Society's own balance sheet other than around £0.1 billion of mortgage assets (2019: £0.2 billion) from its subsidiary Godiva Mortgages Limited and the liquid assets held within the Society's covered bond and securitisation programmes referenced above.

The over collateralisation of £4.3 billion in Template C (2019: £3.7 billion) predominantly represents over-collateralisation in respect of covered bonds, securitisations and whole mortgage pool operations.

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

A general description of the terms and conditions of the collateralisation agreements entered into for securing liabilities are available in the 2020 Accounts as follows; for sale and repurchase transactions of debt securities in note 14; for covered bonds, securitisation and whole mortgage pools in note 15; and for derivatives in note 23.

Appendix 4: Leverage Ratio – Disclosure Templates

Reference date	31 December 2020 (31 December 2019 for comparatives)
Entity name	Coventry Building Society
Level of application	Consolidated

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

		Applicable Amount	
		2020 **£m**	2019 £m
1	Total assets as per published financial statements	**51,498.3**	49,530.8
4	Adjustments for derivative financial instruments	**27.8**	51.6
5	Adjustments for securities financing transactions "SFTs"	**76.1**	1,817.5
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**515.7**	345.4
7	Other adjustments	**(429.7)**	(240.0)
8	**Total leverage exposure**	**51,688.2**	51,505.3

Template B - Table LRCom: Leverage ratio common disclosures

		CRR leverage ratio exposures 2020 £m	2019 £m
	On balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**51,321.6**	49,392.9
2	(Asset amounts deducted in determining Tier 1 capital)	**(43.7)**	(75.4)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**51,277.9**	49,317.5
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**64.6**	39.4
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**136.7**	150.1
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(382.8)**	(164.7)
11	**Total derivative exposures (sum of lines 4 to 10)**	**(181.5)**	24.8
	Securities financing transaction exposures		
14	Counterparty credit risk exposure for SFT assets	**76.1**[1]	1,817.5
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**76.1**[1]	1,817.5
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**2,534.0**	1,675.9
18	(Adjustments for conversion to credit equivalent amounts)	**(2,018.3)**	(1,330.4)
19	**Other off-balance sheet exposures (sum of lines 17 to 18)**	**515.7**	345.5
	Capital and total exposures		
20	Tier 1 capital	**2,198.3**	2,106.0
21	**Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**51,688.2**	51,505.3
	Leverage ratio		
22	**Leverage ratio**	**4.3%**	4.1%[2]
	Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Fully phased in**	Fully phased in

1. During 2020 the Society refined the calculation of this measure and concluded that Loan pools do not meet the definition of securities funding transactions. For this reason they have been considered not to lead to an additional exposure when used as collateral. This change in approach increased the CRR leverage ratio by 0.1%.
2. This balance has been updated to show the CRR leverage ratio as opposed to the previously disclosed UK leverage ratio.

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

		CRR leverage ratio exposures	
		2020 £m	2019 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**51,321.6**	49,392.9
EU-3	Banking book exposures, of which:	**51,321.6**	49,392.9
EU-4	Covered bonds	**162.1**	242.7
EU-5	Exposures treated as sovereigns	**5,979.2**	5,736.0
EU-6	Exposures to regional governments, MDB, international organisations and PSE not treated as sovereigns	**167.5**	165.5
EU-7	Institutions	**960.1**	672.3
EU-8	Secured by mortgages of immovable properties	**43,826.0**	42,356.4
EU-9	Retail exposures	**16.2**	19.6
EU-10	Corporate	–	1.6
EU-11	Exposures in default (standardised)	**6.8**	6.3
EU-12	Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	**203.7**	192.5

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

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

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

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

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

The leverage ratio has remained broadly stable at 4.3% (2019: 4.1 %). This is largely the result of the Society having concluded that loan pools do not meet the definition of securities funding transactions and therefore do not to lead to an additional exposure when used as collateral, this change has increased the CRR and UK leverage ratio by 0.1%. Beyond this there was little change in the underlying ratio, as the increase in eligible Tier 1 capital was matched by a slightly smaller relative increase in leverage ratio exposures, which was largely driven by the growth in the mortgage book. This reflects the Society’s strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Appendix 5: Countercyclical Capital Buffers - Disclosure Templates

The countercyclical buffer is an additional requirement introduced by CRD IV, calculated by applying a weighted average of country countercyclical buffer rates based on the geographical distribution of relevant exposures to the overall capital requirements of the Society. The following templates disclose information relevant for the calculation of the countercyclical buffer as at 31 December 2020 in accordance with Regulation (EU) 2015/1555 on a consolidated basis.

