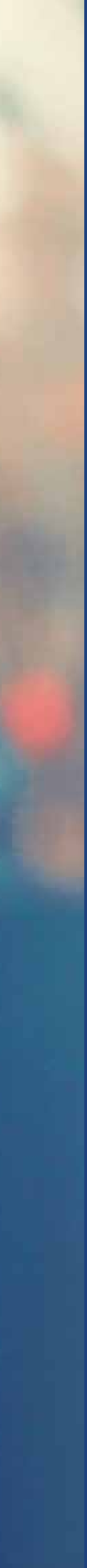
Annual Report & Accounts

for the year ended 31 December 2016

COVENTRY
Building Society



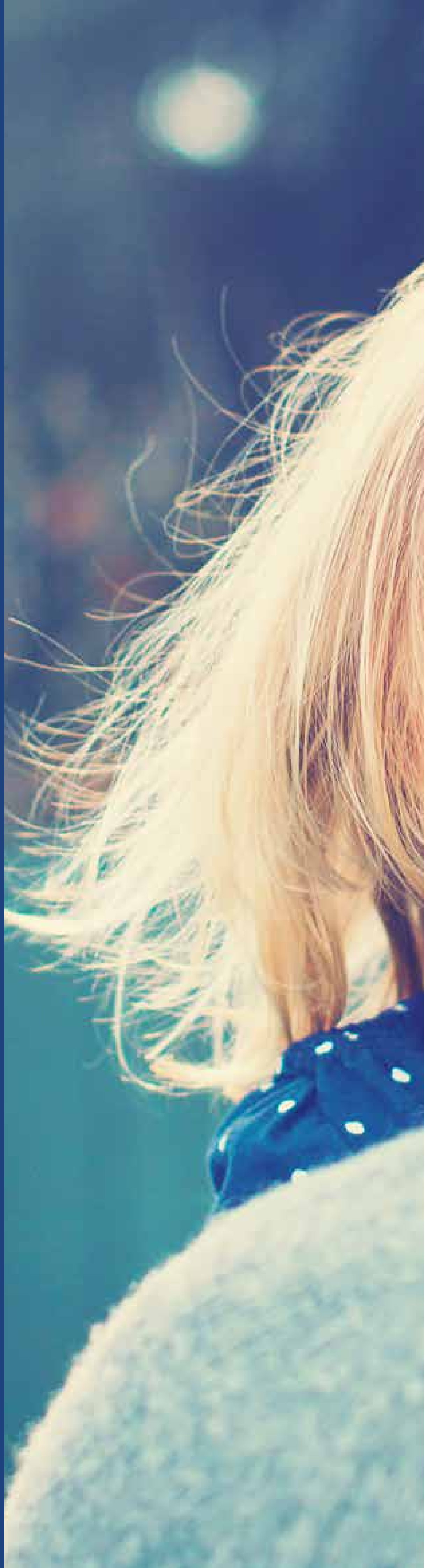
Welcome

Putting members first

Coventry Building Society has a simple purpose. It exists to meet the needs of its current and future members for savings and residential mortgages.

In 2016, the Society maintained its long record of growth by continuing to attract and retain members through competitive products and excellent service. This has been achieved whilst delivering a strong financial performance that generates a sustainable level of profitability, and an increase in the Society's reserves, whilst supporting investment in new services and infrastructure.

Coventry Building Society shows that an independent mutual organisation can thrive by offering a genuinely member-focused approach.



Strategic Report

This section provides commentary on the Society's 2016 performance, our overall business strategy and approach to risk management and corporate responsibility.

For our full glossary please go to page **146**

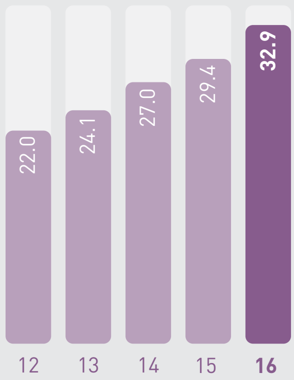
Strategic Report

Performance Highlights 2016

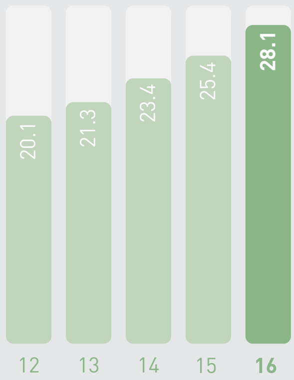
Consistent and well-managed growth continues to deliver a stronger Society, for the benefit of all members.

Please go to page **08** for more information

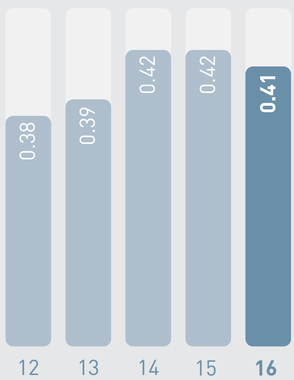
£32.9bn
Mortgages
(£bn)



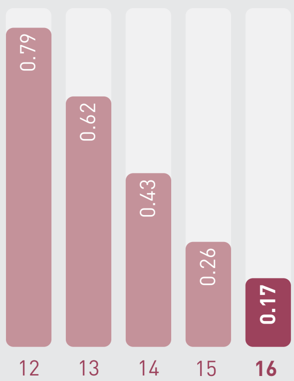
£28.1bn
Savings
(£bn)



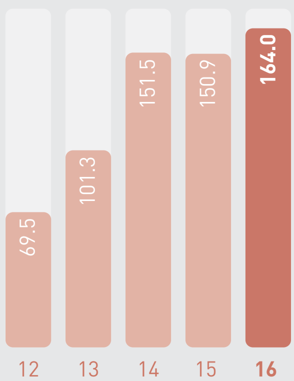
0.41%
Cost to mean assets ratio[1]
(%)



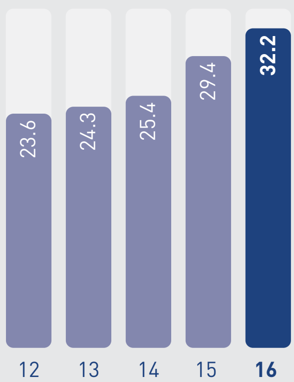
0.17%
Arrears
% mortgage balances 2.5% or more in arrears, including possessions



£164.0m
Added to member reserves[2]
(£m)



32.2%
Common Equity Tier 1 ratio
(%)



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

Chairman's Statement

The Society continues to perform strongly and deliver genuine value to its members.

Ian Pickering

Last year I highlighted that a strength of Coventry Building Society is the consistency of its performance whether in benign times or when the environment has been more uncertain.

It is worth repeating this statement when reviewing a year that has witnessed the United Kingdom's first steps towards exiting the European Union, a cut in the Bank of England Base Rate and continued cuts in retail savings rates, as well as significant regulatory and taxation changes, affecting both savers and borrowers.

It is an evolving situation and, the impact on the UK of what has become known as Brexit will remain uncertain for some time to come. However, the Society is financially strong, and the robust performance we achieved in 2016 gives me confidence that we can continue to grow and protect the interests of members notwithstanding the uncertainties of the coming years.

Part of this stems from the fact we are a national business with no operations outside the UK. Our business model is simple and straightforward. We grow by attracting and retaining savers, offering competitive long-term value and we use these deposits to fund responsible lending in the residential housing market.

In this regard, the significance of Brexit for the Society is the impact it could have on interest rates and the wider economy, in particular unemployment and the housing market.

The impact on interest rates has been stark. Whilst the expectation had been that the next movement in the Bank of England Base Rate would be upwards, the reduction in August took it to a new low of 0.25%. The Bank of England's other initiatives to support financial stability, particularly the launch of the Term Funding Scheme have also had a significant effect on savings rates.

We are very aware that savers, who constitute the majority of the Society's members, are bearing the brunt of these changes, and whilst I am proud of our record of maintaining competitive savings rates I am under no illusions as to the impact this historically low interest rate environment is having, particularly against the backdrop of rising inflation.

For borrowers the environment is largely more favourable. The housing market is proving to be resilient to the changes affecting it, with transactions and prices remaining robust throughout the year albeit there are signs that in some London boroughs prices are starting to decline. The ongoing imbalance between the supply and demand for houses is a factor that continues to support the level of house prices.

2016 was notable for the implementation of new stamp duty rules affecting ownership of multiple properties, and in 2017 we will start to see the impact of restricting income tax relief on buy to let mortgage interest payments. We believe it is important that the housing market should operate efficiently in providing a variety of options, including rental opportunities and houses for owner occupation.

It is important to encourage competition in all markets, including the savings and mortgage markets, and diversity of business models is one way of achieving this. Building societies have a particularly important role to play, with an ownership structure that is inherently better placed to deliver clear benefits to members rather than the conflicting priorities of shareholders and customers that can arise in a public limited company.

> I am always impressed by the knowledge and professionalism of our employees, but even more so by their genuine commitment and pride in Putting Members First.

I am in no doubt that Coventry Building Society's continued success is due to the very clear focus we have on Putting Members First, and the Board remains firm in its conviction that the interests of our members are best served by it remaining an independent mutual building society.

An important part of the work of the Board is succession planning and the recruitment and appointment of new members to the Board. This ensures that there is an appropriate balance of skills, knowledge and experience on the Board, and that these skills are regularly refreshed. Detailed succession plans are in place to manage both planned and unplanned vacancies as they arise. This has enabled the Board to remain effective while dealing with the departure of two of its members this year. I am pleased that following these departures the Board has been able to welcome two new members who bring valuable skills and experience.

Catherine Doran joined the Board in August, bringing extensive technology experience from a career spent in major UK companies across both the financial and non-financial sectors. Most recently she worked as chief information officer of Royal Mail and her experience and insight are invaluable to the Board as we continue to invest in our core IT infrastructure and services.

In November, we welcomed Alasdair Lenman to the Board. Alasdair, an experienced accountant with a wealth of financial services experience, began his career at Mars and has held a number of senior positions for the last 10 years, including finance director of Lloyds TSB's retail products division.

These changes resulted from the retirement of longstanding director, Bridget Blow, whom I mentioned in last year's Annual Report & Accounts and the resignation of Glyn Smith in September.

Glyn, who joined the Board as a non-executive director in 2010 and had served as Chairman of the Board Audit Committee, resigned to take up a Board position with The Co-operative Bank. Glyn made a considerable contribution to the Society's success in recent years, and in particular through his chairmanship of the Board Audit Committee. I would like to thank him personally and on behalf of the Society for his support and insight.

Janet Ashdown, who joined the Board in 2013, has decided not to stand for re-election to the Board at the Annual General Meeting. Janet served as a member of the Remuneration Committee and Board Risk Committee during her time on the Board and brought both knowledge and integrity to her responsibilities. I would like to thank her and wish her well for the future.

In addition to the changes to our non-executive directors, we announced in October that John Lowe, Finance Director, has also decided to retire from the Board in 2017. John, who joined the Society in 2007, has been Finance Director for six years. During a period of great volatility and change, he has helped the Society deliver financial security and growth, whilst being a strong advocate for the interests of our members. The Board and I would like to thank him for his contribution and wish him every success in the future. An announcement about John's successor will be made in due course.

And finally I would like to again thank our employees for their contribution to another very successful year. I meet many of them in the course of the year and I am always impressed by their knowledge and professionalism, but even more so by their genuine commitment and pride in Putting Members First. It is their enthusiasm and commitment that make the Society the successful organisation it is.

Ian Pickering
Chairman
23 February 2017

Strategic Report

Chief Executive's Review

2016 was a successful year with continued savings and mortgage growth, and high levels of member satisfaction supported by a healthy financial performance.

Mark Parsons

In 2016, Coventry Building Society continued to pursue its mission of Putting Members First whilst delivering strong growth and investing to enable future success.

The performance highlights were:

- **Record growth in mortgages:** Mortgage assets increased by £3.5 billion, representing growth of 12%, more than four times faster than the market[1].
- **Record savings balances:** Savings deposit balances grew by 11%, nearly twice the rate of the market[1].
- **Strong capital:** Profit before tax increased by 11% to £239 million, increasing the Common Equity Tier 1 (CET 1) ratio to 32%, the highest reported by any top 20 lender[2] and a leverage ratio of over 4%.
- **Low costs:** The Society's cost to mean asset ratio reduced to 0.41%[3], the lowest reported by any building society[4] and key to our ability to offer consistently competitive interest rates.
- **Low risk:** The Society is a low risk lender which protects individual borrowers and the Society alike. During the year, arrears greater than 2.5% of the balance due were less than a quarter of the industry average[5].
- **Low margin:** The Society aims to operate at a low net interest margin[6]. The comparatively low margin of 1.06% in 2016 is a tangible example of returning value to members, underpinned by low costs and low credit losses.
- **Competitive savings rates:** As testament to this and in an unprecedented period of low interest rates, our average savings rate in 2016 was 1.77% compared with a market average of 0.92%[7].
- **Exceptional customer service:** The Society works hard to sustain and improve the service it provides to members in branches, over the phone, online and also to intermediaries. It measures this using the common metric of Net Promoter Score® and in 2016 achieved a very high score of +70[8], representing a strong endorsement from our members.
- **Highly engaged employees:** Excellent service is delivered by our people, who are proud to Put Members First. In 2016 the Society was awarded the ORC International Award for the highest employee engagement of any medium-sized company in Europe that it surveyed.
- **Supporting local communities:** In 2016 over three quarters of employees were actively involved in volunteering, fundraising or raising awareness for local charities and community groups.

These highlights demonstrate a strong performance across all aspects of the business.

Not only has this performance supported our members in the shorter term, but our financial strength supports the investment that enables us to compete and grow in the future.

This is particularly true of our investment in technology, both in terms of core infrastructure and member services. The investment we began in 2015 has started to deliver enhancements, with our new website going live in January 2017. As well as making the Society's services easy to access across different devices, it brings a level of transparency that is unusual in financial services. In addition, we are investing to stay reliable and secure, so that we are protecting our members from the ever present threat of cybercrime and maintaining their trust in the services we provide. This investment will continue.

A key thrust of our investment is the intent to keep things simple. Earlier in the year we were praised by independent savings advisers Savings Champion for the explanation we provided to new and existing members about the changes to the taxation of savings. Our new website develops this theme further, to the extent of providing members with information about competitor products to help them make the right choice.

The Board is confident that the Society is well positioned to continue its strong, profitable, member-focused growth.

Our ambition to deliver simple high quality services extends to our work with mortgage intermediaries, who are responsible for introducing the majority of our new mortgage business. There continues to be significant change in mortgage regulation and the introduction of new stamp duty rules in April was a test for the industry as a whole. We attracted record business during this time, and beyond, while sustaining our normal high service levels – a performance which was recognised by the Society being one of the few lenders achieving the 2016 Financial Adviser Five Stars mortgage service award in November.

We do sometimes make mistakes, but when we do, we work hard to put them right. Our record with the Financial Ombudsman Service bears this out. In comparison with an industry average of 48%[9], the overturn rate on complaints reported to the Financial Ombudsman Service about the Society was just 4%[9], reflecting our commitment to do the right thing for our members.

A consequence of our investment in people and technology is that the independent consumer champion, Fairer Finance has ranked us first for savings and first for mortgages for the second year running, based on its survey of customer happiness, trust, complaints performance and transparency.

I believe strongly that our high level of member satisfaction also reflects the investment we make in our people. We recruit on the basis of values and behaviours as much as skills and experience. We encourage internal mobility and support the personal and career aspirations of our employees to make this happen, with over 40% of vacancies in 2016 being filled by internal applicants. The result is a team of highly committed people – 91% of employees say they are proud to work for Coventry Building Society.

The high level of employees' engagement is underlined by their support for national and local causes. Our community programmes extend from our longstanding support for The Royal British Legion, with total donations to date of £13.9 million, to supporting over 70 local community partners. Much of our contribution comes through volunteering – as an example in 2016 more than 100 employees supported over 1,300 students and young adults in developing their financial literacy and employability skills.

These examples show the progress we have made across all aspects of our business in 2016. But I believe that the investment we make in delivering long-term value to our members is the most significant of all.

I am particularly proud of the growth in savings we have achieved. This clearly reflects our competitive pricing, shown by our average savings rates in 2016 being 0.85% above the market average[7]. Competitive pricing has been equally successful in attracting new mortgage business. Our low operating costs and impairment losses give us the ability to operate at low but sustainable margins. This returns real value to our members – but it is also underpinned by strong and growing capital ratios supported by our 2016 profits.

This in turn provides reassurance that we have the financial strength and flexibility to sustain the Society into the future whatever the economic conditions.

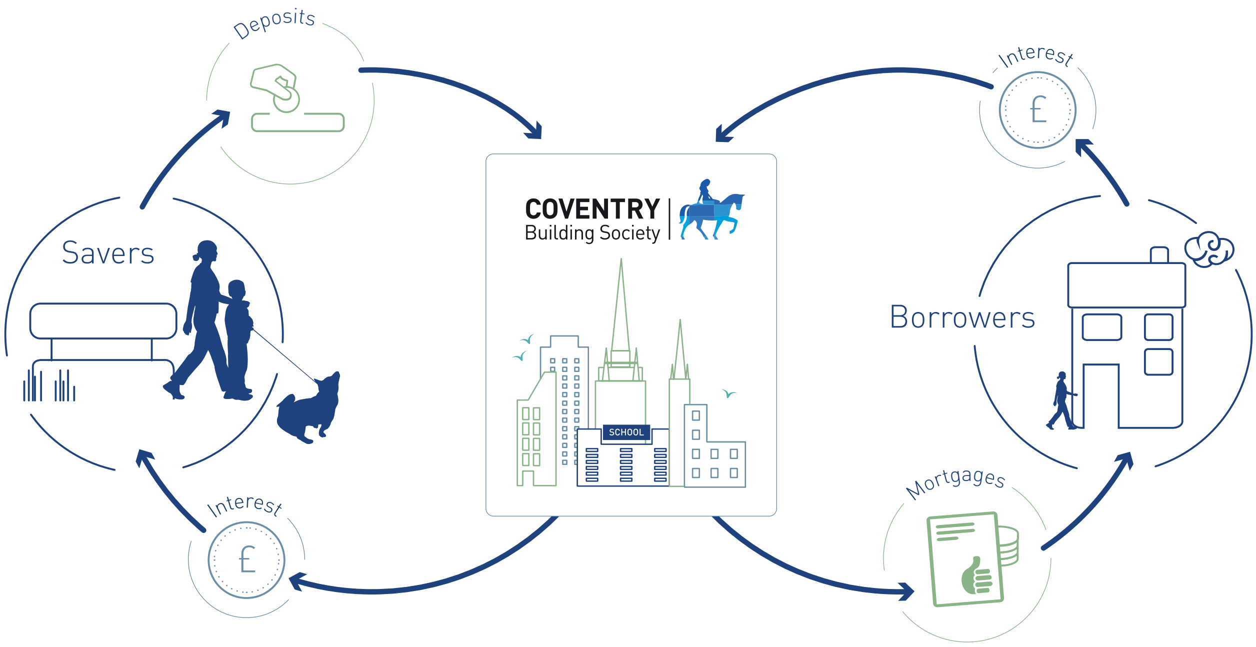
Looking forward, the Board is confident that the Society is well positioned to continue its strong, profitable, member-focused growth. There are some economic and political uncertainties at present and will be for the foreseeable future. However, this is no longer unusual and our strong track record shows that our simple business model based on Putting Members First, with low risk lending and low cost operations, can thrive even in uncertain conditions.