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

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

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

2020		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	Breakdown by country												
	UK	**640.2**	**46,378.5**	**–**	**–**	**25.4**	**–**	**371.1**	**–**	**0.3**	**371.4**	**1.0**	**0%**
020	**Total**	**640.2**	**46,378.5**	**–**	**–**	**25.4**	**–**	**371.1**	**–**	**0.3**	**371.4**	**1.0**	**0%**

2019		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	Breakdown by country												
	UK	1,322.6	45,437.9	–	–	20.3	–	368.8	–	0.2	369.0	1.0	1%
020	**Total**	1,322.6	45,437.9	–	–	20.3	–	368.8	–	0.2	369.0	1.0	1%

Table 2: Amount of institution specific countercyclical capital buffer

Row		2020 Column	2019 Column
		010	**010**
010	**Total risk exposure amount**	**£5,410.9m**	£5,283.6m
020	**Institution specific countercyclical buffer rate**	**0%**	1%
030	**Institution specific countercyclical buffer requirement**	**–**	£52.8m

Appendix 6: Non-performing and forborne exposures

Gross carrying amount of forborne exposures and the related accumulated impairment, provisions, accumulated change in fair value due to credit risk, and collateral and financial guarantees received, according to the scope of regulatory consolidation in accordance with Chapter 2 of Title II of Part One of the CRR.

The Society's non-performing and forborne exposures are only associated to its Loans and advances. Overall movements year on year within all tables shown below reflect the growth of the book and low levels of arrears and impairment. These movements have been explained within section 5.

Template 1: Credit quality of forborne exposures

2020		**Gross carrying amount/nominal amount of exposures with forbearance measures**				**Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions**		**Collateral received and financial guarantees received on forborne exposures**	
			Non-performing forborne						
Row		**Performing forborne £m**	**£m**	**Of which defaulted £m**	**Of which impaired £m**	**On performing forborne exposures £m**	**On non-performing forborne exposures £m**	**£m**	**Of which collateral and financial guarantees received on non-performing exposures with forbearance measures £m**
1	**Loans and advances**	**7.7**	**2.1**	**0.4**	**1.1**	**–**	**–**	**9.8**	**2.1**
7	***Households***	**7.7**	**2.1**	**0.4**	**1.1**	**–**	**–**	**9.8**	**2.1**
9	**Loan commitments given**	**0.1**	**–**	**–**	**–**	**–**	**–**	**0.1**	**–**
10	***Total***	**7.8**	**2.1**	**0.4**	**1.1**	**–**	**–**	**9.9**	**2.1**

2019		Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forborne exposures	
			Non-performing forborne						
Row		Performing forborne £m	£m	Of which defaulted £m	Of which impaired £m	On performing forborne exposures £m	On non-performing forborne exposures £m	£m	Of which collateral and financial guarantees received on non-performing exposures with forbearance measures £m
1	Loans and advances	4.9	3.4	0.3	2.3	–	–	8.3	3.4
7	*Households*	4.9	3.4	0.3	2.3	–	–	8.3	3.4
9	Loan commitments given	0.1	–	–	–	–	–	0.1	–
10	*Total*	5.0	3.4	0.3	2.3	–	–	8.4	3.4

Template 3: Credit quality of performing and non-performing exposures by past due days

2020

Row		Gross carrying amount/nominal amount											
		Performing exposures			Non-performing exposures								
		£m	Not past due or past due ≤ 30 days £m	Past due > 30 days ≤ 90 days £m	£m	Unlikely to pay that are not past due or are past due ≤ 90 days £m	Past due > 90 days ≤ 180 days £m	Past due > 180 days ≤ 1 year £m	Past due > 1 year ≤ 2 years £m	Past due > 2 years ≤ 5 years £m	Past due > 5 years ≤ 7 years £m	Past due > 7 years £m	Of which defaulted £m
1	**Loans and advances**	**43,252.5**	**43,171.5**	**81.1**	**206.6**	**128.6**	**36.6**	**27.2**	**10.8**	**3.1**	**0.2**	**0.1**	**206.6**
6	***Non-financial corporations***	**1.4**	**1.4**	**–**	**0.4**	**0.4**	**–**	**–**	**–**	**–**	**–**	**–**	**0.4**
7	***Of which SMEs***	**1.4**	**1.4**	**–**	**0.4**	**0.4**	**–**	**–**	**–**	**–**	**–**	**–**	**0.4**
8	***Households***	**43,251.1**	**43,170.1**	**81.1**	**206.2**	**128.2**	**36.6**	**27.2**	**10.8**	**3.1**	**0.2**	**0.1**	**206.2**
15	**Off-balance-sheet exposures**	**2,541.9**			**0.4**								**–**
21	***Households***	**2,541.9**			**0.4**								**–**
22	***Total***	**45,794.4**	**43,171.5**	**81.1**	**207.0**	**128.6**	**36.6**	**27.2**	**10.8**	**3.1**	**0.2**	**0.1**	**206.6**

2019

Row		Gross carrying amount/nominal amount											
		Performing exposures			Non-performing exposures								
		£m	Not past due or past due ≤ 30 days £m	Past due > 30 days ≤ 90 days £m	£m	Unlikely to pay that are not past due or are past due ≤ 90 days £m	Past due > 90 days ≤ 180 days £m	Past due > 180 days ≤ 1 year £m	Past due > 1 year ≤ 2 years £m	Past due > 2 years ≤ 5 years £m	Past due > 5 years ≤ 7 years £m	Past due > 7 years £m	Of which defaulted £m
1	Loans and advances	41,971.4	41,877.2	94.2	197.6	130.6	41.2	18.1	5.6	2.1	–	–	34.5
6	*Non-financial corporations*	1.6	1.6	–	0.4	0.4	–	–	–	–	–	–	–
7	*Of which SMEs*	1.6	1.6	–	0.4	0.4	–	–	–	–	–	–	–
8	*Households*	41,969.8	41,875.6	94.2	197.2	130.3	41.2	18.1	5.6	2.1	–	–	34.5
15	Off-balance-sheet exposures	1,675.5			0.4								–
21	*Households*	1,675.5			0.4								–
22	*Total*	43,646.9	41,877.2	94.2	198.0	130.6	41.2	18.1	5.6	2.1	–	–	34.5

Template 4: Performing and non-performing exposures and related provisions

2020		Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
		Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions					
Row		£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	On performing exposures £m	On non-performing exposures £m
1	Loans and advances	43,252.5	39,703.4	3,549.1	206.6	–	206.6	(36.9)	(8.50)	(28.4)	(11.1)	–	(11.1)	–	43,145.5	198.4
6	*Non-financial corporations*	1.4	–	1.4	0.4	–	0.4	(0.2)	–	(0.2)	(0.2)	–	(0.2)	–	1.2	0.2
7	*Of which SMEs*	1.4	–	1.4	0.4	–	0.4	(0.2)	–	(0.2)	(0.2)	–	(0.2)	–	1.2	0.2
8	*Households*	43,251.1	39,703.4	3,547.7	206.2	–	206.2	(36.7)	(8.5)	(28.2)	(10.9)	–	(10.9)	–	43,144.3	198.2
15	Off-balance-sheet exposures	2,541.9	2,532.2	9.7	0.4	–	0.4	–	–	–	–	–	–		27.4	0.3
21	*Households*	2,541.9	2,532.2	9.7	0.4	–	0.4	–	–	–	–	–	–		27.4	0.3
22	Total	45,749.4	42,235.6	3,558.8	207.0	–	207.0	(36.9)	(8.5)	(28.4)	(11.1)	–	(11.1)	–	43,172.9	198.7

2019		Gross carrying amount/nominal amount						Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
		Performing exposures			Non-performing exposures			Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions					
Row		£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	Of which stage 1 £m	Of which stage 2 £m	£m	Of which stage 2 £m	Of which stage 3 £m	£m	On performing exposures £m	On non-performing exposures £m
1	Loans and advances	41,971.4	40,892.9	1,078.5	197.6	0.1	197.3	(4.2)	(1.0)	(3.2)	(7.8)	–	(7.7)	–	41,854.9	191.7
6	*Non-financial corporations*	*1.6*	–	*1.6*	*0.4*	–	*0.4*	*(0.2)*	–	*(0.2)*	*(0.2)*	–	*(0.2)*	–	*1.4*	*0.2*
7	*Of which SMEs*	*1.6*	–	*1.6*	*0.4*	–	*0.4*	*(0.2)*	–	*(0.2)*	*(0.2)*	–	*(0.2)*	–	*1.4*	*0.2*
8	*Households*	*41,969.8*	*40,892.9*	*1,076.9*	*197.2*	*0.1*	*197.0*	(4.0)	*(1.0)*	*(3.0)*	*(7.6)*	–	*(7.5)*	–	*41,853.4*	*191.5*
15	Off-balance-sheet exposures	1,675.5	1,672.1	3.4	0.4	–	0.4	–	–	–	–	–	–		31.5	0.4
21	*Households*	*1,675.5*	*1,672.1*	*3.4*	*0.4*	–	*0.4*	–	–	–	–	–	–		*31.5*	*0.4*
22	Total	43,646.9	42,565.0	1,081.9	198.0	0.1	197.7	(4.3)	(1.0)	(3.2)	(7.8)	–	(7.7)	–	41,886.4	192.1

Template 9: Collateral obtained by taking possession and execution processes

		2020		2019	
		Collateral obtained by taking possession		Collateral obtained by taking possession	
		Value at initial recognition £m	**Accumulated negative changes £m**	Value at initial recognition £m	Accumulated negative changes £m
3	*Residential immovable property*	**3.4**	**0.4**	5.60	0.40
8	***Total***	**3.4**	**0.4**	5.60	0.40

Appendix 7: Liquidity Coverage Ratio (LCR) disclosures

In accordance with regulation (EU) 575/2013 this Appendix sets out the Liquidity Coverage Ratio (LCR) disclosures in the format prescribed under CRR. The LCR is a measure which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions. These disclosures complement the disclosure of liquidity risk management under the CRR which are included in section 6 and within the 2020 Accounts Risk Management Report.