Mark Parsons
Chief Executive
23 February 2017

1. Source: Bank of England.
2. Source: Council of Mortgage Lenders - 2015 top mortgage lenders (balance outstanding) – latest published CET 1 data, as at 23 February 2017.
3. Administrative expenses, depreciation and amortisation/Average total assets.
4. As at 23 February 2017.
5. Source: Prudential Regulation Authority – Quarter 1, Quarter 2 and Quarter 3 data. Arrears greater than 2.5% of the balance due, including possessions.
6. Net interest income as a percentage of average total assets.
7. The Society's average month end savings rate (Society mix of products) compared to the Bank of England weighted average rate for household interest-bearing deposits (market mix of products).
8. Net Promoter®, Net Promoter Score®, and NPS® are trademarks of Satmetrix Systems, Inc., Bain &Company, Inc., and Fred Reichheld. NPS of +70, is a calculated average from 5 surveys: branch survey of 12,732 customers, savings contact centre survey of 17,461 callers, mortgage contact centre survey of 1,910 callers, online survey amongst 4,214 users, and a survey amongst 1,976 brokers.
9. Source: Financial Ombudsman Service – latest published information: 1 January 2016 to 30 June 2016.

Strategic Report
Business Review

The Society's strategy is unchanged – sustainable growth, through the provision of simple good value savings products and low risk residential property mortgages underpinned by a cost-efficient operating model.



Strategic Review

Objectives

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

Business model

As a mutual building society, the Society is owned by its members and not shareholders. It operates within a legal framework with statutory limits set by the Building Societies Act 1986 to ensure a focus on its prime objectives of deposit taking and mortgage lending.

Even within this legal framework, the Board chooses to operate a very simple business model – simple products, simple ways of operating and simple communications to members. It operates solely within the UK retail financial services market and only takes on risks that it understands and can manage. In order to ensure the business model is sustainable, capital generation is required to support future growth.

The Society accepts deposits from savings members and provides secured mortgage lending on residential properties. It also raises funds from the wholesale markets to provide diversity of source and term.
The difference between the interest rates earned on mortgages and liquid assets and the interest rates paid on funding (retail and wholesale) provides the Society with net interest margin to cover operating expenses, impairment losses, provisions and taxation. The remaining profits provide the Society with the capital to support future growth and also protect members during periods of economic downturn.

As a mutual organisation, the Society does not have external shareholders or pay dividends; its customers have membership rights and are the 'owners' of the organisation. This creates clarity of purpose. The Society exists to serve its members and to protect their interests, and strategic and operational decisions are taken with these responsibilities in mind.

Central to this is the provision of long-term sustainable value to members through competitively priced savings and mortgage products supported by excellent customer service. The Society balances this with the requirement to protect members' interests by remaining financially strong and secure. As a result the Society aims to achieve sustainable levels of profitability rather than maximising profit, enabling it to provide improved pricing for its members. This longer-term strategic focus also enables the Society to maintain a longstanding and consistent presence in the savings and mortgage markets.

Strategic focus

The Society's strategy is unchanged from previous years and continues to be focused on:

- The provision of simple transparent retail savings products offering long-term value.
- Helping customers buy residential properties through low risk mortgage lending primarily via mortgage intermediaries but also through our branches and other direct channels.
- Sustainable growth realised without taking on excessive levels of risk in order to protect existing members during periods of economic stress, and to safeguard the Society's future.
- Efficient operations with effective use of technology to allow members to self-serve where they choose to do so and to maintain a cost advantage over competitors.
- Strong ethical standards and conduct principles supporting Putting Members First. This extends to the service provided to members, recruitment, training and reward of employees, the design of products and services, and consultation with members about how the Society can better meet their financial needs for savings and mortgages.

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

Future outlook

Last year we commented on the pace and extent of regulatory change. These challenges remain. Of particular note is the minimum requirement for own funds and eligible liabilities (MREL – see page 59 of the Risk Management Report) and proposed changes which are likely to require additional capital to be held against assets that are currently subject to a low risk weighting. These changes are particularly relevant to the Society's business model which concentrates on growth in low risk assets.

Notwithstanding this the Board believes the Society's business model is the right one, a view that has been reinforced by the Society's strong performance in recent years but also during the last recession.

We also noted last year the uncertainty created by a referendum vote on the UK's membership of the European Union (EU). It seems very likely that Article 50 will be triggered in 2017, which will commence the formal process to exit the EU.

Based upon latest available data, the UK economy has expanded at a pace that compares well to many European countries during 2016. At this early stage there has been no material impact from the referendum result other than a fall in sterling which many predict may boost the economy as a result of the positive impact this has on exporters.

Ultimately the longer-term impact of Brexit will depend on a range of factors including the time it takes to reach trade agreements with EU and non-EU states, the nature of these agreements and the broader political position.

Whilst a sustained economic slowdown could result, the Society is well placed to withstand such a downturn. The Society's retail operations are solely within the UK and treasury exposures to EU counterparties are mitigated by the exchange of high quality collateral (see page 39 of the Risk Management Report).

Business Review cont.

Consequently, second order effects are the most likely source of any adverse impact of Brexit. Most notably if house prices fall, losses may increase in the event of default, or borrowers may experience payment difficulties perhaps as a result of rising unemployment.

The outlook for interest rates remains uncertain. Despite expectations in 2015 that the next rate movement would be upwards the Monetary Policy Committee cut the Bank of England Base Rate to 0.25% in August 2016. Whilst more recent expectations of higher inflation may mean a rate rise will still take place in the near term, the likelihood is that rates will remain low for the foreseeable future.

Consequently, and supported by the Bank of England's latest liquidity support scheme, the Term Funding Scheme, little upward pressure is expected on savings rates in the immediate future.

Increased stamp duty for second homes and regulatory changes on buy to let underwriting finalised during 2016, together with restrictions on buy to let income tax relief to be phased in from 2017, are likely to reduce overall buy to let investor demand. From July 2016 the Society required all new buy to let lending to be assessed against a minimum interest coverage ratio of 140% (previously 125%). In December 2016 the stressed interest rate used to assess this ratio was increased to 5.5%. Being a significant participant in the buy to let sector, the Society will continue to evolve its lending policy in response to future developments and remains committed to participating in this market whilst maintaining strong underwriting standards.

In the UK financial services sector, competition is continuing to increase with the prospect that established banking groups or new challenger organisations may be able to gain market share. This could impact the Society's growth plans, for example if competitors successfully compete in the mortgage intermediary distribution channel which is an area of strength for the Society, or if competition for retail funding intensifies. However, the Society's focused business model, established distribution relationships and low cost base, position it well to deal with these potential threats and to continue to grow and maintain a strong financial position.

Fines and regulatory action against financial firms have been commonplace over recent years. Although the Society has not been subject to any such censure, reflecting its commitment to delivering good customer outcomes, the adverse publicity associated with such actions continues to impact the reputation of the whole of the financial services sector. The Board therefore remains conscious of the conduct risks that have the potential to impact the Society and continues to take the necessary steps to mitigate such risks.

The Society continues to invest in ensuring that its core IT infrastructure and systems are robust and secure, and are able to support increased functionality and methods of distribution, including developments in online services. This programme of work will enable the Society to remain competitive, help to contain operating costs and respond efficiently to future regulatory change and the changing needs of members.

The Society will remain flexible and respond to changes in the economic, regulatory and competitive environment to ensure that performance is sustainable and balances the needs of current and future members.

Principal risks and uncertainties

Information on the Society's principal risks and uncertainties can be found in the Risk Management Report on pages 22 to 62.

Performance against the 2016 strategic goals

Key performance indicators are set out in tabular form below. These goals are expected to be the strategic priorities for 2017 to 2021.

Our strategic goals	What we measure	Performance in 2016
Delivering sustainable growth, balancing the interests of current and future members	Growth in our mortgage and savings balances with the aim to grow our market share and membership over time.	For the tenth successive year, we grew faster than both UK savings and mortgage markets[1], increasing our share overall. In 2016, our membership reached 1.8 million for the first time.
Offering products that give long-term value for money and provide good member outcomes	Our mortgage and savings rates for both new and existing customers plus our level of customer complaints.	Our average savings rate in 2016 was 1.77% compared with a market average of 0.92%[2]. Our average interest rate on new mortgage lending continued to fall to 2.45% (2015: 2.71%). The Society recorded less than 1.2 complaints per 1,000 members and only 4% of complaints referred to the Financial Ombudsman Service[3] were overturned.
Simple products, easy to use UK-based customer services, transparent communications	Our customer recommendation scores and independent awards and endorsements.	A Net Promotor Score® of +70[4], a measure of customers who would strongly recommended our services to friends and family. The Society received several awards and endorsements during the year, outlined on pages 6 and 7.
Remaining safe and secure, only taking risks that we understand and can manage	The level of customers who are behind on their mortgage payments relative to market averages.	As at 31 December 2016 only 0.17% of mortgage balances were 2.5% or more in arrears (including possessions). The latest available industry data[5] (as at 30 September 2016), showed arrears were less than one fifth of the industry average of 0.96%.
	Our capital and liquidity strength relative to the risks we take.	Our Common Equity Tier 1 Capital ratio remains the highest reported of any top 20 lender[6] at 32.2%. Our leverage ratio increased to 4.1%, considerably in excess of the regulatory minimum of 3% (currently only applicable to organisations with retail deposits in excess of £50 billion). Our Liquidity Coverage Ratio at 151% also remains significantly above minimum limits.
Spending our members' money wisely to be highly cost-efficient while investing to remain effective in the long term	Our level of costs relative to our size compared with other building societies and delivery of our investment programme.	At 41p per £100 of assets, this ratio remains the lowest reported of all other building societies[7]. The Society delivered a number of projects to improve our proposition to both customers and employees and to improve our technology and risk capabilities.
Valuing the contribution, diversity and engagement of our people and actively supporting them	Our employee engagement score and other feedback from confidential opinion surveys plus external endorsement.	We scored an 'Outstanding' level of engagement in the 2016 Best Companies annual survey and continue to hold a Gold award from Investors in People.
Enhancing the communities in which we operate and wider society	The level of employee involvement in our community programmes and funds raised for good causes.	Total contribution to good causes from the Society's charitable activities reached £1.9 million. Over three quarters of employees were actively involved in the programmes and activities outlined on page 21.

1. Source: Bank of England.
2. The Society's average month end savings rate (Society mix of products) compared to the Bank of England weighted average rate for household interest-bearing deposits (market mix of products).
3. Source: Financial Ombudsman Service – latest published information: 1 January 2016 to 30 June 2016.
4. Net Promoter®, Net Promoter Score®, and NPS® are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc., and Fred Reichheld. NPS of +70, is a calculated average from 5 surveys: branch survey of 12,732 customers, savings contact centre survey of 17,461 callers, mortgage contact centre survey of 1,910 callers, online survey amongst 4,214 users, and a survey amongst 1,976 brokers.
5. Source: Prudential Regulation Authority – latest available information, as at 30 September 2016.
6. Source: Council of Mortgage Lenders – 2015 top mortgage lenders (balance outstanding) – latest published CET 1 data, as at 23 February 2017.
7. As at 23 February 2017.

The Board is committed to remaining an independent mutual building society. The strong performance detailed above supports this commitment.

For further information on the Society's financial performance, please read the Financial Review overleaf. For non-financial performance, please read the Corporate Responsibility Report on pages 18 to 21.

Business Review cont.

Financial Review

Income Statement

Overview

Statutory profit before tax has increased by 10.7% to £239.1 million.

Underlying profit represents management's view of underlying performance and is presented to aid comparability across reporting periods and has increased by 4.0% to £239.5 million.

Whilst the Society does not aim to maximise profit, it is the key source of capital to protect members' interests and to support growth. In this context, both underlying and statutory profit measures have increased in 2016. This continues a track record of sustainable profitability that has seen capital ratios continue to strengthen.

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

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

Year to 31 December 2015	Statutory profit £m	Gain on sale of Visa Europe Limited £m	Financial Services Compensation Scheme levy £m	Movements on derivatives and hedge accounting £m	Underlying profit £m
Net interest income	363.9	–	–	–	363.9
Other income	5.4	–	–	–	5.4
Losses on derivatives and hedge accounting	(0.3)	–	–	0.3	–
Total income	369.0	–	–	0.3	369.3
Management expenses	(137.4)	–	–	–	(137.4)
Impairment credit	1.9	–	–	–	1.9
Provisions	(15.8)	–	14.1	–	(1.7)
Charitable donation to Poppy Appeal	(1.7)	–	–	–	(1.7)
Profit before tax	216.0	–	14.1	0.3	230.4

Net interest income

Net interest income at £385.0 million is £21.1 million higher than the previous year, primarily as a result of growth in mortgage assets offset by a slight decrease in the net interest margin. The increase in net interest income was a key driver in the increase in both underlying and statutory profit before tax. The Society's net interest margin has decreased by 5 basis points to 1.06% in the year to 31 December 2016.

	Year to 2016 £m	Year to 2015 £m
Net interest income	385.0	363.9
Average total assets	36,205	32,696
	%	%
Net interest margin	1.06	1.11

This is as a result of increased competition for mortgage customers and the impact that this has had on new business margins and redemption levels. The Board has taken the decision not to seek to recover all of this reduction from reducing the interest paid on savings accounts. The Board believes that there will be a further modest decrease in the net interest margin in future years as a consequence of continuing competition in the mortgage market and its desire to protect savers.

Savings rates paid to existing account holders have continued to fall across the industry during the year and, although the Society has taken selective action to reduce rates on some of its accounts, it has not done so to the same extent as many of its competitors. All the Society's variable rate mortgage customers received the full benefit of the reduction in the Bank of England Base Rate. The Society therefore continues to manage the net interest margin to deliver value to members through both attractive savings rates and competitive mortgage products.

For example, a Coventry ISA product has been in the national press best buy tables every week for over four years and at the end of the year, all of our variable rate cash ISA balances paid more than double the average rate in the market, and over 85% paid more than 1.2%[1].

In addition, as at the end of 2016 over 92% of the Society's variable rate balances paid at least three times the Bank of England Base Rate.

Taking our instant access accounts and variable cash ISAs alone, this translates to an additional £90.0 million[2] of interest received by members compared with average market rates of interest. This demonstrates the delivery of a key strategic goal.

The Board continues to balance achieving this goal with the need to protect the overall financial strength of the Society and meet increasing capital requirements by strengthening reserves through retained profits (see page 17).

Other income

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

Other income has increased to £10.5 million (2015: £5.4 million). The increase primarily relates to a £4.9 million gain on completion of the acquisition of Visa Europe Limited by Visa Inc. The Society has received cash proceeds and preference shares, and will be eligible for future cash consideration, in exchange for its membership of Visa Europe Limited. The gain has been excluded from underlying profit. Further information is set out in note 17 to the accounts.

Derivatives and hedge accounting

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

Even though the Society uses derivatives exclusively for risk management purposes, Income Statement volatility arises due to the accounting ineffectiveness of designated hedges. The Board believes that this volatility arises from application of the accounting rules rather than because of economic reality and consequently it is excluded from underlying profit. An analysis of the net loss from derivatives and hedge accounting is set out in note 8 to the accounts.

Management expenses

Management expenses for 2016 were £149.5 million (2015: £137.4 million). The increase is a reflection of the growth of the Society, the costs of servicing a larger membership, continuing investment in the Society's IT infrastructure and the Society's response to ongoing regulatory requirements.

1. Source: Bank of England. Average quoted interest rate on all variable rate cash ISAs including bonus as at 31 December 2016.
2. Based on the Society's instant access and variable cash ISA monthly weighted average savings rates and balances versus Bank of England average quoted interest rates for instant access variable non ISA and variable rate cash ISA balances.

Business Review cont.

There has been significant growth in employee costs in 2016. In addition to the average salary increase of 3.2% for employees, additional costs were incurred in order to comply with new regulations and also to further improve the quality of service offered to members.

The Society has increased investment in order to ensure that its core IT infrastructure and systems are robust and secure, and are able to support increased functionality and methods of distribution, including developments in online services. Depreciation and amortisation of property, plant and equipment and intangibles have accordingly increased to £15.0 million (2015: £12.9 million).

Despite the absolute increase in management expenses, the Society's ratio of costs to mean total assets has reduced to 0.41%. For over 10 years the Society has achieved the lowest reported cost to mean asset ratio of all UK building societies and expects to retain this position comfortably for 2016.

Continuing cost increases are expected, arising from sustained levels of investment in technology, increased regulation and organic growth. The Society's ability to grow whilst retaining control of costs continues to represent a significant competitive advantage.

Impairment charge

The Society has a strong record of low impairments, reflecting the success of its low risk lending strategy which has always been a key element of its business model. Other than as a result of small books acquired as part of the merger with Stroud & Swindon in 2010, the Society has never undertaken commercial lending or second charge lending, and its exposure to unsecured lending is negligible with no new lending of this type since 2009.

There was an impairment credit of £1.5 million in 2016 (2015: £1.9 million credit). This release is a reflection of the continuing improvement in economic conditions, including moderate house price growth, prolonged low interest rates, falling unemployment, and wage increases outstripping increases in the cost of living. These factors have led to the percentages of mortgage balances 2.5% or more in arrears falling 35% year-on-year.

Provisions

The £6.1 million (2015: £15.8 million) provision for liabilities and charges comprises £4.3 million (2015: £14.1 million) for the Financial Services Compensation Scheme (FSCS) levy, £1.2 million (2015: £1.7 million) for Payment Protection Insurance (PPI), and £0.6 million (2015: £nil) in relation to compensation that may be due to customers impacted by a recent Financial Conduct Authority (FCA) publication on the calculation of monthly payments for customers in arrears (see below).

The Society pays levies (in relation to the banking failures during the financial crisis) to the FSCS based on its share of protected deposits and such levies are excluded from underlying profit. During the year, the FSCS advised that recoveries had been made against assets funded by the FSCS scheme, resulting in a reduced charge for the Society in 2016.

The PPI charge in the year reflects the impact of the delayed introduction of a deadline for PPI claims, which is expected to be set by the FCA. Provisions for PPI claims continue to be materially lower for the Society than for many other organisations. This is a consequence of the design of the PPI product previously offered by the Society. Further information on the provisions for liabilities and charges is included in note 27 to the accounts.

The Society will be impacted by the FCA's recent publication in relation to mortgage regulations. This addresses instances where arrears balances have been automatically included within customers' monthly mortgage payments when they have been recalculated from time to time, for example when an interest rate changes or they have switched products. The FCA considers this practice to be automatic capitalisation and in October 2016 issued a guidance consultation on a proposed voluntary remediation framework. As a result, the Society has set aside £0.6 million to compensate customers who may have been adversely impacted by these issues.

Charitable donation to the Poppy Appeal

The Society donated £1.3 million to The Royal British Legion's Poppy Appeal during the year (2015: £1.7 million). The contribution to this appeal since 2008 now totals £13.9 million.

Taxation

The Board strongly believes the Society should contribute its fair share of tax and in 2016 the corporation tax charge arising on profits earned was £56.7 million (2015: £44.7 million). This represents an effective rate of tax of 23.7% (2015: 20.7%) which is significantly above the statutory corporation tax rate of 20% (2015: 20.25%). This is primarily due to a charge of £9.4 million in respect of the 8% surcharge on the profits of banking companies (i.e the Society) that was introduced from 1 January 2016. The Society's subsidiaries are outside the scope of the surcharge. The Society expects that its future effective tax rate will exceed the standard rate due to the impact of this surcharge.

Balance sheet

Overview

Mortgage balances have grown by 11.8% from £29.4 billion to £32.9 billion in the year and on-balance sheet liquidity by £0.5 billion. These have been funded by increases in retail funding of £2.7 billion and wholesale funding of £1.4 billion.

	2016 £m	2015 £m
Assets		
Loans and advances to customers	32,881.6	29,411.0
Liquidity	4,827.8	4,375.3
Other	586.5	328.1
Total assets	38,295.9	34,114.4
Liabilities		
Retail funding	28,054.3	25,355.8
Wholesale funding	7,742.0	6,336.0
Subordinated liabilities and subscribed capital	67.1	219.8
Other	611.2	551.3
Total liabilities	36,474.6	32,462.9
Equity		
General reserve	1,376.1	1,222.3
Other equity instruments	396.9	396.9
Other	48.3	32.3
Total equity	1,821.3	1,651.5
Total liabilities and equity	38,295.9	34,114.4
Unencumbered FLS Treasury bills (off-balance sheet liquidity)*	1,142.8	1,142.2

* Treasury bills (obtained under the FLS quoted at market value above) provide very high quality liquidity but, in accordance with accounting standards, are not recognised on the balance sheet, as the Society does not retain the risks and rewards in relation to these assets.