Qualitative information

The Society reported the LCR of 179% as at 31 December 2020 (2019: 214%) which is significantly above the regulatory requirement. The LCR reduced year-on-year, which results from the increased retail and pipeline requirements, the availability of Term Funding Scheme with additional incentives for SMEs (TFSME) and repaying £2.0 billion of Term Funding Scheme (TFS) in December 2020 which impacted the cash levels at the end of year but reduced maturity concentration risk in 2021-22.

The liquidity buffer encompasses deposits with the Bank of England and holdings of highly rated and highly liquid debt securities, 93% of the liquidity portfolio is rated Aaa–Aa3 (2019: 96%). Furthermore, 98% of liquid assets are held in UK sovereign or UK financial institutions (2019: 99%).

The retail deposits are the main driver in the LCR requirement, representing over 63% of the total stressed outflows. Periodic changes in the retail requirement typically result from the maturity of term deposits falling into the LCR stress window. The Society's mortgage pipeline is a major driver of liquidity risk and constitutes about 20% of the LCR requirement, albeit fluctuating over 2020.

The Society's retail deposit base was £37.2 billion as at 31 December 2020 (2019: £36.3 billion), which represents 78.6% (2019: 76.2%) of the Society's liabilities (excluding capital). The Society held £10.3 billion (2019: £10.6 billion) of wholesale funding; 94% (2019: 95%) of this funding was from longer-term sources such as Covered Bonds, Medium-Term Notes, Residential Mortgage Backed Securities and the Bank of England funding schemes such as TFS and TFSME. The relatively large size of long-term wholesale funding deals and their typical structure as bullet maturity creates re-financing risk. As such wholesale maturities are monitored and spread to avoid concentrations.

As at 31 December 2020, the Society does not report on any other material currencies.

The Society only undertakes derivative trades with counterparties where a Credit Support Annex (CSA) is in place. Under the terms of a CSA, the Society posts and receives collateral with counterparty banks (including its central clearing brokers) that offset the net mark-to-market position of derivatives with the counterparty. These arrangements are effective in mitigating the credit risk incurred in derivatives, but create a potential liquidity requirement via initial margin and variation margin calls. The Society is exposed to liquidity outflows if collateral postings are required should the Society be downgraded. However, these thresholds have largely passed with little incremental risk remaining.

Template EU LIQ1 - Quantitative information of LCR

2020 **Produced on a consolidated basis** **Currency and units (£ million)**		**Total unweighted value**				**Total weighted value**			
Quarter ending on		**31-Dec-20**	**30-Sep-20**	**30-Jun-20**	**31-Mar-20**	**31-Dec-20**	**30-Sep-20**	**30-Jun-20**	**31-Mar-20**
Number of data points used in the calculation of averages		**12**	**12**	**12**	**12**	**12**	**12**	**12**	**12**
HIGH-QUALITY LIQUID ASSETS									
1	Total high-quality liquid assets (HQLA)					**5,888.3**	**5,542.2**	**5,646.3**	**5,772.2**
CASH-OUTFLOWS									
2	Retail deposits and deposits from small business customers, of which:	**36,219.0**	**35,840.4**	**35,782.9**	**35,554.6**	**1,958.6**	**1,912.1**	**1,937.8**	**1,898.6**
3	*Stable deposits*	**16,369.7**	**16,685.2**	**16,811.4**	**17,308.2**	**818.5**	**834.3**	**840.6**	**865.4**
4	*Less stable deposits*	**9,160.3**	**8,756.0**	**8,957.7**	**8,487.1**	**1,140.1**	**1,077.8**	**1,097.2**	**1,033.2**
5	Unsecured wholesale funding	**265.7**	**156.8**	**194.6**	**190.7**	**216.6**	**112.6**	**149.9**	**139.7**
6	*Operational deposits (all counterparties) and deposits in networks of cooperative banks*	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
7	*Non-operational deposits (all counterparties)*	**180.3**	**119.4**	**155.8**	**181.4**	**131.2**	**75.2**	**111.1**	**130.4**
8	*Unsecured debt*	**85.4**	**37.4**	**38.8**	**9.3**	**85.4**	**37.4**	**38.8**	**9.3**
9	Secured wholesale funding					**–**	**–**	**–**	**–**
10	Additional requirements	**272.5**	**273.9**	**270.5**	**267.5**	**272.5**	**273.9**	**270.5**	**267.5**
11	*Outflows related to derivative exposures and other collateral requirements*	**216.9**	**218.8**	**215.7**	**212.9**	**216.9**	**218.8**	**215.7**	**212.9**
12	*Outflows related to loss of funding on debt products*	**55.6**	**55.1**	**54.8**	**54.6**	**55.6**	**55.1**	**54.8**	**54.6**
13	*Credit and liquidity facilities*	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
14	Other contractual funding obligations	**23.3**	**25.0**	**26.2**	**24.5**	**7.4**	**8.0**	**8.5**	**9.3**
15	Other contingent funding obligations	**2,398.1**	**2,298.5**	**2,364.0**	**2,251.7**	**617.2**	**609.0**	**649.9**	**646.8**
16	**TOTAL CASH OUTFLOWS**					**3,072.3**	**2,915.6**	**3,016.6**	**2,961.9**
CASH-INFLOWS									
17	Secured lending (e.g. reverse repos)	**15.6**	**13.9**	**13.9**	**–**	**–**	**–**	**–**	**–**
18	Inflows from fully performing exposures	**246.3**	**241.2**	**232.6**	**224.9**	**190.1**	**170.7**	**164.1**	**158.9**
19	Other cash inflows	**5.3**	**17.7**	**20.6**	**21.6**	**5.3**	**14.6**	**17.5**	**18.5**
20	**TOTAL CASH INFLOWS**	**267.2**	**272.8**	**267.1**	**246.5**	**195.4**	**185.3**	**181.6**	**177.4**
EU-20a	***Fully exempt inflows***	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
EU-20b	***Inflows Subject to 90% Cap***	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
EU-20c	***Inflows Subject to 75% Cap***	**267.2**	**272.8**	**267.1**	**246.5**	**195.4**	**185.3**	**181.6**	**177.4**
21	**LIQUIDITY BUFFER**					**5,888.3**	**5,542.2**	**5,646.3**	**5,772.2**
22	**TOTAL NET CASH OUTFLOWS**					**2,880.8**	**2,716.1**	**2,816.9**	**2,766.4**
23	**LIQUIDITY COVERAGE RATIO (%)**					**205.5%**	**205.4%**	**202.1%**	**211.1%**

Template EU LIQ1 - Quantitative information of LCR

2019 Produced on a consolidated basis Currency and units (£ million)		**Total unweighted value**				**Total weighted value**			
Quarter ending on		**31-Dec-19**	**30-Sep-19**	**30-Jun-19**	**31-Mar-19**	**31-Dec-19**	**30-Sep-19**	**30-Jun-19**	**31-Mar-19**
Number of data points used in the calculation of averages		**12**	**12**	**12**	**12**	**12**	**12**	**12**	**12**
HIGH-QUALITY LIQUID ASSETS									
1	Total high-quality liquid assets (HQLA)					5,562.0	5,522.5	5,339.7	5,020.3
CASH-OUTFLOWS									
2	Retail deposits and deposits from small business customers, of which:	34,887.3	34,221.7	33,535.9	32,672.3	1,790.8	1,690.3	1,575.1	1,536.3
3	*Stable deposits*	18,247.8	19,062.4	19,845.8	20,181.7	912.4	953.1	992.3	1,009.1
4	*Less stable deposits*	7,337.1	6,265.6	5,154.8	4,621.0	878.4	737.2	582.8	527.2
5	Unsecured wholesale funding	263.1	317.5	316.8	327.7	211.4	263.3	260.1	270.3
6	*Operational deposits (all counterparties) and deposits in networks of cooperative banks*	–	–	–	–	–	–	–	–
7	*Non-operational deposits (all counterparties)*	223.9	280.4	283.9	294.8	172.2	226.2	227.2	237.4
8	*Unsecured debt*	39.2	37.1	32.9	32.9	39.2	37.1	32.9	32.9
9	Secured wholesale funding					–	–	–	–
10	Additional requirements	226.7	226.4	226.6	225.7	226.7	226.4	226.6	225.7
11	*Outflows related to derivative exposures and other collateral requirements*	226.7	226.4	226.6	225.7	226.7	226.4	226.6	225.7
12	*Outflows related to loss of funding on debt products*	–	–	–	–	–	–	–	–
13	*Credit and liquidity facilities*	–	–	–	–	–	–	–	–
14	Other contractual funding obligations	12.3	11.0	10.7	13.7	1.9	1.3	0.9	1.0
15	Other contingent funding obligations	2,137.7	2,024.0	1,851.6	1,862.9	647.2	650.9	641.2	740.8
16	**TOTAL CASH OUTFLOWS**					2,878.0	2,832.2	2,703.9	2,774.1
CASH-INFLOWS									
17	Secured lending (e.g. reverse repos)	–	–	–	–	–	–	–	–
18	Inflows from fully performing exposures	235.7	240.1	251.9	255.1	168.6	191.7	205.3	210.1
19	Other cash inflows	53.3	41.2	37.9	37.5	50.2	41.2	37.9	37.5
20	**TOTAL CASH INFLOWS**	289.0	281.3	289.8	292.6	218.8	232.9	243.2	247.6
EU-20a	***Fully exempt inflows***	–	–	–	–	–	–	–	–
EU-20b	***Inflows Subject to 90% Cap***	–	–	–	–	–	–	–	–
EU-20c	***Inflows Subject to 75% Cap***	289.0	281.3	289.8	292.6	218.8	232.9	243.2	247.6
21	**LIQUIDITY BUFFER**					5,562.0	5,522.5	5,339.7	5,020.3
22	**TOTAL NET CASH OUTFLOWS**					2,641.0	2,599.4	2,460.7	2,526.6
23	**LIQUIDITY COVERAGE RATIO (%)**					212.0%	213.9%	217.0%	199.3%