Loans and advances to customers

The Society's lending strategy for owner-occupier and buy to let mortgages is focused on high quality, low loan to value loans within the prime residential market, through competitively priced mortgages. These loans are primarily distributed through UK-wide third party intermediaries, and to a lesser extent through a number of advisors within the Society's network of branches and the Coventry-based contact centre.

In 2016, the Society advanced £9.0 billion of mortgages, a 13.3% increase over 2015 (2015: £8.0 billion), outperforming the rate of market growth[3]. As a result, organic mortgage balance growth was £3.5 billion, a 41.6% increase from 2015 (2015: £2.5 billion), increasing our market share of stock to 2.5%[3] (2015: 2.3%). This performance is expected to ensure the Society remains the UK's eighth[4] largest mortgage lender in what has been an increasingly competitive market.

The growth in the mortgage book has been achieved whilst retaining the Society's focus on low risk lending. The result is an overall indexed loan to value of the mortgage book at 31 December 2016 of 48% (simple average), a position that is largely consistent with previous years (2015: 48%).

The result of this responsible lending approach is highlighted by an arrears performance which is significantly better than that of the industry as a whole and credit losses which are consistently amongst the lowest reported by any top 10 mortgage lender[4].

As at 31 December 2016, 0.17% of mortgage balances were 2.5% or more in arrears, including possessions (23 properties) (2015: 0.26%, 32 properties). At the time of the latest published data[5], arrears were 19% of the industry average.

Liquidity

On-balance sheet liquid assets have increased to £4.8 billion (2015: £4.4 billion). Unencumbered Treasury bills drawn under the Funding for Lending Scheme (FLS) remained broadly unchanged. Liquid assets continue to be held primarily in deposits at the Bank of England and UK Government investment securities and the growth of liquid assets reflects the Society's larger retail savings book.

The credit quality of total liquid assets remains high with 96% of the portfolio rated Aaa–Aa3 (2015: 95%) and 4% rated A1–A3 (2015: 5%). The Society has no direct exposure to the peripheral Eurozone countries.

As at 31 December 2016, no amounts in the liquid asset portfolio were either past due or impaired and as such no impairment provision has been made.

3. Source: Bank of England.
4. Source: Council of Mortgage Lenders – 2015 balance outstanding.
5. Source: Prudential Regulation Authority – latest available information, as at 30 September 2016.

Business Review **cont.**

Of the £4.8 billion liquid assets, £1.4 billion are held as Available-for-sale (AFS) and under IFRS are marked to market with any changes in value recorded through other comprehensive income. The non-AFS assets are loans and advances to credit institutions or deposits with the Bank of England. As at 31 December 2016, the balance on the AFS reserve was £6.7 million gain, net of tax (2015: £2.5 million gain, net of tax), reflecting increased market values of UK Government investment securities and equity holdings.

On-balance sheet liquid assets are supplemented by unencumbered Treasury bills obtained under the FLS, which are readily available to meet cash flow requirements (£1.1 billion). Total amounts drawn down through the FLS increased to £2.4 billion during the year (2015: £2.0 billion).

The Liquidity Coverage Ratio at 31 December 2016 was 151% (2015: 141%), comfortably above the minimum regulatory requirement. The Society also monitors its position against the Net Stable Funding Ratio (NSFR), a longer-term funding measure which is due to become a regulatory standard in January 2018. Based on current interpretations of regulatory requirements and guidance, the Society exceeds the expected 100% minimum future requirement.

Retail funding

The Society continues to be predominantly funded by retail savings, which have increased in the year by £2.7 billion to £28.1 billion (2015: £25.4 billion), representing growth of 10.6%, in comparison to market growth of 6.1%[6]. As such our market share increased to 2.0% (2015: 1.9%)[6] with over 200,000 new savings accounts opened in 2016.

Our growth in the savings market demonstrates our commitment to providing our members with attractive rates of interest relative to the market, despite the availability of cheaper wholesale funding. This increase in savings balances allowed us to offer mortgages on an additional 16,000 homes. In total over 90% of mortgage balances are funded by retail savings or capital.

The Society has continued to support the cash ISA market with competitive rates of interest, as demonstrated by growth, which was nine times greater than that of the market[6], increasing our share to 3.9% (2015: 3.2%).

Wholesale funding

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

In 2016, on-balance sheet wholesale funding increased by £1.4 billion with a year end balance of £7.7 billion (2015: £6.3 billion). Around £1.1 billion of this increase reflects the utilisation of marketable securities in sale and repurchase agreements and other deposits from banks. The balance of the increase is mainly attributable to foreign exchange movements in euro denominated debt securities in issue where the currency risk was already fully hedged.

In March 2016, the Society successfully completed a £275 million issuance of Residential Mortgage Backed Securities (RMBS) secured on buy to let loans under its newly established Offa RMBS programme. Outstanding notes on the Society's Leofric programme were repaid in full in November 2016 on the call date. See notes 16 and 25 to the accounts.

In early January 2017, the Society became the first UK institution to enter the euro covered bond market since the UK referendum on EU membership, with a €500 million issuance.

Subordinated liabilities and subscribed capital.

During the year the Society exercised its right to call £120.0 million of Permanent Interest Bearing Shares (PIBS) at par, leading to a reduction in this balance sheet category. The PIBS no longer qualified as capital, and consequently this call had no material impact on key capital ratios.

The Society also repaid £32.0 million of subordinated liabilities during the year, which similarly had no material impact on key capital ratios.

Equity

The Society's equity is predominantly made up of its General reserve and Additional Tier 1 capital (other equity) but also includes the AFS reserve and cash flow hedge reserve. The Society's total equity increased by around £0.2 billion over the year to £1.8 billion, driven primarily by retained profits generated during the period.

6. Source: Bank of England.

Regulatory capital

The Society's CRD IV capital position (excluding any transitional provisions) as at 31 December 2016 is summarised in the following table. The increase in CET 1 capital, total Tier 1 capital and total capital is primarily driven by profit after tax of £182.4 million.

Despite an 11.8% growth in the mortgage book, the related risk weighted assets have only marginally increased as a result of house price inflation reducing effective risk weights.

The movements described above have resulted in an increase in the Society's CET 1 ratio from 29.4% to 32.2% and in its leverage ratio from 4.0% to 4.1%. At 31 December 2016, and throughout the year, the Society complied in full with all of the regulatory capital requirements that were in force.

	End-point 31 Dec 2016 £m	End-point 31 Dec 2015 £m
Capital resources:		
Common Equity Tier 1 (CET 1) capital	1,320.8	1,167.2
Total Tier 1 capital	1,717.7	1,564.1
Total capital	1,722.0	1,568.4
Risk weighted assets	4,099.3	3,974.6
Capital and leverage ratios:	%	%
Common Equity Tier 1 (CET 1) ratio	32.2	29.4
Leverage ratio[1]	4.1	4.0
Leverage ratio (modified)[2]	4.4	n/a

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

The Society is provided with Individual Capital Guidance (ICG) by the Prudential Regulatory Authority (PRA). Following a Supervisory Review process in the first half of 2016, the Society has been issued with an ICG of 12.8% which is the sum of its Pillar 1 and Pillar 2A requirements. With a CET 1 ratio of 32.2% the Society comfortably meets this requirement using CET 1 capital alone.

On 1 August 2016, the PRA announced a modification of the calculation of leverage exposure for the purpose of the UK leverage ratio framework by excluding central bank reserves. Under the modified basis of measurement the Society's leverage ratio at 31 December 2016 would be 4.4%.

Additional information

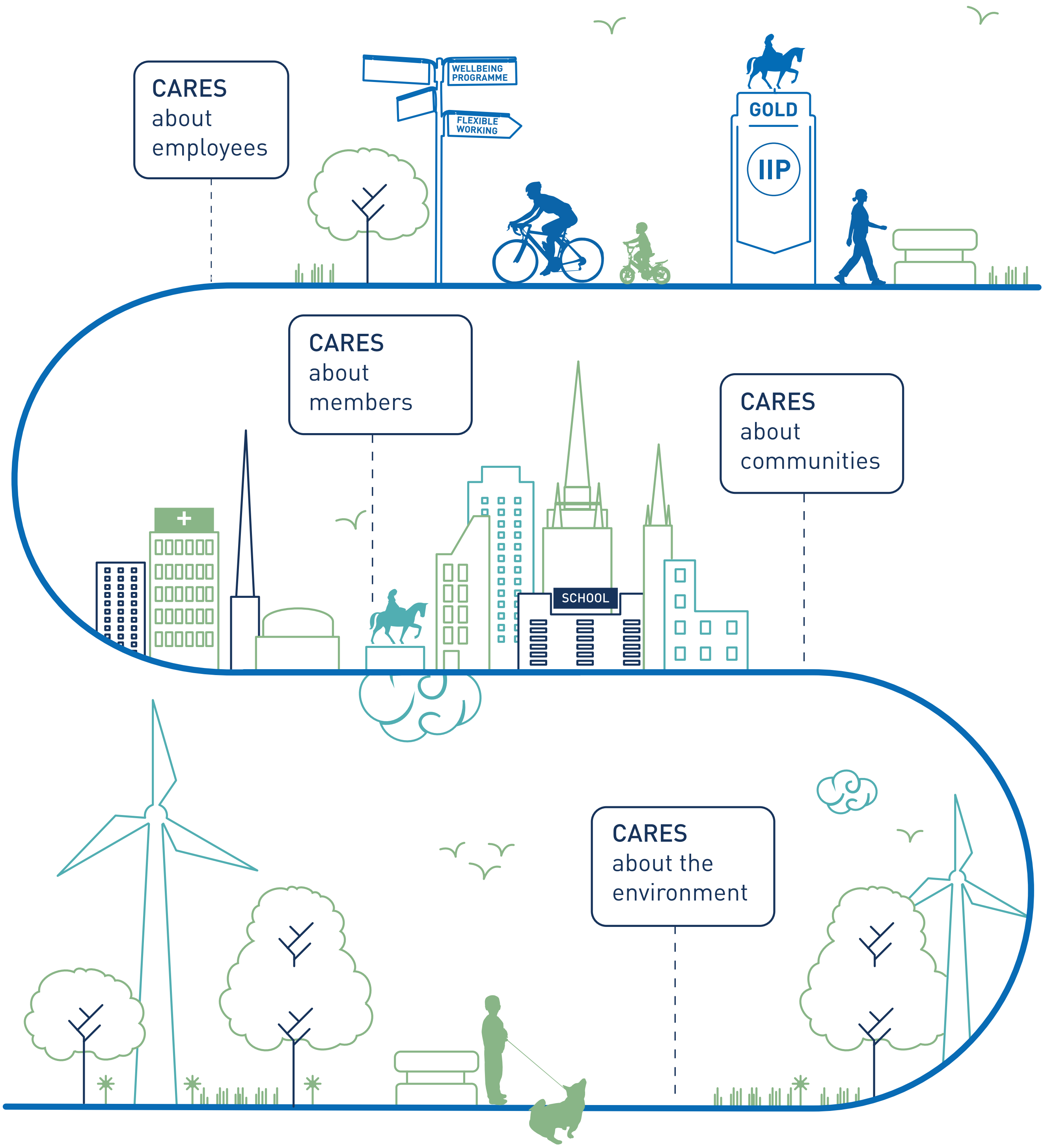
Further analysis is set out in the Risk Management Report as follows:

- Loans and advances to customers on pages 30 to 37.
- Treasury credit risk on pages 38 to 40.
- Liquidity on pages 44 and 45.
- Wholesale funding on pages 46 to 50.
- Capital and its management on pages 56 to 62.

Strategic Report

Corporate Responsibility Report

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



Putting Members First is not a slogan, it underpins our approach to corporate responsibility.

Coventry CARES

Coventry Building Society is an independent mutual organisation with a simple purpose – to meet the needs of its members for savings and residential mortgages. This is articulated as Putting Members First and guides decision making at all levels and for all activities across the Society. It is underpinned by a set of Values – Caring, Attentive, Responsive, Ethical, Straightforward, and the Society's commitment to the Coventry CARES Values are the foundation on which its approach to corporate responsibility is built; for members, for employees, for the communities it serves and for the environment.

In 2016, more than 9 out of 10 members who visited our branches or called our savings call centre were satisfied with our service.

Consumer champion organisation Fairer Finance rated us first for savings and mortgages for the second year in a row.

Coventry CARES about members

Putting Members First is central to the Society's corporate responsibility – its overarching aim is to protect members' interests and it does so by maintaining a strong, sustainable financial position, delivering long-term value in savings and mortgages and meeting the service expectations of its members.

Research has shown that simplicity and transparency in financial services is highly valued by members. In 2016 the Society worked hard to deliver this and the launch of a new website in January 2017 introduced elements that stand out in the market, including details of competing products and links to market comparison sites. Encouraging new and existing members to shop around for the best deal demonstrates not only confidence in the Society's competitiveness, but its commitment to doing the right thing for its members.

It is clear that listening to members is key. The Society continues to consult quarterly with its Members' Council, made up of volunteers from the membership, who this year have heard from members of the Board and senior managers on matters as diverse as regulation, product development, remuneration and corporate strategy.

Beyond the Council, the Society has also sought the views of over 53,000 members on issues ranging from their service experiences across all channels, the account opening process, and how complaints are handled. The Society continues to achieve exemplary levels of customer satisfaction and this research is reinforced by the low level of complaints referred to the Financial Ombudsman Service and the very low overturn rate of these complaints.

The strength of the Society's performance in meeting the expectations of its members is independently endorsed by consumer champion Fairer Finance rating the Society first for savings and first for mortgages for the second year in succession.

Corporate Responsibility Report **cont.**

On 17 May 2016 Mark Parsons signed our Time to Change pledge, a campaign encouraging organisations to challenge the stigma and discrimination associated with mental health. 'Within our strategic principles, which guide our decision making and behaviours, we pledge to value the contribution, diversity and engagement of our people and actively support them.'

Coventry CARES about employees

Employees bring the Values to life, and so it is critical that the Society invests in recruiting people who share these attitudes and behaviours, and helps them to reach their full potential in the workplace.

The Society's training provision, which is recognised by the National Skills Academy for Financial Services, ensures employees have the skills and knowledge required for their role. But it is important that they also have the opportunity to develop beyond their current role and accordingly, managers spend time with employees supporting their personal and career development. In 2016, a new development portal was launched which provides a wealth of content and ideas to help employees with their ongoing development. The outcome of these initiatives was that in 2016 over 200 employees assumed new roles with the Society and many others undertook internal secondments to broaden their knowledge and experience.

Another key area of focus has been Equality, Diversity and Inclusion (ED&I). Following the launch of a new internal ED&I network in 2015, the Society has progressed a range of initiatives focusing on flexible working, enhancing representation of women and minority ethnic groups in the workplace and support for those suffering with mental health problems.

These initiatives are having a real impact. Requests for flexible working – a significant enabler of working families – continue to increase, with the Society's approach being highlighted in the 2016 government report 'Empowering Productivity – Harnessing the Talents of Women in Financial Services'.

Listening to employees is as important as listening to members and in 2016 the Society chose to work with Best Companies on its employee opinion survey in order to compare itself with some of the best employers in the UK and was recognised as 'Outstanding' for employee engagement, with a 2 star rating being awarded.

Coventry CARES about the environment

In recent years steps have been taken to reduce the impact of carbon used in heating and lighting the Society's buildings, including 100% use of green energy and the use of energy efficient lighting. In addition, initiatives have been taken to reduce transport emissions through an employee shuttle bus and trialling the use of electric vehicles. The Society has an ongoing campaign to encourage members to use electronic communications rather than paper.

In 2016 the Society maintained its progress in reducing the amount of general waste going to landfill and now 100% is either recycled or is used to generate renewable energy.

Coventry CARES about our communities

As a mutual organisation, the Society is firmly rooted in the communities it serves and where its members and employees live. Over the years, its support for communities has grown and become an increasingly important part of the Society's activities, an approach guided by four areas of focus; employee engagement, making a difference, balancing national and local interests, and using expertise.

The Society continues to develop initiatives based on these areas of focus. For example, the Society increasingly works with schools on a range of programmes from developing financial literacy to offering students and young adults the opportunity to learn and practice skills for the workplace. These programmes are extremely rewarding for the employees who volunteer as well as the students, and provide both groups with opportunities for personal and career development.

This is in addition to the Society's Charitable Foundation which has donated over £1.1 million to locally based charities since it was launched in 1998.

Through this contribution of direct fundraising, donations and volunteering, the Society has invested £0.6 million in its community programme.

In addition, the Society's successful corporate charity partnership with The Royal British Legion continues to go from strength to strength. As well as donating over £1.3 million in 2016, taking the overall amount donated to £13.9 million since 2008, it also provides increasing opportunities for volunteering and this year 116 employees volunteered to help at the Fields of Remembrance and city collection days.

Including the donation to The Royal British Legion, our total community investment was £1.9 million.

In addition, the Society operates a number of initiatives which support employees in volunteering and fundraising for local community groups and charities. These include providing two days paid volunteering leave to any employee, community grants for volunteers working in their communities and an employee fund-matching scheme. The balance between supporting local and national charities is an extremely important part of the overall programme and means that employees can support local groups, often with a very personal connection to the groups they choose to help.

The range of initiatives has enabled an increasing number of employees to get involved in charitable activity. This helps the Society to make more of a difference but also has a very positive impact on employee engagement and motivation. In 2016 over three quarters of employees were actively engaged in the Society's community programme and the Society was recognised by Best Companies for its 'Outstanding' employee engagement.

We worked with over

1,300

children and young adults on everything from improving literacy and numeracy to employability skills.

Over

80%

of young people involved said that their confidence and communication skills had improved as a result of the programme.

Risk Management Report

Introduction and principal risks

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

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

The Society's purpose and objectives

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

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

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

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

Risk class	Brief definition
Credit risk	Credit risk is the risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual principal risk categories.
Market risk	Market risk is a collective principal risk category and is defined as the risk that the value of net interest income or market value derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign exchange rates.
Liquidity and Funding risk	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Liquidity and Funding risks are principal risks of the Society.
Conduct risk	Conduct risk is a principal risk category. Conduct risk is the risk that the Society's actions fail to deliver good customer outcomes.
Operational risk	Operational risk is a principal risk category which assesses the risk of loss arising from inadequate internal processes, systems or people, or from external events. The Society assesses the risks at a more granular level using the following operational risk categories: legal and regulatory, IT systems, information security, business continuity, financial crime, people, change, property and physical security, third party, business processes and financial reporting.
Business risk	Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors. The Society considers strategic risk, the risk to delivering the Strategic Plan, to be a principal risk.

In addition to these risks, the Society is also exposed to model risk. Models are used extensively within the Society to aid management decisions, where these are informed by modelled financial projections, to assess the Society's resilience to stress events and to support financial reporting. Failure in the design of a model, the assumptions used, or the interpretation of the results, may lead to an adverse outcome. The Society uses a variety of techniques to mitigate model risk, including sensitivity analysis to key assumptions, comprehensive documentation and strong governance. This includes the use of a formal committee dedicated to the oversight of the Internal Ratings Based (IRB) credit models and extensive independent model validation.

Pension obligation risk exists by virtue of the Society having previously offered a defined benefit pension scheme. As at 31 December 2016, the scheme had a surplus of assets over liabilities of £2.5 million as remeasured under IAS 19 *Employee Benefits (Revised).* The scheme was closed to new entrants in 2001 and to future service accrual during 2013. These actions have served to reduce the potential volatility of the scheme's liabilities. Pension obligation risk is not considered to be a principal risk, and therefore is not discussed further in this report.

Controlling and managing risk

Overview

The Society's risk management approach has continued to operate effectively during 2016 following the implementation of the Enterprise Risk Management Framework (ERMF) in 2015. The primary purpose of the ERMF is to set out the Board's approach to managing risk and the provision of oversight by defining and documenting the Society's purpose and objectives; risk strategy; risk appetite; governance and control; and risk management together with the principles upon which the framework is based.

The focus in 2017 will be continuous improvement of the ERMF, through operation and enhancement in response to future changes and developments within the Society and also to best practice and regulatory requirements.

The Society's approach to how it controls and manages risks is set out in the sections that follow.

Risk strategy

Set by the Board, the risk strategy translates the Society's purpose and objectives into an approach to risk management that incorporates risk culture, the Board risk appetite and the adoption of the 'three lines of defence' model (see diagram on page 25).

Risk culture

Risk culture is derived from the Society's strategic principles and values, and supports the achievement of the Society's stated purpose and objectives. Risk culture is defined as the normal attitudes and behaviour exhibited by employees at all levels with regard to risk awareness, risk taking and risk management.

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

- Tone from the top – the Board and executive management encourage employees to act with integrity, especially in the fair treatment of customers, and to escalate observed non-compliance. Employees are encouraged to report risk incidents and 'near misses'.
- Accountability – employees understand the core values of the Society and therefore the approach to risk. Where individuals have specific responsibilities with regard to risk, these are included within role profiles and objectives, and employees understand that they will be held accountable for their actions and risk taking behaviours. This is supported by the Society's performance management process. Where employees hold roles which are regulated under the Senior Managers and Certification Regimes, they are also subject to the Prudential Regulatory Authority (PRA)/Financial Conduct Authority (FCA) Conduct Rules.
- Incentives – the Society's performance management arrangements promote the Society's desired risk management behaviours and attitudes. In particular, the Society does not operate any sales incentives for employees.

Risk Management Report cont.

Board risk appetite

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

The Board has a risk philosophy to be a 'below median risk mutual' which also provides a backstop against the underlying risk appetite statements and limits for each of the Society's risk categories. Additionally, the Board has set a requirement that the Society is able to withstand a severe but plausible stress and still report an accounting profit and meet minimum capital requirements. The Society operates with a lower level of risk than its stated appetite or boundary conditions, if it is possible to do so and still meet its Strategic Plan targets.

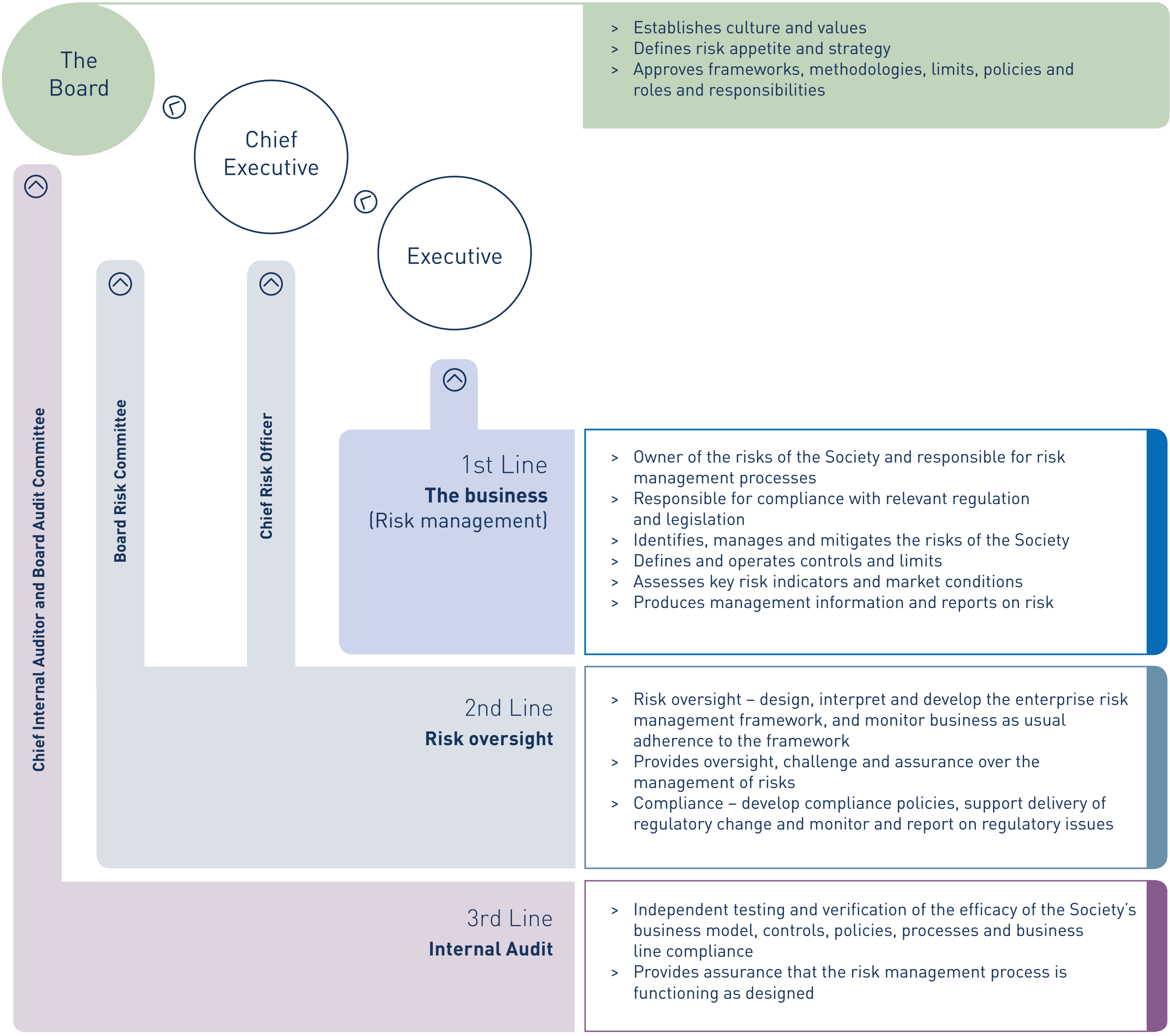
The Society's performance and adherence to Board limits is reviewed as part of a consolidated risk report by the Executive Risk Committee (ERC), the Board Risk Committee (BRC) and the Board.

Three lines of defence

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

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

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



Governance and control

Risk governance structure

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

The risk governance structure set out overleaf has been in place since 2015 when it was implemented as part of the ERMF. The key principle is that a first line Risk Committee is in place for each relevant risk category with ROC facilitating a comprehensive second line review of risks across all categories.

Further information on BRC is included in the Directors' Report on Corporate Governance on page 69 and on BAC in the BAC Report on pages 74 to 78.

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Risk Management Report cont.

The Board

Please go to pages 64 to 73 for more information on the Board

Board Risk Committee (BRC)
Chair: Non-executive Director

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

Please go to page 69 for more information on the Board Risk Committee

Board Audit Committee (BAC)
Chair: Non-executive Director

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

Internal Audit

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

External Audit

- Independently examines and expresses an opinion on the financial statements.

Please go to pages 74 to 78 for more information on the Board Audit Committee

Chief Executive

Executive Risk Committee (ERC)
Chair: Chief Executive

- Oversees and monitors strategic risk.
- Ensures that risk is being identified and managed efficiently across the Society.
- Ensures that the Society's risk management framework remains effective.
- Considers any emerging risks which may impact the Society's Strategic Plan.

Risk Oversight Committee (ROC)
Chair: Chief Risk Officer

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

Conduct Risk and Compliance Committee (CRCC)
Chair: Chief Executive

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

Asset and Liability Committee (ALCO)
Chair: Finance Director

- Oversees the asset and liability risks faced by the Society, specifically market risk, treasury credit risk and liquidity and funding risk.
- Ensures the robustness of the overall stress testing and scenario analysis programme for risks faced by the Society.

Retail Credit Risk Committee (RCRC)
Chair: Chief Risk Officer

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

Operational Risk Committee (ORC)
Chair: Chief Operating Officer

- Provides primary oversight of all operational risk categories.

Risk management

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

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

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

Stress testing and planning

The Society employs stress testing as a key tool to understand and manage the impact of risks crystallising. In support, the Society maintains a stress testing framework covering the frequency, scope and scale of stress testing, scenario planning and contingency planning. As well as an understanding of the Society's resilience to internal and external shocks, stress testing forms a key component of the Society's capital and liquidity assessments.

The stress testing that the Society undertakes is designed to:

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

ICAAP

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

The Society bases its capital requirements on a stressed scenario specified by the regulator but overlaid with additional adverse effects. In addition, a range of more severe stresses are considered in support of the overall capital assessment. The stresses used reflect both low and high Bank of England Base Rate scenarios.

ILAAP

The Internal Liquidity Adequacy Assessment Process (ILAAP) is the Society's documentation of its liquidity position and requirements, assessed against regulatory requirements and the Society's internal risk tolerance. An integral component of the approach to liquidity risk management is stress testing, some of which is prescriptive using very detailed rules and guidance issued within prudential regulations and reported within regulatory returns. In addition to the regulatory prescribed stress testing, the Society undertakes its own stress tests against which it sets Board limits – these tend to be more onerous than those defined by the regulator. The Society's stress tests and regulatory returns are completed weekly, albeit the Society can run these daily if needed. The stress tests are complemented by a monthly operational-based stress test and six-monthly 'alternative' stress tests.

Reverse stress testing

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

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

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

Recovery and Resolution Plan

The regulatory authorities are keen to avoid committing more taxpayers' funds towards any failed banks and building societies and require institutions to formulate plans to avoid such eventualities. The recovery section of the plan outlines what actions can be undertaken to stop the Society from failing, whilst the resolution section of the plan provides the data required by the Resolution Authority to effect Stabilisation Powers should the recovery options prove ineffective. The preferred resolution strategy for the Society means it will be

Risk Management Report **cont.**

required to hold additional subordinated debt in order to meet the minimum requirement for own funds and eligible liabilities (MREL) prior to full regulatory implementation on 1 January 2022. For further details see page 59.

The process of preparation for such extreme events enables the Board to plan the actions needed to recover from adverse conditions which would otherwise lead to failure. The recovery plan represents a 'menu of options' for the Society to deal with firm-specific or market-wide stresses and which can be incorporated into a credible and executable plan. As part of the annual review of the plan, testing is performed to assess the credibility of combining management actions in order to satisfactorily deal with a range of extreme stress events. The choice of extreme events draws on the analysis conducted for Reverse Stress Testing.

Top and emerging risks

Economic environment

The UK's referendum on European Union (EU) membership dominated economic headlines for much of the year but despite significant falls in sterling, inflationary impacts have remained modest so far with the economy outperforming expectations.

The most notable impact on the UK economy from the referendum vote has been the impact from the falling pound which may have a positive impact on exporters but is likely to lead to higher consumer price inflation. While this may not be sufficient to warrant a rise in the Bank of England Base Rate in the immediate near term, uncertainty may dampen domestic spending and reduce economic growth. There is a possibility that this could lead to falling house prices in some areas of the country, and rising unemployment.

Global growth has remained muted and whilst the situation in many emerging economies has stabilised the benefits of this are being diminished by the risk of political shocks in advanced economies (as disaffection with established political parties and institutions has increased). In addition concerns exist about the ability of central banks to address adverse shocks, given many are already deploying significant asset purchase schemes, and maintaining low or in some cases negative interest rates in an attempt to stimulate growth and support liquidity.

Interest rate shocks

At the start of 2016 most commentators expected that the next movement in the Bank of England Base Rate would be upwards. Against this expectation the downward movement in August was surprising, albeit clearly signalled in the aftermath of the referendum vote. In its assessment of the economic environment, the Board has always taken a prudent approach to possible interest rate movements and will position the Society to protect it against any adverse outcomes. Specifically the Society considers within its lending process the inherent risks to mortgage borrowers currently enjoying relatively low rates, who could suffer from a 'rate shock' in the event that the Bank of England Base Rate begins to rise and any consequent effects on mortgage affordability. To this end, through a thorough underwriting process, the Society only lends to those customers who it believes can afford repayments at a higher rate than is currently being charged. Regular and extensive stress testing is undertaken on the mortgage book under various scenarios, such as increased interest rates, and movements in unemployment levels and house prices.

The Society anticipates interest rates will remain low by historical standards for the foreseeable future but notes that if trade negotiations both within and beyond Europe prove too protracted, import costs could once again increase leading to further inflation and the prospect of earlier rises in interest rates.

Operationally, the Society successfully implemented the first change in the Bank of England Base Rate since 2009.

Savings markets

The UK savings market continues to be impacted by central bank funding schemes with the latest one, the Term Funding Scheme (TFS), announced in August 2016. This scheme has served to reinforce the impacts from its predecessor the Funding for Lending Scheme (FLS), resulting in savings rates continuing to be cut across the market, further exacerbated by the recent reduction in the Bank of England Base Rate.

Whilst this reduces funding and liquidity risk there are longer-term risks from reducing the reward for saving. Combined with increasing longevity and lack of pension provision, wealth in retirement, or indeed the ability to retire, is likely to be negatively impacted.

Lending markets

House prices compared with earnings remain at historically elevated levels. Whilst in previous economic cycles such imbalances may have contributed to house price falls, affordability continues to be supported by record low interest rates and the outlook for interest rates remains well below historical longer-term trends. In addition whilst 2016 saw higher house price inflation compared with 2015, real house prices in most of the UK are still considerably less than previous peaks. The ongoing imbalance between the supply and demand for houses also provides support for the level of house prices.

The Council of Mortgage Lenders (CML) data reveals gross lending increased by 12% in 2016 to the highest level since 2008. Lending was volatile during the year as a consequence of stamp duty changes on second properties during the second quarter and the EU referendum, but recovered towards the end of the year with a strong pipeline of approvals that is expected to feed through into lending figures in the early months of 2017. However the overall outlook for the housing market in 2017 is more subdued due to economic uncertainty and regulatory and income tax changes which may adversely impact the buy to let market. As a result the CML predicts lending volumes in 2017 will be similar to 2016.

The Society is a relatively large participant in the buy to let market and may therefore be more adversely impacted than others by the regulatory changes to buy to let underwriting together with restrictions on income tax relief which will come into force in 2017. From July 2016 the Society required all new buy to let lending to be assessed against a minimum interest coverage ratio of 140% (previously 125%) and in December 2016 the Society increased the stressed interest rate used to assess this ratio to 5.5%. Given the timing of these changes the full impact is uncertain but most commentators are expecting reduced buy to let lending during 2017. This may lead to margin compression as lenders attempt to retain their share in a smaller market.

Cyber threat

Cyber-attacks remain a significant risk for all financial institutions. The risk is heightened as criminals increasingly move away from traditional crime and turn towards cybercrime. Financial institutions have had to respond to this increasingly sophisticated threat through substantial investment, primarily in technology, but also in educating employees and customers regarding the cyber threat.

The Society is determined to ensure that its defences remain robust by making continuous improvements to its infrastructure in accordance with its Cyber Security Strategy. To support this approach, and building on a significant Information Security programme undertaken in 2016, the Society continues with its programme of updating its underlying technology and platforms which support those defences, ensuring the necessary level of resilience is maintained.

Regulatory reforms

The pace of regulatory change continues unabated. At the end of 2016, the PRA published its policy on the setting of MREL. The Society has received its interim individual MREL requirement and although it meets this in full, the Society, along with many of its peers, will be required to issue additional subordinated debt to meet the final requirements.

Final calibration of the leverage ratio will not be completed until 2018 and the impact of new standardised risk weights and associated capital floors on IRB lenders remains subject to speculation. Planning against this backdrop is challenging, and the capital floors in particular could impact the Society more than some of its peers given the large concentration of low IRB risk weighted assets. The Board has considered the impact of these changes on the Society's Strategic Plan, based upon its understanding of current consultations, and is confident it remains achievable.

During the year, the Society implemented changes required under the Mortgage Credit Directive, Payment Account Regulation, Cash Savings Remedies and Deposit Guarantee Scheme Directive. Whilst these changes ensured the Society remained compliant with latest requirements, the cost and scale of regulatory change does risk diverting resources from investing in the Society's commercial proposition.

Investment programme

The pace of technological developments and rising customer expectations are creating significant change in financial services. In response to these challenges, the Society continues to make progress in delivering its IT change programme. This investment in the Society's core infrastructure will provide increased functionality and methods of distribution, including developments in online services, as well as improving responsiveness to future changes and system resilience.

The undertaking of any change programme is not without risk. The Board recognises that the successful management of risks and uncertainties in the delivery of this programme is key. There will therefore continue to be a strong focus on change capability and the governance of programmes to minimise these risks.

Risk Management Report cont.

In addition to these top and emerging risks, each of the Society's principal risks as highlighted in the table on page 22, are discussed in detail in the following sections.

Credit risk

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

Maximum exposure to credit risk (Audited)

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

	On-balance sheet carrying value 2016 £m	Off-balance sheet exposures[1] 2016 £m	Maximum credit risk exposure 2016 £m	On-balance sheet carrying value 2015 £m	Off-balance sheet exposures[1] 2015 £m	Maximum credit risk exposure 2015 £m
Cash and balances with the Bank of England	3,260.0	–	3,260.0	2,587.8	–	2,587.8
Loans and advances to credit institutions	213.5	–	213.5	235.8	–	235.8
Debt securities	1,354.3	2,398.6	3,752.9	1,551.7	2,045.5	3,597.2
Loans and advances to customers	32,881.6	1,689.7	34,571.3	29,411.0	1,684.2	31,095.2
Hedge accounting adjustments	144.5	–	144.5	78.1	–	78.1
Derivative financial instruments	354.2	–	354.2	173.0	–	173.0
Total	38,208.1	4,088.3	42,296.4	34,037.4	3,729.7	37,767.1

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

Retail credit risk

Retail credit risk profile

Lending to low risk owner-occupier and buy to let borrowers continues to be the focus of the Society's business model. Balances on discontinued non-traditional mortgages (near-prime and self-certification, both of which were withdrawn in 2008) and unsecured personal loans (withdrawn in 2009) continue to reduce and now comprise just 1.2% of total gross balances. The Society also has a very small exposure to commercial loans (comprising lending to small businesses and on which no new advances have been undertaken since 2009) that were part of the Stroud & Swindon portfolio that was added to the Society's overall assets upon merger of the two societies in 2010.

The Society does not currently offer interest-only mortgages for owner-occupiers but has a legacy book that is currently in run-off. Balances continue to reduce and by balance 11.1% of the owner-occupier book is on an interest-only product (2015: 14.3%). The Society has a dedicated team which proactively makes contact with customers on an interest-only product in order to help assess the ability to repay the capital amount at the end of the term, and provide alternative solutions where appropriate, for example extending the loan on a capital and interest repayment basis. As at 31 December 2016, 404 cases were past term (2015: 536 cases). The average loan to value of the interest-only owner-occupier book was 39.9% as at 31 December 2016 (2015: 41.2%).

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

Loans and advances to customers (Audited)	2016 £m	2016 %	2015 £m	2015 %
Residential mortgages: owner-occupier	20,094.5	61.0	18,402.5	62.6
Residential mortgages: buy to let	12,423.8	37.8	10,595.9	36.0
Total traditional residential mortgages	32,518.3	98.8	28,998.4	98.6
Residential near-prime mortgages	87.8	0.3	95.1	0.3
Residential self-certification mortgages	252.9	0.8	291.1	1.0
Commercial mortgages[1]	3.6	–	4.6	–
Total non-traditional mortgages	344.3	1.1	390.8	1.3
Unsecured personal loans[1]	37.5	0.1	43.5	0.1
Total gross balance	32,900.1	100.0	29,432.7	100.0

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

Geographical concentration (Audited)

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

Region	2016 %	2015[1] %
London	24.6	22.7
South East England	18.1	17.6
Central England	15.9	17.1
Northern England	14.8	15.7
East of England	11.0	10.6
South West England	9.2	9.4
Scotland	3.7	4.0
Wales and Northern Ireland	2.7	2.9
Total	100.0	100.0

1. Regions have been redefined in line with those used by the Office for National Statistics and comparative numbers have been updated accordingly.