Glossary

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

Term	Definition
Accounts	The Society's Annual Report & Accounts
Additional Tier 1 (AT 1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to a form of Common Equity Tier 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Average loan to value	The average of individual loan to values (simple average). The average loan to value of the residential mortgage book, weighted by balance (balance weighted). For indexed loan to value – see 'Indexed loan to value'.
Basel III	The Basel Committee on Banking Supervision issued proposals for a strengthened capital regime in response to the financial crisis, which are referred to as Basel III. These standards were implemented in the European Union via CRD IV, which came into force on 1 January 2014.
Basel IV	The alternative industry name given to the Basel Committee's final implementation of its Basel III Banking Supervision reforms published in December 2017 addressing credit risk (standardised approach with floors, and IRB), operational risk, and the leverage ratio. They are applicable from January 2022 and are phased in over five years.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital Conservation Buffer (CCoB)	A CRD IV risk adjusted capital requirement for all banks that can be used to absorb losses whilst avoiding breaching minimum capital requirements.
Capital requirements	Amount of capital required to be held by the Group to cover the risk of losses and to protect against excessive leverage. The level is set by regulators and the firm's own assessment of its risk profile.

Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)	CRD IV is the European Union legislation (part regulation and part directive) which came into force from 1 January 2014 to implement Basel III, revising the capital requirements framework and introducing liquidity requirements, which regulators use when supervising firms.
Capital Requirements Regulations (CRR) leverage ratio	A ratio defined by the Capital Requirement Regulations (CRR) which measures Tier 1 capital as a proportion of total CRR leverage ratio exposures. These exposures are the sum of the on-balance sheet exposures, adjusted for derivatives and securities financing transaction exposures, and off-balance sheet items.
Capital resources	Capital comprising the general reserve, fair value through other comprehensive income (FVOCI) reserve, Additional Tier 1 capital less all required regulatory adjustments.
Central clearing	The process by which parties to an OTC derivative contract replace this with a separate contract with a central counterparty, which takes over each party's positions under the original contract.
Collateral	Security pledged by the borrower to the lender in case of default.
Common Equity Tier 1 (CET 1) capital	Common Equity Tier 1 capital comprises general reserves and the fair value through other comprehensive income (FVOCI) reserve, less regulatory deductions. Common Equity Tier 1 must absorb losses on a going concern basis.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Contractual maturity	The date in the terms of a financial instrument on which the last payment or receipt under the contract is due for settlement.
Core Capital Deferred Shares (CCDS)	A form of Common Equity Tier 1 (CET 1) capital. The Society's Perpetual Capital Securities (PCS) convert into CCDS at the rate of one CCDS for every £67 PCS held if the end-point CET 1 ratio, calculated on either an individual or consolidated basis, falls below 7%.
Countercyclical Buffer (CCyB)	A CRD IV risk adjusted capital requirement for all banks that is varied over the financial cycle to match the resilience of the banking system to the scale of risks faced.
Countercyclical Leverage Buffer (CCLB)	A leverage capital requirement under the UK leverage regime that is set at 35% of the corresponding risk adjusted Countercyclical Buffer (CCyB).
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.