Loan to value and income multiples

The Society's low risk approach to lending is reflected in the loan to value profile of the mortgage book. The estimated value of the mortgage portfolio is updated on a quarterly basis using the Nationwide Regional House Price Index. For owner-occupier mortgages the standard maximum income multiple at which the Society will lend is 4.5. However, this is subject to the discretion of skilled underwriters on a case by case basis. In 2016 and 2015 less than 1% of lending was above the 4.5 multiple.

For buy to let mortgages a minimum interest coverage ratio of 140% is currently required and was increased to this level during the year in order to reflect the impact of restricted income tax relief for higher rate taxpayers. The Society is planning to introduce a lower interest coverage ratio during 2017, for borrowers not impacted by this tax change.

Risk Management Report cont.

The loan to value distribution of the mortgage book as at 31 December 2016 is analysed below, together with an analysis of gross new lending in the year. The following tables are by value of loans unless stated otherwise:

Total mortgage book profile by number of accounts (Audited)	2016 %	2015 %
Indexed loan to value:		
< 50%	49.7	48.8
50% to 65%	25.2	24.5
65% to 75%	14.3	14.1
75% to 85%	7.7	8.7
85% to 95%	2.9	3.6
> 95%	0.2	0.3
Total	100.0	100.0
Average indexed loan to value of stock (simple average)	47.8	48.4
Average indexed loan to value of stock (balance weighted)	54.6	55.2

Gross lending – new business profile (Audited)	2016 %	2015 %
Owner-occupier purchase	32.3	36.6
Owner-occupier remortgages	24.8	23.2
Owner-occupier further advances	1.3	1.3
Buy to let	41.6	38.9
Total	100.0	100.0
Average loan to value (simple average)	60.9	63.0
Average loan to value (balance weighted)	63.7	66.1

Retail credit risk management – mortgages

Meeting current and future members' needs for residential mortgages remains fundamental to the Society's simple business model. Credit risk for the Society is therefore most likely to present itself in the potential inability of a borrower to repay their mortgage, and will materialise if that inability to repay results in repossession of the borrower's property, and subsequent loss if the value of the property upon sale is insufficient to pay the mortgage balance in full.

Exposure to this risk is monitored and managed by a specialist department that reports to the Chief Risk Officer, and is overseen by the Retail Credit Risk Committee (RCRC). RCRC's activities and decisions are ultimately overseen by the Board via the Committee hierarchy set out on page 26.

The Board sets risk limits within the context of the Society's prudent risk appetite, and RCRC ensures the quality and mix of new lending and the overall portfolio remain within these limits. The Board does this by setting and monitoring lending policy and ensuring appropriate controls are in place to maintain the quality of lending, including reviewing comprehensive management information and undertaking extensive benchmarking against comparative data. This is sourced from both publically available data and via membership of industry benchmarking groups.

A comprehensive quality assurance programme to review new lending processes and decision making is in place. The first line (i.e. new lending operations teams) undertakes checks whilst applications are being processed, whilst the second line (i.e. the specialist credit risk department) reviews lending decisions post completion, to ensure that continuous learning and improvement is embedded, whilst minimising the chances of systemic issues remaining unidentified and adversely impacting the quality of new lending. The third line (i.e. Internal Audit) regularly reviews the controls and processes surrounding the quality assurance programme, to provide assurance that they are operating effectively.

To meet its objectives with regard to the quality of new lending, the Society operates a combination of statistical modelling (credit scoring) and assessment of applications against lending policy criteria which are embedded as rules within the Society's automated decision system. This system uses information from the statistical modelling and assessment against policy rules to provide consistent lending decisions, and helps determine when manual intervention is required by skilled underwriters.

On all owner-occupier mortgage applications, the Society also assesses borrower affordability to ensure that the applicants' income, after considering key expenditure requirements, is sufficient to meet the mortgage payments both currently and also in a much higher (stressed) interest rate environment. This stressed affordability assessment forms part of the Society's approach to meeting its obligations as a responsible lender.

The Society considers that the risks in its buy to let portfolio are comparable to or even lower than the risks in its owner-occupier portfolio. It makes this assessment after consideration of its prudent lending policy with respect to buy to let lending. This includes limiting the number of properties it will consider when lending to landlords, requiring rental properties to be readily saleable into the owner-occupier market (thereby giving recourse to two markets in the event the property is repossessed), and applying a stressed interest rate to ensure its prudent minimum rental coverage requirements (percentage of the monthly interest payment covered by the rental income) can be met even in a future higher interest rate environment. This latter requirement helps ensure that the borrower can accommodate periods of rental voids or the cost of unexpected repairs without undue strain on the ability to meet monthly payments as they fall due. During the year, the Society increased the minimum interest coverage ratio to 140%, and also the stressed rate upon which this calculation is based to 5.5% in response to the regulatory consultation and changes to income rate tax relief for higher rate taxpayers.

The Society also operates at lower loan to value maximums for buy to let lending than it does for owner-occupier, which means that in the event of default, credit losses are typically low.

The Society has a natural concentration in the UK market, as it only lends on properties within the UK. Close monitoring of the geographical distribution of exposures, lending by distribution channel, and by type of product, together with lending limits to specific segments of the market help to manage the risk of overexposure to any one region or counterparty.

Regular stress testing is undertaken on the mortgage portfolio which seeks to establish the extent to which losses may emerge under a range of macroeconomic and specific stress scenarios and to ensure that the Society continues to remain within its retail credit risk appetite.

These stress tests primarily translate a range of economic variables such as interest rates, unemployment rates and house price movements into estimates of default rates and loss severity, and the consequent impact on impairment losses and capital consumption.

The Society places great emphasis on working with existing borrowers who experience financial difficulty on an individual basis, and to consider each case of financial hardship on its own merits, where it affects the borrower's ability to make their mortgage payments. Reasonable and realistic arrangements are sought, based on what the customer can afford, provided there is a high degree of confidence that any missed payments will be repaid over a reasonable timeframe. This work is undertaken by a specialist department. Forbearance remains one of the tools at the disposal of this department, and more information on the extent and type of forbearance offered by the Society is given later in this section. The work undertaken by the specialist department is overseen by RCRC, which monitors arrears performance and sets arrears policy in accordance with the objective of treating customers fairly and within the Society's overarching mission of Putting Members First.

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

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

Identifying impaired loans (Audited)

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

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

Risk Management Report cont.

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

(Audited)	2016 Society %	2016 CML[1] %	2015 Society %	2015 CML[1] %
Greater than three months	0.31	1.00	0.45	1.12
Greater than six months	0.12	0.58	0.17	0.62
Greater than one year	0.04	0.27	0.05	0.27
In possession	0.01	0.03	0.01	0.03

1. Council of Mortgage Lenders' data as at 31 December 2016 (31 December 2015).

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

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

As at 31 December 2015 (Audited) Indexed loan to value:	Not impaired		Impaired				
	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
< 50%	10,945.7	106.1	18.3	8.4	–	(3.4)	11,075.1
50% to 65%	8,522.1	91.9	19.9	12.4	0.1	(3.8)	8,642.6
65% to 75%	5,034.6	54.4	13.6	9.8	0.3	(2.0)	5,110.7
75% to 85%	3,155.5	45.1	10.3	8.4	0.1	(1.7)	3,217.7
85% to 95%	1,182.5	22.9	8.2	5.8	0.5	(1.6)	1,218.3
> 95%	85.6	11.7	5.0	5.6	4.4	(4.8)	107.5
Unsecured	39.5	3.3	0.4	0.3	–	(4.4)	39.1
Total	28,965.5	335.4	75.7	50.7	5.4	(21.7)	29,411.0

The Society held properties valued at £3.3 million (2015: £4.0 million) pending their sale against balances of £2.8 million (net of provisions) (2015: £3.7 million). Shortfalls between expected sale proceeds (less anticipated costs) and the balance outstanding are fully provided.

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

As at 31 December 2016 (Audited)	Not impaired		Impaired				
	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Residential mortgages							
Owner-occupier	19,844.2	189.1	35.1	24.4	1.7	(5.1)	20,089.4
Buy to let	12,348.9	61.8	6.0	5.6	1.5	(7.1)	12,416.7
Non-traditional mortgages							
Residential near-prime	57.5	18.6	7.8	3.9	–	(0.3)	87.5
Residential self-certified	220.1	21.7	5.8	4.7	0.6	(0.9)	252.0
Commercial lending	3.3	0.3	–	–	–	(0.8)	2.8
Unsecured	33.8	3.0	0.4	0.3	–	(4.3)	33.2
Total	32,507.8	294.5	55.1	38.9	3.8	(18.5)	32,881.6

As at 31 December 2015 (Audited)	Not impaired		Impaired				
	Not past due £m	Past due up to three months £m	Past due over three to six months £m	Past due over six months or in litigation £m	In possession £m	Impairment provision £m	Total £m
Residential mortgages							
Owner-occupier	18,097.9	217.9	52.0	32.1	2.6	(7.1)	18,395.4
Buy to let	10,516.2	64.7	6.7	6.7	1.6	(7.7)	10,588.2
Non-traditional mortgages							
Residential near-prime	56.5	22.8	9.1	6.3	0.4	(0.5)	94.6
Residential self-certified	251.3	26.2	7.5	5.3	0.8	(1.2)	289.9
Commercial lending	4.1	0.5	–	–	–	(0.8)	3.8
Unsecured	39.5	3.3	0.4	0.3	–	(4.4)	39.1
Total	28,965.5	335.4	75.7	50.7	5.4	(21.7)	29,411.0

Movement in impaired loans

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

As at 31 December 2016 (Audited)	Traditional residential mortgages		Non-traditional mortgages				
	Owner-occupier £m	Buy to let £m	Residential near-prime £m	Residential self-certified £m	Commercial lending £m	Unsecured £m	Total £m
Impaired at 1 January 2016	86.7	15.0	15.8	13.6	–	0.7	131.8
Classified as impaired during the year	77.6	18.3	18.0	14.7	0.2	0.8	129.6
Transferred from impaired to unimpaired	(91.6)	(18.7)	(22.4)	(17.8)	(0.2)	(0.5)	(151.2)
Amounts written off	(1.3)	(0.1)	(0.1)	(0.4)	–	–	(1.9)
Charged to impaired loans	1.0	0.3	0.3	0.2	–	–	1.8
Repayments and other movements	(11.2)	(1.7)	0.1	0.8	–	(0.3)	(12.3)
Impaired at 31 December 2016	61.2	13.1	11.7	11.1	–	0.7	97.8

Loan balances are shown gross of provisions. Amounts written off reflect losses on properties sold from possession where the balances on these loans were in excess of the sale proceeds. Repayments and other movements include disposals (sale proceeds from properties in possession), and repayments from customers reducing the outstanding balances. Amounts charged to impaired loans include interest accrued and charges. The movement in impairment provisions on loans and advances to customers is further detailed in note 11 to the accounts.

Extent and use of forbearance (Unaudited)

The Society will always seek to work with existing borrowers who experience financial stress to arrive at a mutually acceptable, sustainable solution. The exercising of forbearance will be considered if it is in the best interests of both the borrower and the Society to do so, and it represents a viable means of regularising the mortgage and helping borrowers manage their financial difficulties in a sustainable manner.

Should borrowers find themselves in financial difficulty resulting in arrears, the Society will seek to help and work with them on a case by case basis to resolve matters subject to the mortgage being put back on to a sustainable footing in the longer term.

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

- Arrangements, where monthly payments are maintained and the arrears are repaid over a period of time.
- Concessions, where it is agreed to accept the normal monthly payment 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 may be considered as part of a longer-term solution, provided that payments will be sustainable over the life of the mortgage.

In very rare cases, the Society may consider eliminating arrears through the capitalisation of arrears or putting the mortgage, if on a repayment basis, on to an interest-only scheme for a temporary period (there have been no such transfers in the last two years).

Capitalisation of arrears will only be considered once during the lifetime of the mortgage and only where the customer has made at least six consecutive monthly payments, and it has been determined that the level of payment required post capitalisation is both affordable and sustainable in the long term. In 2016 the Society capitalised arrears in this manner on just seven accounts (2015: six).

Where the case is not in arrears, the most common means of exercising forbearance as a means of helping borrowers overcome temporary financial difficulties is by granting a short-term payment holiday. Whilst payment holidays are a feature of some of the products offered by the Society, where it has been determined that financial difficulties are the reason for the request, the action is recorded as being a forbearance measure rather than as one where the borrower is utilising the product feature.

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

	2016		2015	
	No. of accounts	Carrying value £m	No. of accounts	Carrying value £m
Forbearance: Accounts past due				
Arrangements	1,263	136.3	1,754	196.0
Concessions	44	5.6	64	6.2
Term extensions[1]	18	2.8	10	1.4
Capitalisation of arrears[1]	1	0.1	1	0.2
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	485	55.9	762	88.7
Term extensions[1]	84	12.6	61	9.4
Capitalisation of arrears[1]	6	0.5	5	0.4

1. Granted in the last 12 months.

With the exception of term extensions and capitalisation of arrears (increase of just one case) all the forbearance categories have fallen compared with the previous year end reflecting the improving economic environment and improved credit risk profile of the Society's borrowers. The use of term extensions has increased as a result of the engagement with interest-only borrowers who do not have sufficient means to pay the outstanding capital balance but can sustainably address any shortfall by extending the term of the loan on a repayment basis.

Whilst accounts not past due are not considered to be individually impaired, it is recognised that collectively impairment exists. Provisions have therefore been raised against accounts subject to a forbearance measure (see note 11 to the accounts), totalling £2.7 million (2015: £4.7 million) for all cases in these forbearance categories.

In addition the Society has identified the following situations as indicating potential impairment amongst members whose mortgages are nonetheless not past due:

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

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

As at 31 December 2016, there were 1,955 members with such potential impairment indicators, to the value of £202.3 million (0.61% of the mortgage book). A collective provision of £0.1 million is being held, which reflects the low probabilities of default (since 31 December 2015, only 10 cases in these categories have gone into arrears by six or more months) and high collateral values (the average simple loan to value is 43.1% and only 12 cases are above 95% loan to value) of these mortgages.

The Society continues to collect information on all requests by borrowers for changes to the terms and conditions of their mortgage, and is tracking the performance of these changes over time to determine if there are further incidences of potential impairment that are not immediately evident at the time of the request. Examples of the types of changes include amendments to payment date or method and requests for permission to temporarily let the (owner-occupier) borrower's property. Currently there is no objective evidence that, following these changes, the performance of these mortgages has deteriorated to the extent that would lead us to conclude that additional provision for these cases was appropriate.

Outlook

The Society continues to focus its lending on high credit quality, low risk business to protect it from the risk of non-performing loans, and on low loan to value business to protect it from the risk of unacceptable levels of losses. It also assesses affordability under a higher interest rate environment to protect the borrower, both owner-occupier and buy to let. Whilst expectations for the timing of an increase in interest rates continue to remain uncertain, the Society nonetheless recognises that interest rate rises will place borrowers under additional strain. As part of its commitment to Putting Members First the Society has proactively contacted borrowers most at risk with the aim of raising awareness amongst them and to provide reassurance that the Society will continue to support them if financial difficulties do arise. This is one example of how the Society seeks to protect its members' interests whilst at the same time helping to mitigate the scale of adverse impacts on the financial performance of the Society.

Regulatory intervention in the buy to let market and the restriction of income tax relief for higher rate taxpayers are likely to impact demand and potentially the supply of buy to let mortgages. As noted previously, the Society has already responded to some of these changes and during 2017 will consider its approach to the remaining regulatory requirements. Given the low loan to value nature of the Society's buy to let book, the nature of the properties considered appropriate security, and the interest coverage ratios achieved, the expectation is that any future credit losses will remain comparable to owner-occupier loans.

Notwithstanding any speculation regarding the timing of any future interest rate increases, and the likelihood that when rates do rise they are expected to do so gradually, the Society undertakes stress testing as part of its strategic planning process to understand the impact of much more rapid rises, should they materialise, coupled with other adverse macroeconomic effects such as increasing unemployment and falling house prices. The Society is well placed to manage the impact of adverse economic stresses and the effect these could have on the future performance of the mortgage book.

Treasury credit risk

Management of treasury credit risk

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

Treasury exposures and limits are focused in the main on UK institutions, with additional limits extended to a small number of highly rated banks in Europe and other developed economies such as Australia and Canada. Limits are set in line with a Board approved Treasury and Prudential Policy Statement, which sets maximum limits taking into account internal analysis, external credit ratings, country of domicile and any other relevant factors. All credit limits require Board approval, and are subject to an initial assessment of the creditworthiness of the counterparty, with the approved limit then subject to at least an annual review. Exposures are reviewed on a real time basis to ensure that they remain within the approved limits. Ongoing developments with treasury counterparties are closely monitored, and are reported to, and reviewed by the Treasury Credit Committee. This Committee meets weekly and is chaired by the Chief Risk Officer. The Committee is empowered to take immediate action to reduce or suspend limits where this is warranted by adverse changes in the creditworthiness of counterparties or market or local developments. The Committee reports through the Asset and Liability Committee (ALCO) to the Board via the Committee structure set out on page 26.

Derivatives are only executed with organisations that have a Board approved credit limit, and the vast majority include arrangements requiring that any movement in the value of the derivative be offset by the placing of cash collateral to reduce the resulting credit exposure. As part of its liquidity management, the Society also enters into sale and repurchase (repo) transactions where highly rated assets such as gilts are sold with an agreement to repurchase at an agreed price on a later date. The cash received may be less than the market value of the asset, creating a credit exposure. Any subsequent market movements in the value of the asset will alter this repo exposure and is therefore subject to daily collateralisation to mitigate this position. All repo counterparties are subject to review by the Treasury Credit Committee and are ultimately approved by the Board. The Society has no exposure to emerging markets, hedge funds, non-UK Residential Mortgage Backed Securities (RMBS), non-UK covered bonds or credit default swaps and in excess of 99% of exposures have an investment grade rating.

Treasury liquid assets profile (Audited)

The Society's treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions, debt securities, and Treasury bills drawn under the Funding for Lending Scheme (FLS). Analysis of the Society's treasury assets by credit rating is set out below:

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

	Exposure value by Moody's rating				
2015 (Audited)	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	5,866.0[2]	–	–	–	5,866.0
Multilateral development banks (supranational bonds)	35.1	–	–	–	35.1
Financial institutions	113.5	316.1	13.1[3]	4.5	447.2
Mortgage backed securities	68.7	3.8	–	–	72.5
Total	6,083.3	319.9	13.1	4.5	6,420.8

1. Unrated financial institutions comprises an exposure to a building society (2015: £1.7 million). In addition, 2015 also included a single credit support annex in relation to a derivative liability with an unrated bank of £2.8 million.
2. Balance includes the off-balance sheet Treasury bills of £2,398.6 million (2015: £2,045.5 million) drawn under the Bank of England's FLS.
3. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities.

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

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

2015 (Audited)	Liquid assets Sovereign £m	Supranational £m	Financial institutions £m	Mortgage backed securities £m	Total liquid assets £m	Of which, debt securities Amortised cost £m	Market value movement £m	Fair value £m
United Kingdom	5,866.0[1]	–	383.2	72.5	6,321.7	3,469.2[1]	92.8	3,562.0
Denmark	–	–	10.4[2]	–	10.4	–	–	–
France	–	–	20.1[2]	–	20.1	–	–	–
Germany	–	–	14.5[2]	–	14.5	–	–	–
Switzerland	–	–	17.3[2]	–	17.3	–	–	–
Supranational[3]	–	35.1[3]	–	–	35.1	35.1	–	35.1
Australia	–	–	0.7[2]	–	0.7	–	–	–
Canada	–	–	1.0[2]	–	1.0	–	–	–
Total	5,866.0	35.1	447.2	72.5	6,420.8	3,504.3	92.8	3,597.1

1. Balance includes the off-balance sheet Treasury bills of £2,398.6 million (2015: £2,045.5 million) drawn under the Bank of England's FLS.
2. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities.
3. Supranational relates to amounts held with the European Investment Bank, which are guaranteed by a number of European sovereigns.

Credit risk mitigation

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

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

The European Market Infrastructure Regulation (EMIR) introduced a requirement to clear derivatives in scope through a third party regulated central clearing counterparty in order to reduce systemic and operating risk and the Society became subject to mandatory clearing during November 2016. Under central clearing collateral is exchanged on a daily basis. The Society enters into a number of swaps with other counterparties with an amortising profile and a variable rate linked to the Sterling Overnight Index Average (SONIA) that are not currently cleared by any of the central clearing houses. For these the Society is taking action to move exchange of collateral from a weekly to a daily basis to better manage counterparty risk.

Coventry Building Society Covered Bonds LLP undertakes each swap it executes under a separate ISDA agreement. Each agreement includes a CSA which provides for full collateralisation of the swap exposure, with the exception of one swap, where full collateralisation only occurs when the counterparty bank credit rating falls below a certain threshold. The majority of the £45.0 million net derivative credit exposure in the following table relates to this latter arrangement. The counterparty has a credit rating of Aa2.

Risk Management Report cont.

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

Counterparty credit risk – derivative financial instruments (Audited)

Counterparty credit risk includes the risk of default of a counterparty to such a derivative instrument. All counterparties are subject to credit assessments and the regular exchange of collateral to mitigate any exposure. The balance sheet net credit exposure values of derivative instruments are presented in the following table:

(Audited)	2016 Exposure value £m	2015 Exposure value £m
Gross positive fair value of contracts	354.2	173.0
Netting benefits	(185.2)	(106.9)
Net credit exposure	169.0	66.1
Collateral held	(124.0)	(24.2)
Net derivative credit exposure	45.0	41.9

The result of the EU referendum saw sharp falls in both interest rates and the value of sterling. These falls had a significant impact on the fair value of the Society's derivatives, netting benefits and collateral held.

As at 31 December 2016, £41.2 million of the £45.0 million exposure is to a single Aa2 rated UK institution with a further £2.8 million to A1 or above rated financial institutions.

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

Impairment provisions: Available-for-sale assets

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

When a decline in the fair value of an AFS financial asset has been recognised directly in equity reserves and there is objective evidence that the asset is impaired, accounting standards require that the cumulative loss recognised in equity reserves be removed and recognised in the Income Statement. In assessing impairment, the Society considers the credit ratings of the counterparties and current market valuations (such as negative fair value adjustments) as well as the extent to which coupon payments have been made on a timely basis. As at 31 December 2016 no amounts in the treasury portfolio were either past due or impaired, and as such no provision has been made.

Outlook

Global growth has remained muted and whilst the situation in many emerging economies has stabilised the benefits of this are being diminished by the risk of political shocks in advanced economies (as disaffection with established political parties and institutions has increased). In addition concerns exist about the ability of central banks to address adverse shocks, given many are already deploying significant asset purchase schemes, and maintaining low or in some cases negative interest rates in an attempt to stimulate growth and support liquidity.

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

Market risk

Management of market risk

Market risk is the risk of a reduction in Society net interest income and/or the value of assets/liabilities resulting from adverse movements in interest rates or foreign exchange rates. Market risk only arises in the banking book as the Society does not have a trading book, and is mainly related to interest rates as the Society has an immaterial unhedged foreign currency risk exposure. The Society does not trade or take speculative positions in derivatives.

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

Control of market risk exposure is overseen by ALCO, and ultimately the Board via the Committee hierarchy set out on page 26. The accounting policy for derivatives and hedge accounting is described in the accounting policies in note 1 to the accounts.

Interest rate risk (Audited)

Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of differences between interest rates received and paid on mortgages and deposits respectively. Interest rate risk can also arise from the options that feature within the design of savings and mortgage products.

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

This risk increases with the term of the asset and is particularly relevant for equity release mortgages (£287.9 million) held by the Society; however, approximately £141.9 million of this balance is hedged with interest rate swaps, while the remainder is notionally matched against reserves.

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

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

The following tables show the impact of a 200 basis points parallel shock to interest rates on the PV of the assets and liabilities (PV200) and net interest income throughout the reporting period. As part of these calculations, there are a series of assumptions concerning prepayment of loans of different terms. These assumptions are based on historical prepayment profiles. In addition, it is assumed that non-maturing deposits, which do not have any specific re-pricing terms in the PV200 analysis, have a defined amortising profile. These assumptions are periodically reviewed and are subject to independent oversight by the Society's Prudential Risk and Compliance function.

Shock applied	+200bps 31 Dec 2016 £m	-200bps 31 Dec 2016 £m	+200bps 31 Dec 2015 £m	-200bps 31 Dec 2015 £m
PV200 results	(4.7)	(12.7)	(1.7)	19.9

Shock applied	+200bps 2016 £m	-200bps 2016 £m	+200bps 2015 £m	-200bps 2015 £m
Impact on profit and loss	49.9	(6.1)	43.7	(10.4)

Risk Management Report cont.

The PV200 measures the impact of a market yield change on the value of the assets and liabilities and incorporates the investment of reserves with a duration approved by the Board. When interest rates are low, it is assumed that future interest yields will not become negative. The falling shock therefore has a different impact to the rising shock because it has a reduced impact on repricing positions in the nearer future, where the full rate shock is not experienced. If this constraint is removed the impact of the falling rate shock is similar but opposite to that of the rising shock.

The impact to net interest income reflects the impact of an immediate change in interest rates, typified by the Bank of England Base Rate, and the expected consequential effects that would occur, such as changes in customer behaviour, over the reporting period following the rate shock. When interest rates are low it is assumed that key interest rates will not fall below zero.

As part of these calculations, there are assumptions made about the expected prepayment behaviour of mortgages and the attrition of non-maturing deposits, which do not have a specific re-pricing term in the PV200 analysis. These assumptions are based on observation of historical customer behaviour, are periodically reviewed and are subject to independent oversight by the Society's Prudential Risk and Compliance function.

The reported sensitivity will vary over time due to strategic changes to the balance sheet mix and general market conditions and should not be considered predictive of future sensitivity.

Product option risk

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

There are three groups of product option risk: Pipeline, Prepayment and Savings access.

Pipeline risk

Pipeline risk arises from prospective mortgage customers and is described as the risk that between the point of mortgage application and completion, customers choose not to take the product. If this occurs during a period in which interest rate expectations have changed, this could leave the Society with an imbalance of funding or hedging that is no longer at prevailing interest rates.

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

Prepayment risk

Prepayment risk arises when customers have the option, albeit sometimes after paying a charge or fee, to reduce their mortgage loan (in full or as a partial prepayment). The risk materialises if the reduction in the mortgage loan exposes a previously offsetting risk position during adverse rate changes.

Savings access risk

Early access of fixed rate savings will have an impact on liquidity levels but can also give rise to interest rate risk for the same reason as mortgage prepayment.

Mortgage prepayment and savings access may be managed through a combination of the following:

- Redemption charges on mortgage products and withdrawal charges on savings products to reflect the risk.
- Offering products which encourage more predictable behaviour under anticipated future interest rate outcomes.
- Monitoring past trends and stress testing future forecasts to better understand possible customer behaviour.
- Matching hedging to the expected attrition profile of the product.
- Balance tracking hedges for the Society's legacy equity release mortgage portfolio.

Basis risk

Basis risk is a type of interest rate risk where assets and liabilities have a different underlying basis to their variable rates.

Variable rate instruments may cause interest rate risk where the underlying basis of the rate differs from that of the Society's administered variable rate. The risk is driven by market influences on the different basis, creating uneven changes in the rates over time (e.g. Bank of England Base Rate, LIBOR and SONIA). This risk is characterised as basis risk and is quantified by applying an uneven change to different variable rates i.e. a basis spread shock, to the financial forecast. This assessment includes assumptions about customer behaviour and current business plans but excludes the impact of any consequential response. The Board has defined limits for the level of reduction in net interest income each quarter that could arise from the basis shock applied.

Swap spread risk

In order to diversify its liquidity holdings the Society maintains part of its liquidity portfolio in gilts, which are issued with long-term fixed rates, and have associated derivatives (swaps). In order to hedge the interest rate risk, the present value of the hedging contract (which is determined by the swap curve) will provide some protection against offsetting movements in the present value of the gilts. However, the credit element of gilt value movements arising from perceptions of sovereign quality remains unprotected. It is this which creates 'swap spread risk'. This risk only crystallises if and when the gilts are sold. Generally gilts are held to their full term as part of the Society's liquidity resources. However, under CRD IV the net difference is included within capital as part of the AFS reserve. Swap spread risk is monitored against a Board limit.

Concentration risk

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

Foreign currency risk (Audited)

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

The Society has a very low risk appetite for foreign currency risk and manages this through the use of currency swaps and foreign currency forward contracts. The Society also offsets foreign currency liabilities with foreign currency assets where appropriate. After taking into account the effects of cross currency swaps, the Society has an immaterial exposure to foreign exchange risk fluctuations and changes in foreign currency interest rates.

Redenomination risk

This is where a currency risk arises because an exposure in sterling, or some other hedged currency, becomes redenominated in a different currency because of geopolitical changes.

In the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent).

The Society has no foreign currency denominated assets within its treasury book, and therefore has no redenomination risk, however a form of redenomination risk could exist if, for example, Scotland left the UK and adopted the euro as its currency.

Outlook

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

Liquidity and Funding risk

Strategy

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

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

Wholesale funding is used to provide diversification by source and term, and value to members through lowering the overall cost of funding. The Society continues to retain access to wholesale funding markets. Bank of England programmes such as the FLS facility have been accessed to ensure that borrowing members are not disadvantaged and to manage liquidity and funding risk. The Society intends to access the Term Funding Scheme (TFS), launched in 2016, on the same basis. The Society's policy is to hold sufficient quality and quantity of liquidity to withstand a severe, but plausible combined market-wide and Society-specific stress that would last for a three month period. In addition the Society is obliged to meet regulatory requirements set by the PRA.

Liquidity resources

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

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

The Society's liquidity resources at 31 December 2016 are set out in the following table, split by the four key categories. This table is not a representation of the accounting balance sheet as it includes unencumbered Treasury bills drawn under the FLS which are not recognised on the balance sheet and excludes any encumbered assets such as cash held in the Society's covered bonds and RMBS programmes, and balances posted with counterparties as collateral under swap agreements. All amounts are held in sterling.

	Notes to the accounts[1]	2016 £m	2015 £m
i. Balances with the Bank of England	13	2,935.8	2,343.6
ii. UK Government securities and other qualifying securities			
Securities – on-balance sheet[2]	15	9.9	553.5
Securities – FLS Treasury bills[2]	15	1,142.8	1,142.2
Sub-total categories (i) and (ii)		4,088.5	4,039.3
iii. Other securities – on-balance sheet[2]	15	15.5	74.1
iv. Bank of England approved mortgage portfolios, self-issued covered bonds and RMBS[3]	16	2,720.8	3,588.1
Total		6,824.8	7,701.5

1. Refer to notes to the accounts for reconciliation to on-balance sheet liquid assets.
2. Market value.
3. Nominal value of Notes and mortgage portfolio. Total amount of asset collateral is £2,731.7 million (see page 49).

i. The first category consists of cash held at the Bank of England.
ii. The second category comprises highly rated debt issued by the UK Government and certain other qualifying debt securities. The sum of categories (i) and (ii) represents the most liquid assets held by the Society and equates to the measure of liquidity resources used in the calculation of the Liquidity Coverage Ratio (LCR) (see below). The amount of these liquidity resources has only marginally increased, but there has been a more material increase in the LCR due to a lower liquidity requirement.
iii. The third category consists of other liquid assets where the Society can be reasonably certain that they could be realised in a liquidity stress.
iv. The fourth category consists of approved portfolios of mortgage collateral that could be used to access Bank of England liquidity facilities, and self-issued covered bonds and RMBS that could be used in Bank of England facilities or sold to and repurchased from third parties under repo agreements.

The amount of liquidity resources held is also subject to regulatory requirements set by the PRA. At 31 December 2016, and throughout the year, the Society complied in full with the liquidity requirements that were in force.

CRD IV contains requirements on liquidity and stable funding based on the principles issued by the Basel Committee on Banking Supervision. These include the LCR and the Net Stable Funding Ratio (NSFR):

- LCR – a 30 day short-term liquidity measure that came into effect from 1 October 2015. The PRA set a minimum requirement of 80% from October 2015, rising to 90% in 2017 and to 100% thereafter from 1 January 2018. The Society monitors compliance against this measure on a daily basis and as at 31 December 2016, the Society's LCR was 151% (2015: 141%).
- NSFR – a measure of stable funding. This is currently expected to be implemented from 2018. The Society continues to monitor its position relative to the anticipated requirement of the NSFR. Based on its current interpretation, the Society holds sufficient stable funding to meet the new requirement.

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Wholesale funding

The tables below analyses the Society's wholesale funding by type, currency and maturity, and does not include the €500 million seven year covered bond issued in January 2017.

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

	Notes to the accounts	2016 £m	2016 %	2015 £m	2015 %
Deposits from banks, including repo agreements	24	2,937.5	37.9	1,809.9	28.6
Other deposits and amounts owed to other customers		826.4	10.7	809.5	12.8
Debt securities in issue	25				
Certificates of deposit		156.5	2.0	87.7	1.4
Medium-term notes		1,742.6	22.5	1,617.4	25.5
Covered bonds		1,847.8	23.9	1,787.4	28.2
Residential Mortgage Backed Securities		231.2	3.0	224.1	3.5
Total		**7,742.0**	**100.0**	6,336.0	100.0

The currency analysis of wholesale funding outstanding at the end of 2016 was:

	GBP £m	EUR £m	Total £m
Deposits from banks, including repo agreements	2,887.7	49.8	2,937.5
Other deposits and amounts owed to other customers	826.4	–	826.4
Debt securities in issue			
Certificates of deposit	156.5	–	156.5
Medium-term notes	758.2	984.4	1,742.6
Covered bonds	1,423.0	424.8	1,847.8
Residential Mortgage Backed Securities	231.2	–	231.2
Total as at 31 December 2016	**6,283.0**	**1,459.0**	**7,742.0**
Total as at 31 December 2015	5,111.0	1,225.0	6,336.0

All of the euro denominated wholesale funding has been swapped back into sterling with the exception of euro denominated deposits from banks that have been deposited by a counterparty under a cross currency swap collateralisation agreement.

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

	2016 £m	2016 %	2015 £m	2015 %
Less than one year	4,371.6	56.5	2,268.2	35.9
One to two years	763.5	9.9	1,066.8	16.8
Two to five years	2,208.3	28.5	2,238.0	35.3
More than five years	398.6	5.1	763.0	12.0
Total	**7,742.0**	**100.0**	6,336.0	100.0

Maturity profile of financial assets and liabilities

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

At 31 December 2016 (Audited)	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England[1]	3,260.0	–	–	–	–	3,260.0
Loans and advances to credit institutions	213.5	–	–	–	–	213.5
Debt securities	–	114.1	–	790.3	449.9	1,354.3
Loans and advances to customers	49.2	640.7	1,802.0	8,519.0	21,870.7	32,881.6
Derivative financial instruments	–	–	39.0	246.9	68.3	354.2
Other financial assets	–	1.1	10.3	94.0	45.0	150.4
Total financial assets	3,522.7	755.9	1,851.3	9,650.2	22,433.9	38,214.0
Liabilities						
Shares	24,996.1	–	1,937.1	1,121.1	–	28,054.3
Sale and repurchase agreements[2]	–	1,670.5	899.5	–	–	2,570.0
Deposits from banks – other	115.7	251.8	–	–	–	367.5
Other deposits	–	6.0	1.0	–	–	7.0
Amounts owed to other customers	–	710.3	105.1	4.0	–	819.4
Secured debt securities in issue – RMBS and covered bonds	–	0.3	24.9	2,053.8	–	2,079.0
Senior unsecured debt funding	–	93.4	493.1	914.0	398.6	1,899.1
Derivative financial instruments	–	3.4	15.0	197.1	151.2	366.7
Other financial liabilities	–	–	4.7	99.6	54.4	158.7
Subordinated liabilities	–	0.6	–	10.0	14.9	25.5
Subscribed capital	–	1.6	–	–	40.0	41.6
Total financial liabilities	25,111.8	2,737.9	3,480.4	4,399.6	659.1	36,388.8
Net liquidity gap	(21,589.1)	(1,982.0)	(1,629.1)	5,250.6	21,774.8	1,825.2

1. Includes £52.5 million mandatory reserve with the Bank of England.
2. Included in Deposits from banks on the Statement of Financial Position.

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At 31 December 2015 (Audited)	Repayable on demand £m	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England[1]	2,587.8	–	–	–	–	2,587.8
Loans and advances to credit institutions	235.8	–	–	–	–	235.8
Debt securities	–	173.6	–	544.8	833.3	1,551.7
Loans and advances to customers	56.0	587.5	1,649.1	7,737.9	19,380.5	29,411.0
Derivative financial instruments	–	–	9.0	117.2	46.8	173.0
Other financial assets	–	0.4	9.7	37.2	34.1	81.4
Total financial assets	2,879.6	761.5	1,667.8	8,437.1	20,294.7	34,040.7
Liabilities						
Shares	22,306.2	–	1,501.9	1,547.7	–	25,355.8
Sale and repurchase agreements[2]	–	1,050.8	–	699.5	–	1,750.3
Deposits from banks – other	–	59.6	–	–	–	59.6
Other deposits	–	3.0	–	–	–	3.0
Amounts owed to other customers	–	622.3	180.2	4.0	–	806.5
Secured debt securities in issue – RMBS and covered bonds	–	0.7	24.7	1,397.7	588.4	2,011.5
Senior unsecured debt funding	–	67.8	35.4	1,203.5	398.4	1,705.1
Derivative financial instruments	–	1.3	11.9	157.0	183.3	353.5
Other financial liabilities	–	–	6.4	73.7	40.9	121.0
Subordinated liabilities	–	0.8	17.6	15.0	24.8	58.2
Subscribed capital	–	1.6	120.0	–	40.0	161.6
Total financial liabilities	22,306.2	1,807.9	1,898.1	5,098.1	1,275.8	32,386.1
Net liquidity gap	(19,426.6)	(1,046.4)	(230.3)	3,339.0	19,018.9	1,654.6

1. Includes £45.3 million mandatory reserve with the Bank of England.
2. Included in Deposits from bank on the Statement of Financial Position.