Covered bonds	Debt securities that are backed by both the resources of the issuer and a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.
Credit quality step	A credit quality assessment scale as set out in CRD IV.
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual Principal risk categories.
Credit risk mitigation	Techniques used to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, set off or netting.
Credit valuation adjustment	An adjustment to the valuation of financial instruments held at fair value to reflect the creditworthiness of the counterparty.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	Liabilities of the Group that are transferable by external investors that operate within the global financial markets.
Default	Circumstances in which the probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with CRD IV. This is defined as when an account reaches a pre-defined past due status or where, on accounts that are up to date or in arrears by less than the pre-defined status, certain unlikeliness to pay indicators have been met. The unlikeliness to pay indicators are those that the Society has determined as having a higher propensity to eventually reaching the pre-defined arrears status.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods as a result of the carry-forward of tax losses or unused tax credits, or from deductible (or taxable) temporary differences between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
EEA parent institution	A parent financial institution situated in a Member State of the European Economic Area which is not a subsidiary of another financial institution also situated in the EEA.

Encumbered assets	Assets used to secure liabilities or otherwise pledged. This excludes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes.
End-point	Full implementation of regulation (for example, CRD IV) with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A Board approved framework which provides the context, guidance and principles needed for cohesive risk management activity across the Society and its subsidiaries.
European Banking Authority (EBA)	An independent European Union authority which works to ensure effective and consistent financial regulation and supervision across the European banking sector.
Expected credit loss (ECL)	The present value of all cash shortfalls over the expected life of the financial instrument. The term is used for the accounting for impairment provisions under the new IFRS 9 standard.
ECL – 12 month	Cash shortfalls resulting from default events that are possible in the next 12 months weighted by the probability of that default occurring.
ECL - lifetime	Cash shortfalls resulting from default events that are possible over the remaining expected life of the loan, weighted by the probability of that default occurring.
Expected loss	A calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a 12 month time period.
Exposure	The quantified potential for loss that might occur as a result of a risk occurring.
Exposure at Default (EAD)	A parameter used in IRB approaches and under IFRS 9 to estimate the amount outstanding at the time of default.
External Credit Assessment Institution (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's and Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

Fair value through other comprehensive income (FVOCI) reserve	Financial assets held at fair value on the Balance Sheet with changes on the fair value recognised through other comprehensive income.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
Fitch	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
General reserve	The general reserve is the accumulation of historical and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Gilts Government investment securities (gilts)	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
IFRS/IAS	International Financial Reporting Standards/International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are defaulted loans in IFRS 9 stage 3.
Impairment provision	Expected Credit Losses (ECL) held under IFRS 9 – see ECL glossary definition.
Indexed loan to value	Loan to value calculated on the basis of the latest property valuation being adjusted by the relevant House Price Index movement since that date.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.

Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment of the liquidity resources that are required to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on regulatory benchmarks and on Society-specific tests.
Internal Ratings-Based (IRB) approach	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1. The IRB approach may only be used with permission from the PRA.
ISDA	International Swaps and Derivatives Association is the global trade association for over-the-counter (OTC) derivatives and providers of the industry-standard documentation for derivative transactions.
Leverage ratio	A calculation brought in as part of CRD IV which measures the relationship between eligible Tier 1 capital and exposures to on and off-balance sheet items. There are two bases of calculation – see Capital Requirements Regulations (CRR) leverage ratio and UK leverage ratio.
Liquidity Coverage Ratio (LCR)	A measure brought in as part of CRD IV which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions.
Loan to value (LTV)	The amount of mortgage loan as a percentage of the value of the property.
Loss Given Default (LGD)	A parameter used under IRB approaches and IFRS 9 to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.
Minimum requirement for own funds and eligible liabilities (MREL)	A requirement under the Bank Recovery and Resolution Directive (BRRD) which requires deposit takers to hold minimum levels of capital plus debt eligible for bail-in.
Moody's	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.

Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Netting	The ability to reduce credit risk exposures through entering into ISDA master netting agreements (whereby outstanding transactions with the same party can be settled net following a default or other predetermined event) and the receipt of financial collateral.
Output floor	A future requirement of Basel IV that sets a floor on the determination of risk weights. The floor will be a proportion of the standardised approach and will be phased in for firms using IRB models.
Over-the-counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. Under Basel III PIBS are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Pillar 1	The part of the Basel Framework which sets out the regulatory minimum capital requirements for credit, market and operational risk.
Pillar 2	The part of the Basel Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – TCR (see below) is an outcome of Pillar 2.
Pillar 3	The part of the Basel Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.