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

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

At 31 December 2015 (Audited)	Up to 3 months £m	3-12 months £m	1-5 years £m	More than 5 years £m	Total £m
Liabilities					
Shares	22,263.8	1,550.6	1,595.9	–	25,410.3
Deposits, amounts owed to other customers and debt securities in issue	1,819.8	513.2	3,761.0	1,334.7	7,428.7
Other liabilities and adjustments	79.3	52.4	65.3	376.8	573.8
Subordinated liabilities	0.9	20.3	23.0	33.6	77.8
Subscribed capital	2.4	126.1	19.4	40.0	187.9
Total liabilities	24,166.2	2,262.6	5,464.6	1,785.1	33,678.5
Undrawn loan facilities	74.7	–	–	–	74.7
Leasing commitments	0.9	2.3	10.0	7.4	20.6

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

Asset encumbrance

Society assets can be used to support collateral requirements for secured funding, central bank operations or third party repo transactions. Encumbrance benefits the Society as it provides cheaper and more stable funding. However, saving members and other senior unsecured creditors are unable to benefit from the liquidation of encumbered assets in the event of insolvency, and risk bearing losses from a forced sale. Encumbrance is therefore reported and the associated risks are managed. An analysis of how the Society has used its balance sheet in this regard at 31 December 2016 is set out in the table below:

	Encumbered		Unencumbered		
	Pledged as collateral[1] £m	Other[2] £m	Available as collateral[3] £m	Other[4] £m	Total 2016 £m
Cash and balances with the Bank of England	–	297.2	2,962.8	–	3,260.0
Loans and advances to credit institutions	213.5	–	–	–	213.5
Debt securities	1,328.9	–	25.4	–	1,354.3
Loans and advances to customers	7,217.8	–	2,731.7	22,932.1	32,881.6
Derivative financial instruments	–	–	–	354.2	354.2
Hedge accounting adjustments	–	–	–	144.5	144.5
Other assets	–	–	–	87.8	87.8
Total	8,760.2	297.2	5,719.9	23,518.6	38,295.9
FLS Treasury bills	1,255.8	–	1,142.8	–	2,398.6
Total as at 31 December 2016	**10,016.0**	**297.2**	**6,862.7**	**23,518.6**	**40,694.5**
Total as at 31 December 2015	8,165.1	301.7	7,751.9	19,941.2	36,159.9

1. Assets that have been utilised to support interest rate swap collateralisation agreements, third party secured funding operations, central bank operations or third party repo transactions and cannot be used for any other purpose.
2. Other encumbered assets are assets that cannot be utilised for secured funding due to legal or other reasons. This includes cash and assets supporting secured funding vehicles.
3. These assets are readily available as collateral to secure funding. Loans and advances to customers in this category comprise Bank of England approved portfolios, and those that although technically encumbered are held in respect of retained self-issued notes in the Society's covered bond and securitisation programmes. The total of unencumbered available collateral is therefore referable to the total of on-balance sheet liquid resources in the table on page 45, the difference being £10.9 million of additional collateral.
4. Unencumbered other assets are therefore conservatively defined as not readily available for use as collateral. The loans and advances in this category include £15.6 billion which would be eligible for use to support future external or self-issuance under the Society's covered bond and securitisation programmes. A proportion of the remaining balance would also be suitable for such purpose subject to amending the programme structures.

External credit ratings

The perceived strength of the Society is a key mitigant to funding risk. The Society's long-term and short-term credit ratings were upgraded by Moody's in June 2015 (from A3 to A2, and from P2 to P1 respectively). However in June 2016, following the referendum vote to leave the EU, Moody's placed the Society and a number of other major banks and building societies on negative outlook. During the year Fitch affirmed the Society's 'A' rating for the 22nd consecutive year.

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Short and long-term credit ratings as at 23 February 2017 are set out below:

	Long-term	Short-term	Subordinated	Outlook	Date of last credit opinion
Moody's	A2	P-1	Baa1	Negative	January 2017
Fitch	A	F1	n/a	Stable	June 2016

Management of liquidity and funding risk

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

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

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

The Society's appetite for liquidity risk is set out in the Liquidity Risk Tolerance Statement, which is approved annually by the Board. The tolerance statement is kept under regular review and revised in line with changes to the risk environment and regulatory context. The tolerance statement was last reviewed by the Board in December 2016 (as part of the Internal Liquidity Adequacy Assessment Process (ILAAP)) and is set with reference to the ability to meet all cash requirements throughout a prolonged combination stress as detailed later in this section. The tolerance statement is also set against the regulatory requirements of the LCR and soon to be introduced NSFR.

The amount and type of liquidity held by the Society did not change substantially as a result of the 2016 regulatory developments and continues to reflect a focus on UK Government securities and cash invested with the Bank of England, in a reserve account. Whilst these assets realise a relatively low yield, this reflects the very low credit risk represented by a highly rated sovereign entity, such as the UK Government, and ensures that assets can be readily converted into cash to meet liabilities as they fall due.

Day-to-day management of the Society's liquidity position is the responsibility of the treasury department and overseen by the Society's Prudential Risk and Compliance function. Adequacy is assessed against a variety of limits and measures to ensure compliance with Board approved policy. The frequency of the assessment varies from daily to monthly dependent on the measure. Liquidity positions (including stress testing) are monitored monthly by ALCO, and ultimately overseen by the Board via the Committee hierarchy set out on page 26. All measures were in surplus as at the year end and throughout the year.

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

Liquidity adequacy

The Board determines the level of liquid resources required to support the Society's business objectives through the annual undertaking of the ILAAP as part of the development of the Strategic Plan. In this process the Society reviews its liquidity risk management framework, together with the financial projections developed for the Strategic Plan, in order to assess the significant risks to which it is exposed and the adequacy of its liquid resources. The ILAAP is driven by the Society's risk tolerance and compliance with the ILAA Rules, including the need to meet the Overall Liquidity Adequacy Rule (OLAR).

The ILAAP considers a range of time horizons, in particular intra-day, two day, two weeks, three months and five years. The OLAR combination stress assessed in the ILAAP estimates the impact from a two week Society-specific stress combined with a three month market-wide stress.

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

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

With regard to the OLAR combination stress, the following key assumptions are made:

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

The ILAAP is reviewed by the PRA through its Liquidity Supervisory Review and Evaluation Process (L-SREP), an in-depth periodic review and assessment of a firm's quantitative and qualitative liquidity risk management processes and operations. Following the L-SREP, the PRA provides Individual Liquidity Guidance (ILG), referenced against the LCR, which sets out the amount and composition of eligible liquidity that the PRA requires the Society to hold. As well as applying a transitional LCR from October 2015, the ILAAP is structured in accordance with the PRA Supervisory Statement, SS 24/15. In summary, as part of its L-SREP the PRA determines:

- A quantitative ILG comprising LCR Pillar 1 and Pillar 2 add-ons reflecting liquidity risks that are not captured by the LCR.
- A qualitative ILG, which will include actions required to mitigate risks, if any, outside of the PRA's risk appetite.
- The firm's overall liquidity risk profile.

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

Outlook

The availability of funding through central bank schemes (such as the FLS, and now TFS) has led to a sustained benign funding environment for UK banks and building societies. The ability to draw under the FLS came to an end in 2016. However, the inception of the TFS means that there remains a significant source of low cost liquidity in the market, which to date has countered any increased competition in wholesale and retail markets that would otherwise have emerged.

The Society has a strong track record of being able to attract retail funds and with a competitive offering is well placed to withstand any deterioration in savings markets. The 'A' credit ratings held by the Society support access to wholesale markets giving further availability to funding sources. The Society continues to monitor regulatory changes in relation to bail-in requirements and minimum requirement for own funds and eligible liabilities (MREL) which could have an impact on pricing within the wholesale markets. The Society's credit ratings of A/F1 from Fitch and A2/P-1 from Moody's remain strong relative to other banks and building societies, supported by the quality of the loan portfolio, diversified funding, low cost base and resilient earnings.

Risk Management Report cont.

Conduct risk

Overview

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

The Board defines conduct risk as the risk that the Society's behaviour and decision making, at all levels, fails to deliver good customer outcomes.

The Society's mutual ethos and culture, further reinforced through Putting Members First, means it is well placed to meet its conduct risk responsibilities and ensure the fair treatment of members. Putting Members First provides a clear understanding and expression of the Society's purpose which informs strategy, day-to-day decision making, the products offered and operations across the Society. It is embedded in the Society's people and communication strategies, and the Society's extremely high level of engagement is evidence that employees understand, share and aim to deliver in accordance with its stated ambition.

The Society's focus on simple and transparent savings and mortgage products and not providing investment advice also mitigates against conduct risk and reduces the risk from third party provision of services to members.

Management of conduct risk

Recognising the importance of conduct risk, oversight is provided by the Conduct Risk and Compliance Committee (CRCC). The activities of CRCC are ultimately overseen by the Board via the Committee hierarchy set out on page 26.

During 2016, the Society refreshed its Conduct Risk Framework through which it identifies the potential conduct risks arising from its products, services and the documentation it provides to its members, and the control measures to manage, mitigate and monitor such risks. Representing a key element of the risk management framework, the Conduct Risk Framework provides a robust governance structure to reinforce the Society's inherent low risk appetite in this area.

During 2016, across the financial services industry the proportion of customer complaints upheld by the Financial Ombudsman Service has been 48%[1]. By contrast, the Society has a very low uphold rate of 4%[1]. Since 2009, when the Financial Ombudsman Service started to publish industry tables, it has asked for the outcome of referred Coventry Building Society customer complaints to be changed on just 72 occasions.

In contrast to the experience of many high street banks, Payment Protection Insurance (PPI) is not a material issue for the Society. Out of total PPI provisions of over £40 billion for the industry as a whole, the Society has set aside £5.1 million in total, including a provision of £1.2 million raised during the year. This is a consequence of the design of the PPI product sold and the member-focused approach in distributing the product provided by the Society.

The Society has been impacted by the FCA's recent publication in relation to mortgage regulations. This addresses instances where arrears balances have been automatically included within customers' monthly mortgage payments where they have been recalculated from time to time, for example when an interest rate changes or they have switched products. The FCA considers this practice to be automatic capitalisation and in October 2016 issued a guidance consultation on a proposed voluntary remediation framework. As a result, the Society has set aside £0.6 million to compensate customers who may have been adversely impacted by these issues.

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

The Compliance functions undertake extensive monitoring programmes to provide assurance of adherence to regulatory standards and conduct risk expectations, and also support business change projects that have a regulatory aspect.

Outlook

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

1. Financial Ombudsman Service – latest published information: 1 January 2016 to 30 June 2016.

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

Operational risk

Overview

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

Reflecting both industry practice and recent regulatory expectations and developments, the Society is focused on maintaining an effective operational risk management framework that delivers operational resiliency (i.e. an ability to reduce the risk of failure and continue to effectively deliver critical functions and services after a shock event).

Operational risk consists of the following subcategories: legal and regulatory, IT systems, information security, business continuity, financial crime, people, change, property and physical security, third party, business processes and financial reporting. The most significant of the operational risk sub-categories are considered further below.

Management of operational risk

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

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

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

Legal and regulatory

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

The general objectives of regulatory bodies are to improve consumer protection and choice, and to promote more stable and transparent financial markets.

The Society's simple business model and mission to Put Members First mitigate some of these risks and the Society's Compliance functions support first line management by ensuring appropriate policies are in place and by providing challenge where necessary. The functions are organised to recognise the different objectives of the Society's regulators. The Conduct Risk Oversight and Compliance function focuses on retail conduct, consumer and product regulation. The Prudential Risk and Compliance function focuses on prudential and wholesale conduct regulation. Both functions review government and regulatory proposals for reform, and engage with the regulators and the Society's trade associations on initiatives that impact the building society sector as a whole.

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

IT systems

The Society recognises the risks of not keeping pace with technology. During 2016, the Society has continued to enhance its governance over the development of IT systems and the operation of rigorous controls over changes to its systems and its reporting of systems availability.

Furthermore, and representing a key part of its internally driven change programme, the Society is investing significant resources in ensuring and monitoring the speed, efficiency and resilience of its IT systems and controls. The undertaking of any change programme is not without risk, as new systems and processes are introduced and integrated with existing ones. There is therefore a strong focus on change governance and programme management to minimise these risks.

Risk Management Report cont.

Information security

The ambition and capability of criminals to access an organisation's systems and data is a growing risk. The Society takes information security very seriously and recognises the need to protect the organisation and its members from the threats arising from cyber-attacks, and inadequate resilience and information management. To achieve this, steps have been taken to detect and prevent the unauthorised use of information and any unauthorised attempt to access the Society's systems. Where information needs to be shared with third parties, reviews are carried out to ensure that these organisations provide a similar level of security as the Society.

The Society ensures its defence strategy is supported with appropriate threat intelligence, controls and responses, whilst the overall approach is reviewed against industry standards to ensure the Society operates an appropriate protection programme aligned with the Board's risk appetite.

Business continuity

Reflecting the strong focus on operational resiliency, the Society has no appetite for being unprepared in its response to a planned or unplanned interruption to the delivery of critical products and services. As such, the Society continues to enhance its approach to business continuity management in order to improve the consistency of management of this risk across the Society and to align the Society's framework with industry standards. This has included investment in skills and resources, and in physical continuity capacity and enhancements to governance arrangements. Operational resilience will continue to be a key focus in 2017 where further enhancements will be implemented.

Financial crime

Financial Crime operates as a separate department within the Society with dedicated expertise to respond to the evolving and substantial threats to the security and the safe operation of financial institutions and their customers.

The department's core purpose is to protect the Society and its members from fraud whilst minimising the impact of fraud prevention and detection measures on members.

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

People

The Society manages its people risk from the outset by having rigorous recruitment and selection processes and providing an induction programme for all new starters which includes a risk module. For existing employees, the Society's culture and values ensure that expectations are clear and a robust performance management process supports this. Training and development is provided to ensure competence in all relevant operational systems and processes as well as supporting ongoing employee development. All employees undertake online training modules which encompass important regulatory and conduct matters and satisfactory completion of these is monitored. The Society benchmarks its reward strategy against others in the financial services sector, and offers a range of support services under the Society's Wellbeing Programme and Policy. More generally, procedures and policies are designed to explain what the Society expects from employees and what employees can expect from the Society, with the objective of attracting and retaining high performing individuals. Regular surveys of employee opinion and engagement with the Society's values are undertaken and actions are taken to address any issues identified.

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

Change

The pace and scope of change facing the financial services sector and individual firms continues unabated. The Society maintains a Change Management Framework (comprising governance committees, people, processes and technology), in line with industry practice. This supports management of the challenging change agenda, which is driven by both external regulatory and internally driven initiatives. Including the investment in IT systems detailed on page 53. This significant piece of work represents the largest change risk faced by the Society and consequently is subject to extensive second and third line oversight, and regular reporting to the Board.

Outlook

The pace of regulatory change is expected to continue for the foreseeable future with far reaching impacts. Examples include the new EU General Data Protection Regulation, the next phases of the Mortgage Credit Directive, Payment Accounts Regulations and the Payment Services Directive 2. Revisions driven by the FCA include embedding the Senior Managers' and Certification Regimes, the effectiveness of customer communications and the FCA's review of arrears calculations.

Combined with the IT systems investment planned for the next few years, this change activity represents a heightened level of operational risk. The Board is conscious of the need to actively oversee this risk via enhanced assurance reporting.

In light of continued risk events both within and beyond the financial services sector, the PRA has in 2016 focused on operational resilience and cyber security. This focus is expected to be maintained in the future.

The Society recognises that cyber threat remains a key industry concern and will continue to adopt additional controls where appropriate.

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

Business risk

Business risk is the class of risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to external factors. For example the Society's distribution of mortgage products is primarily undertaken via third party intermediaries. Whilst there is no evidence that this channel will not continue to be a key feature of the UK mortgage market, the Society's business model would need to evolve should this prove to be the case.

The Society considers strategic risk, the risk to delivering the Strategic Plan, to be a principal risk. Strategic risk includes reputational risk.

Strategic risk

Strategic risk focuses on large risks that could become a material threat to the viability and sustainability of the Society's business model either over the medium or longer term. The management of strategic risk is supported by the provision of consolidated business performance and risk reporting data to the Board and senior risk committees whose remit encompasses all risk categories.

A number of the top and emerging risks have the potential to affect more than one risk category and crystallise strategic risk. In addition, regulatory changes have the potential to threaten the viability of the Society's low risk model through increased capital requirements arising from the review of Internal Ratings Based (IRB) modelling outcomes, MREL and proposed revisions to the Standardised approach and capital floors. The continued volume and complexity of regulatory changes also represent a strategic risk with associated costs, implementation risk and continuing compliance effort. Consequently the risk of regulatory changes having a disproportionate impact on the Society's business model and performance is a key strategic risk, particularly the move away from risk sensitive capital measures for low risk lending.

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

Margin compression

Where assets and liabilities are matched in terms of standard market risk measures (e.g. matched basis position) some residual risk may remain. This is because products are priced at a spread to a variable rate and that spread is driven by many things but predominantly competition. If competition increases, the Society may see a smaller difference between mortgage and savings rates; ultimately leading to less margin and therefore lower capital creation. The Society manages this risk through maintaining a significant proportion of assets and liabilities at rates that can be administered by the Society. This approach is supported by a very low cost base which also enables the Society to provide attractive rates. Margin compression is seen as a component of strategic risk.

Outlook

The Board considers that with a low cost model, low risk mortgage lending and minimal reliance on ancillary income products, it is well placed to thrive in a low interest rate environment and will continue to see little impact from past conduct claims.

Risk Management Report cont.

The Board also believes that the intermediary market is well established and will remain responsible for the majority of mortgage distribution within the UK and that the Society is well placed to continue to offer products via this channel.

However the low interest rate environment improves mortgage affordability and potentially encourages greater risk taking by both borrowers and savers looking for a better return. This has the potential to create macroeconomic stresses that could impact the recovery of the economy. Furthermore, the uncertainty created by the Brexit negotiations could lead to falling levels of investment and an increase in unemployment. This could have a knock-on effect on the housing and mortgage markets.

Changes to stamp duty on second homes and concerns about future restrictions of income tax relief for higher rate taxpayers have disrupted this part of the mortgage market in 2016. Further regulatory underwriting changes to be implemented in 2017 could temper the level of buy to let mortgage activity, albeit the recent Government White Paper on the Housing market could see support provided to the rental sector. The Society is particularly active in this area of the market.

Regulatory changes will continue to be monitored and the Society will plan to meet any requirements in a timely fashion. The Board believes non-risk based measures such as the leverage ratio and risk weight floors are appropriate for more complex assets. However in the case of low loan to value secured lending these measures have the potential for lenders to seek higher returns i.e. higher risk to compensate for the increased capital requirements. Maintaining focus on low risk lending is core to the Society's plans and consequently the new regulatory requirements have the potential to moderate the rate of growth targeted, or to lower the returns currently paid to saving members.

The Society is undertaking significant investment in technology to further enhance resilience, to comply with regulatory changes and to meet future customer demands. It is anticipated the Society will retain its low cost position compared with its peers and will continue to focus on efficiency and cost control. Overall the Society will continue only to take on risks that it understands and can manage. It will continue to maintain its core mutual values, offering good quality products through a simple business model.

Capital

Capital management

Capital is held to protect depositors, by ensuring that there will be sufficient assets to repay liabilities even in the face of unexpected losses. When assessing the adequacy of available capital, the Board considers the material inherent risks to which the Society is exposed and also the need for capital to be available to support the growth of the business. Post CRD IV, the regulatory capital framework comprises:

- A risk weighted capital requirement.
- A stress testing process to assess capital required to provide resilience against future adverse scenarios.
- A leverage ratio set in proportion to exposures regardless of their relative risk, which guards against underestimation of risks in risk weighted models.
- A minimum requirement for eligible liabilities and own funds (MREL) to be phased in by 2022.

The risk weighted, leverage ratio and MREL regimes are discussed further on page 59. The Society's stress testing process is outlined in the stress testing and planning section on page 27 of this Risk Management Report. Further information on capital management is also included in the Society's Pillar 3 Disclosures (thecoventry.co.uk/2016pillar3).

Risk weighted capital requirements

The Society has for some time been granted permission by the regulator to use an IRB approach to retail credit risk and capital management. This approach allows the Society to calculate capital requirements for prime owner-occupier and buy to let mortgage exposures using internally developed models that reflect the credit quality of the Society's mortgage book. This permission reflects the Society's detailed understanding of its customer base and credit risk profile. For other exposures and risk areas the Society follows the Standardised approach, which uses capital risk weighting percentages set by CRD IV.

CRD IV sets minimum capital requirements: a Common Equity Tier 1 (CET 1) ratio of 4.5%, a Tier 1 capital ratio of 6% and a total minimum capital ratio of 8%. These ratios must be calculated as percentages of risk exposure amounts, principally in relation to credit and operational risk, and are known as the Pillar 1 requirement.