Point in Time (PiT)	A modelling approach which assesses the credit risk of an exposure at a single point in time.
Post model adjustment (PMA)	A PMA is applied when the Society considers that a modelled output is not sufficiently accurate or complete due to there being potential for additional risks that have not been identified or that cannot be adequately modelled.
PRA Buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
Principal risk	Principal risk is a class of significant inherent risk which could materially compromise the Society's ability to grow and provide attractive products to savings and borrowing members.
Probability of Default (PD)	An estimate of the probability that a borrower will default on their credit obligations over a fixed time period. With respect to impairment provisions under IFRS 9, 12 month ECLs use 12 month PDs, whilst a lifetime ECL uses the estimated PD over the remaining contractual life of the loan. With respect to IRB, PD is the probability of a loan defaulting in the next 12 months calculated as an average over an economic cycle.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
Residential Mortgage Backed Securities (RMBS)	Securities issued with interest and principal backed by that it represent interests in a group of residential mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Residual maturity	The remaining period to the contractual maturity date of a financial asset or financial liability.
Resolution Authority	In the UK, the Resolution Authority is the Bank of England who is responsible for taking charge, recapitalising and restructuring a firm; on account of the firms realised or expected failure.
Reverse stress test	Regulatory stress test that requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.
Risk appetite	The articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.

Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a structured entity which then issues securities (RMBS) backed by the assets. The Group has used residential mortgages as the loan pool for securitisation purposes.
Self-certified mortgage	An owner-occupier mortgage where the lending decision with respect to affordability has been based solely on the borrower's declaration of their income.
Significant increase in credit risk (SICR)	A significant increase in credit risk on a financial asset is judged to have occurred when an assessment, using quantitative and qualitative factors, identifies at a reporting date that the credit risk has increased significantly since the asset was originally recognised.
Sovereign exposure	Exposures to governments and on account of cash balances and deposits with central banks.
Stage 1	Stage 1 assets are assets which have not experienced a significant increase in credit risk since the asset was originally recognised on the Balance Sheet. 12 month ECLs are recognised as the impairment provision for all financial assets on initial recognition. Interest revenue is the EIR on the gross carrying amount.
Stage 2	Stage 2 assets have experienced a significant increase in credit risk since initial recognition. Lifetime ECL is recognised as an impairment provision. Interest revenue is EIR on the gross carrying amount.
Stage 3	Stage 3 assets are identified as in default and considered credit impaired. Lifetime ECL is also recognised as an impairment provision. Interest revenue is the EIR on the net carrying amount.
Standardised approach	The basic method used to calculate capital requirements for credit and operational risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
Stress testing	Testing undertaken to provide an understanding of the Society's resilience to internal and external shocks.
Structured entity	An entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control.
Subordinated liabilities	A form of Tier 2 capital that is unsecured. Subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members (other than holders of Permanent Interest Bearing Shares and Perpetual Capital Securities) as to principal and interest. Under Basel III are included as Tier 2 under transitional rules only.
Subscribed capital	See Permanent Interest Bearing Shares.

Supervisory Review and Evaluation Process (SREP)	The PRA assessment of a firm's own capital assessment (ICA) under Pillar 2.
Supplementary Leverage Ratio Buffer (SLRB)	Applied to systemically important banks and building societies. As a guiding principle, the FPC sets the buffer at 35% of the risk weighted Systemic Risk Buffer.
Systemic Risk Buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.
Term Funding Scheme and the Term Funding Scheme with additional incentives for SMEs	The Term Funding Scheme (TFS) and the Term Funding Scheme with additional incentives for SMEs (TFSME) are tools of the Monetary Policy Committee designed to reinforce the transmission of Bank of England Base Rate cuts to those interest rates actually faced by households and businesses by providing term funding to banks and building societies at rates close to Bank of England Base Rate.
Tier 1 capital	A component of regulatory capital comprising Common Equity Tier 1 and Additional Tier 1 capital.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances.
Total Capital Requirement (TCR)	The minimum amount of capital the Society should hold as set by the PRA under Pillar 1 and Pillar 2A and informed by the Internal Capital Adequacy Assessment Process (ICAAP).
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with an intention to trade. The Society does not have a trading book.
The Standardised Approach: operational risk	The standardised approach to operational risk, calculated using three year historical net income multiplied by a percentage factor depending on the underlying business being considered.
UK Finance	A trade association that incorporates residential mortgage lending.
UK leverage ratio	A ratio prescribed by the PRA based on the CRR leverage ratio but modified to restrict the amount of AT 1 capital that can be included in Tier 1 capital and to exclude eligible central bank holdings from leverage ratio exposures.
Unencumbered assets	Assets readily available as collateral to secure funding. This includes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes and are therefore readily available as collateral to secure funding or to pledge as collateral against margin calls.
Wrong way risk	Defined by the PRA as a situation where there is an adverse correlation between the counterparty's probability of default and the mark-to-market value of the underlying transaction.

Coventry Building Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority (www.fca.org.uk) and the Prudential Regulation Authority (firm reference number 150892).

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