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

To promote the conservation of capital and the build-up of adequate buffers that can be drawn down in periods of stress, CRD IV requires the holding of supplementary common equity capital buffers from 1 January 2016. These comprise a Capital Conservation Buffer (CCoB); a Systemic Risk Buffer (SRB); and a macro-prudential Countercyclical Buffer (CCyB).

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

The Society is provided with Individual Capital Guidance (ICG) by the PRA. Following a Supervisory Review process in the first half of 2016, the Society has been issued with an ICG of 12.8% which is the sum of its Pillar 1 and Pillar 2A requirements. With a CET 1 ratio of 32.2% the Society comfortably meets this requirement using CET 1 capital alone.

CRD IV risk adjusted capital requirements

PRA Buffer (Firm specific)	Applicable from Jan 2016. Firm specific buffer assigned by the PRA if CCoB and CCyB buffers are considered to be insufficient.
Capital Conservation Buffer (CCoB)	Phased in from 2016-2019. Used to absorb losses in periods of economic and financial stress. 0.625% from 1 January 2016, increasing to 2.5% by 1 January 2019.
Systemic Risk Buffer (SRB)	Full application from 1 January 2019 up to 3%. Set at 0% for institutions with total assets less than £175 billion.
Macro-prudential Countercyclical Buffer (CCyB)	Applies now but currently set at 0%. FPC uses core indicators, with other relevant economic and financial data to set the CCyB (from 0% to 2.5%).
Pillar 2A	Firm specific calculation for risks not fully captured under Pillar 1.
Pillar 1	Firm specific calculation based upon individual risks (IRB or standardised) – minimum of 8%.

100% Common Equity Tier 1

Minimum 56% Common Equity Tier 1, up to 44% Additional Tier 1 (incl. maximum 25% Tier 2)

Risk Management Report cont.

The new PRA Buffer (replacing the former Pillar 2B capital planning buffer from 1 January 2016) will only be applied to the extent that the PRA considers the CRD IV buffers to be insufficient. The PRA has stated that it believes that for most firms, most of the time, the CRD IV buffers are likely to be sufficient once fully phased in.

Leverage ratio

CRD IV introduces a non-risk based leverage ratio that is supplementary to the risk based capital requirements and was originally proposed as a 'backstop' measure. The calculation determines a ratio based on the relationship between Tier 1 capital and total exposures, including off-balance sheet items. The leverage ratio does not distinguish between unsecured and secured loans, nor recognise the ratio of loan to value of secured lending. A binding requirement is expected to be introduced at the EU level in 2018.

In the meantime, 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 and on this basis the Society is not currently captured by this requirement. It is anticipated the Society will be subject to the leverage ratio regime from 2018 and given the Society's focus on low risk assets this is expected to be the most binding capital requirement.

The UK leverage ratio framework is more complex than the regime envisaged by the Basel Committee and is intended to 'mirror' aspects of the risk weighted capital requirement. The components of the UK leverage ratio framework are a minimum ratio of 3%, of which a maximum of 25% may be met using high quality AT 1 capital, and two additional buffers that are to be met using CET 1 capital only: a Supplementary Leverage Ratio Buffer (SLRB), which will apply to the largest UK banks and building societies from 2019 (2016 for globally significant firms); and a macro-prudential Countercyclical Leverage Buffer (CCLB). The levels of these buffers will be set to 35% of the corresponding risk weighted SRB and CCyB (see page 57). The CCyB is set by the FPC and is currently 0% (maximum 0.9% leverage impact). The SLRB is currently set at 0% as noted in the previous section.

Following the launch of the TFS the FPC recommended that the leverage ratio exposures to on and off-balance sheet items was modified to exclude central bank reserves. However, the FPC also noted that this may lead to a recalibration of the minimum requirement and remains committed to reviewing the UK leverage ratio framework in 2017, after which a binding ratio is expected to apply to the Society from 1 January 2018. The interaction between the EU and UK leverage ratio frameworks should then also become clearer.

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

The maximum theoretical leverage ratio requirement would be 3.9%. The Board is confident that the Society will meet this requirement with an appropriate level of headroom and expects to maintain a ratio of at least 4%.

UK Leverage Ratio Framework

Supplementary leverage Ratio Buffer (SLRB)	Full application from 1 January 2019 up to 1.05%. Set at 0% for institutions with total assets less than £175 billion.
Macro-prudential Countercyclical Leverage Buffer (CCLB)	Currently set at 0%. Set at 35% of the risk weighted CCyB (ranges from 0% to 0.9%).
Minimum Leverage	Applies from Jan 2018. Minimum leverage ratio set at 3% which the FPC judges to be consistent with domestic and international loss experience during historical banking crises.

100% Common Equity Tier 1 — Minimum 75% Common Equity Tier 1 and maximum 25% Additional Tier 1

Minimum requirement for own funds and eligible liabilities (MREL)

The Bank of England announced new rules in November 2016 that are designed to make it easier to manage the failure of banks and building societies in an orderly way, as part of reforms to prevent future taxpayer bail-outs in the UK. The rules require the Society to meet an interim MREL requirement of 18% of risk weighted assets by 1 January 2020 with the full requirements to be met by 1 January 2022.

MREL capital requirements are split into two elements. Firstly a loss absorption amount, to cover losses up to and in resolution, based on a firm's minimum going concern capital requirement, and secondly a recapitalisation amount, to enable the firm to continue post resolution, likely to be at least equal to minimum going concern capital requirement.

The Bank of England will set MREL requirements on a firm-specific basis, informed by the resolution strategy for that firm. The Bank will review the timing and calibration of the end-state requirement before the end of 2020.

The three resolution strategies are:

- Modified insolvency process – MREL will be set at a level of existing capital requirements i.e. recapitalisation is set at zero.
- Partial transfer – MREL will be set at a level which permits a transfer of critical parts of the business to take place i.e. recapitalisation will be set at a level to reflect the proportion of the balance sheet that would be transferred under resolution.
- Bail-in – MREL will be set at a level to absorb losses and, in the event of their failure, to be recapitalised i.e. two times the binding capital requirement.

The preferred resolution strategy for the Society has been set by the Bank of England as Bail-in, reflecting the size of the Society and consequential risks of an insolvency process, and of being able to affect a partial transfer at short notice. Notwithstanding this, the actual approach taken, should the Society require resolution, will depend on the circumstances at the time of a failure, and all available options would be considered.

Regulatory capital analysis

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

The following table shows CRD IV information on an end-point basis. This is based on all CRD IV requirements that were in force during the period excluding transitional provisions. Further information on CRD IV disclosures on a transitional basis is included in the Society's 2016 Pillar 3 Disclosures (thecoventry.co.uk/2016pillar3).

Capital position	End-point 31 Dec 2016 £m	End-point 31 Dec 2015 £m
Common Equity Tier 1 (CET 1)		
General reserve	1,376.1	1,222.3
Available-for-sale reserve	6.7	2.5
Cash flow hedge reserve	41.6	29.8
Common Equity Tier 1 prior to regulatory adjustments	1,424.4	1,254.6
Common Equity Tier 1 regulatory adjustments		
Prudent additional valuation adjustment[1]	(1.3)	(1.6)
Intangible assets[2]	(32.5)	(16.3)
Cash flow hedge reserve[2]	(41.6)	(29.8)
Pension fund surplus adjustment[2]	(1.9)	(10.5)
Excess of expected loss over impairment[3]	(17.1)	(19.8)
Foreseeable distributions[4]	(9.2)	(9.4)
Common Equity Tier 1 capital	1,320.8	1,167.2
Additional Tier 1 (AT 1) capital		
Additional Tier 1 – Perpetual Capital Securities	396.9	396.9
Total Additional Tier 1 capital	396.9	396.9
Total Tier 1 capital	1,717.7	1,564.1
Tier 2		
Collective provisions for impairment	4.3	4.3
Total Tier 2 capital	4.3	4.3
Total capital	1,722.0	1,568.4
Risk weighted assets		
IRB approach		
Credit risk – retail exposures	3,175.0	3,093.9
Standardised approach		
Credit risk – retail exposures	180.4	199.4
Credit risk – liquidity book	110.8	102.5
Credit risk – other	52.4	54.9
Credit valuation adjustment risk	26.3	37.8
Operational risk	554.4	486.1
Total risk weighted assets	4,099.3	3,974.6
Common Equity Tier 1 ratio	32.2%	29.4%

1. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
2. Items do not form part of regulatory capital, net of associated deferred tax.
3. The expected loss over accounting provisions is deducted, gross of tax.
4. Foreseeable distributions in respect of AT 1 securities are deducted, net of tax.

The increase in CET 1 capital, Tier 1 capital and total capital is primarily caused by retained profit of £182.4 million.

Despite the growth in the mortgage book, total risk weighted assets have only marginally increased as a result of house price inflation reducing effective risk weights.

The Individual Consolidated CET 1 ratio on an end-point basis at 31 December 2016 was 0.5% higher than the Group ratio due to assets held by entities that sit outside of the Individual Consolidation.

At 31 December 2016, and throughout the year, the Society complied in full with the capital requirements that were in force.

The following table details the leverage ratio on an end-point basis. The calculation has been performed in accordance with CRD IV. The calculation reflects constraints on the inclusion of AT 1 capital under the FPC's UK leverage ratio framework. Whilst all of the Society's AT 1 capital meets the Basel III requirements and therefore serves to protect members' interests, only £296.8 million (2015: £266.5 million) is eligible for this measure.

On 4 August 2016, the PRA announced a modification of the calculation of leverage exposure for the purpose of the UK leverage ratio framework by excluding central bank reserves. Under the modified basis of measurement the Society's leverage ratio at 31 December 2016 would be 4.4%.

Leverage ratio	End-point 31 Dec 2016 £m	End-point 31 Dec 2015 £m
Total Tier 1 capital	**1,717.7**	1,564.1
Adjustment for AT 1 restriction	**(100.1)**	(130.4)
Total Tier 1 capital for leverage ratio	**1,617.6**	1,433.7
Leverage ratio exposures		
Total balance sheet assets	**38,295.9**	34,114.4
Mortgage pipeline[1]	**816.1**	810.7
Other committed facilities (undrawn lending)[1]	**27.0**	29.5
Repurchase agreements[2]	**793.9**	638.5
Netted derivative adjustments[3]	**(146.5)**	(17.9)
Other adjustments[4]	**(216.6)**	(44.4)
Total leverage ratio exposures	**39,569.8**	35,530.8
Leverage ratio	**4.1%**	4.0%
Leverage ratio (modified)[5]	**4.4%**	n/a

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

Risk Management Report cont.

Although risk weighted assets have only marginally increased, total leverage ratio exposures have increased much more markedly predominantly due to a £3.5 billion increase in the size of the mortgage book and a £0.5 billion increase in balance sheet liquidity.

However, the increase in total Tier 1 capital wholly attributable to the increase in CET 1 capital, primarily driven by retained profits in the year, has resulted in an increase in the leverage ratio to 4.1 % (2015: 4.0%).

The required leverage ratio disclosures using the European Banking Authority Templates published and subsequently adopted by the EU are available in the Society's 2016 Pillar 3 Disclosures (thecoventry.co.uk/2016pillar3).

Outlook

Although regulation has been clarified on a number of areas during 2016, significant elements of the final capital requirements (in addition to the leverage ratio framework discussed above) need resolving.

The Society continues to monitor regulatory developments that could lead to increased capital requirements. These include the Basel Committee on Banking Supervision review of the Standardised approach to calculating credit risk capital requirements, the replacement for the Basel 1 floor and MREL.

These reforms could have a significant impact and challenge the ability of the Society to grow at the levels seen in recent years. Given the low risk nature of the balance sheet and the Society's strong performance in stressed conditions, the Board has participated in the consultation processes to ensure the final outcome is applied proportionately. All the confirmed regulatory changes are reflected in the Society's capital management plans based on its understanding of the latest position and the Board is confident the Society will continue to be well capitalised.

Long-term viability statement

In accordance with provision C.2.2 of the 2014 revision of the UK Corporate Governance Code, the directors have assessed the prospects of the Society over a longer period than the 12 months required by the 'going concern' basis (see page 94 of the Directors' Report).

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

The review considered all aspects of emerging regulation where there is sufficient clarity over future standards to inform the analysis. For example, the assessment of the Society's capital position reflects current understanding of capital buffer and leverage requirements likely to be imposed on the Society, together with the consequences of MREL.

The directors consider this to be a suitable process to enable them to form a reasonable expectation of the Society's prospects over a five year period. This period was chosen as the Society's Strategic Plan, ICAAP and ILAAP all cover a five year period.

The Strategic Plan projects the Society's ongoing profitability, capital and funding positions as satisfactory to the end of the five year plan period even in a range of adverse scenarios. Inherent uncertainty with regard to a number of factors, including geopolitical, economic and regulatory, inevitably increases over the planning period and the directors consider that, in the outer years, these factors become increasingly difficult to predict. However, the results of reverse stress testing also conclude that those scenarios that have the potential to break the Society were generally highly implausible.

In assessing long-term viability the directors have made the key assumption that the intermediary channel, upon which the Society has a strong reliance, continues to be a key feature of the UK mortgage market.

Subject to the uncertainty in the outer years noted above and based upon the assessment set out above, the directors have a reasonable expectation that the Society will be able to continue in operation and meet its liabilities as they fall due over the period to December 2021.

Governance

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

For our full glossary please go to page **146**

Governance

Board of Directors

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

Ian Pickering Chairman

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

A graduate of Cambridge University, Ian is a qualified Chartered Accountant and has held a number of executive and non-executive directorships. He started his career as an auditor, working principally in financial services. He then spent 20 years in senior positions in the engineering industry, including at the Dennis Group and Manganese Bronze Holdings.

Peter Ayliffe Deputy Chairman

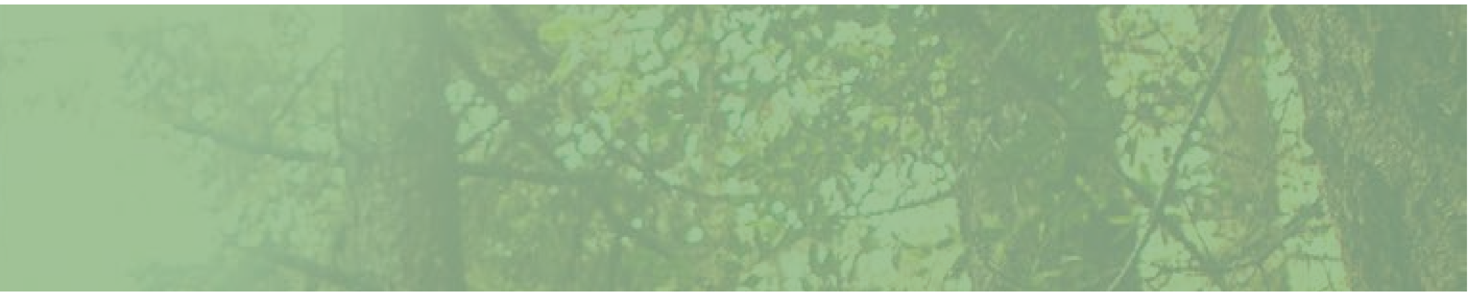
Peter Ayliffe joined the Board as a non-executive director in May 2013. He is a member of the Board Risk Committee and the Nominations and Governance Committee.

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

Roger Burnell Senior Independent Director

Roger Burnell joined the Board as a non-executive director in 2008. Roger is the Society's Senior Independent Director, is Chairman of the Board Risk Committee and Chairman of the Board Audit Committee, and a member of the Nominations and Governance Committee.

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



Janet Ashdown Non-executive Director

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

Janet worked for BP for 30 years until 2010, with experience in the UK and overseas. Her last role in BP was as head of BP's UK retail and commercial fuel marketing and supply business. She also spent over 10 years in BP's oil global trading business as a trader and trading manager. On leaving BP Janet became chief executive of Harvest Energy, a UK-based oil distribution and marketing business. She is currently a non-executive director of SIG, senior independent director and chair of the remuneration committee of Marshalls (both members of the FTSE 250) and on the board of the Nuclear Decommissioning Authority.

Catherine Doran Non-executive Director

Catherine Doran joined the Board as a non-executive director in August 2016. She is a member of the Board Audit Committee and the Remuneration Committee.

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

Ian Geden Non-executive Director

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

Ian has over 40 years' experience in the financial services sector, primarily in the mutual sector, including NFU Mutual where he was chief executive before retiring at the end of 2008. Ian was also vice chairman of the Association of British Insurers (ABI) and chairman of the Association of Mutual Insurers. Ian is chairman of Faraday Underwriting Limited.

Board of Directors cont.

Alasdair Lenman
Non-executive Director

Alasdair Lenman joined the Board as a non-executive director in November 2016. He is a member of the Board Audit Committee.

Alasdair is a Chartered Management Accountant with over 10 years' financial services experience, which began when he joined Lloyds TSB in 2006 as finance director of the insurance division. He then transferred into retail banking where he was finance director, initially for mortgages before assuming responsibility for all retail products through the integration with HBOS. Alasdair joined the BGL Group in 2012 as chief financial officer, before taking up his current role as group chief financial officer of specialist property development lender Wellesley Group in 2016.

Mark Parsons
Chief Executive

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

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

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

John Lowe
Finance Director, Executive Director

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

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

Peter Frost
Chief Operating Officer, Executive Director

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

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

Directors' Report on Corporate Governance

Putting Members First

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

This report explains how the Board applies the principles of the UK Corporate Governance Code 2014 (the Code) and the Building Societies Association Guidance for Building Societies on the Code. The Board has considered the requirements of the Code and will continue to comply in a manner which is appropriate to the nature of the Society's business model.

In 2016, the Society complied with the provisions of the Code with the exception of provisions relating to dialogue with major shareholders (which are not applicable due to the Society's mutual status). Nevertheless, the Society is committed to maintaining a dialogue with its members. This is further discussed on page 72.

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

The role of the Board

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

In particular the Board is responsible for:

- Setting the culture and values of the Society.
- Challenging and approving the long-term strategy of the Society and its subsidiary companies, including the Strategic Plan and annual budget.
- Determining and reviewing the Society's risk appetite and the major risks faced by the Society.
- Assessing the adequacy of the capital and liquidity held by the Society.
- Monitoring the performance of the Society and holding the Chief Executive and the executive team to account on behalf of the members of the Society.
- Approving the Society's Remuneration Policy and the remuneration for directors and certain other members of senior management.
- Approving communications with stakeholders, in particular the annual financial statements, and overseeing the Society's engagement with its members.

The Board of directors

The Society's Rules require that the Board comprises between six and 12 directors. The Board currently comprises a Chairman, six independent non-executive directors and three executive directors. The Board has determined that its current composition is appropriate.

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

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

The following persons served as directors of the Society during the year: Janet Ashdown, Peter Ayliffe, Bridget Blow, Roger Burnell, Catherine Doran, Peter Frost, Ian Geden, Alasdair Lenman, John Lowe, Mark Parsons, Ian Pickering and Glyn Smith.

Catherine Doran and Alasdair Lenman became non-executive directors on 1 August 2016 and 1 November 2016 respectively. Bridget Blow retired as a non-executive director on 28 April 2016 and Glyn Smith resigned as a non-executive director on 30 September 2016. John Lowe and Janet Ashdown will retire from the Board with effect from the end of the 2017 Annual General Meeting (AGM) and will not stand for re-election.

In the opinion of the Board Janet Ashdown, Peter Ayliffe, Roger Burnell, Catherine Doran, Ian Geden and Alasdair Lenman are independent in character and judgement based on guidance in the Code. The Board considered Ian Pickering was independent at the time of his appointment as Chairman on 1 January 2013.

Other than the Chairman of the Board, non-executive directors are independent of the Society's management. Non-executive directors are not required to devote the whole of their time to its affairs.

Directors' Report on Corporate Governance **cont.**

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

The directors' biographies are included on pages 64 to 66. Further information about the directors, including a full list of other directorships, can be found in the Annual Business Statement on page 145.

How the Board fulfils its role

The Board applies the principles of good governance in the following way:

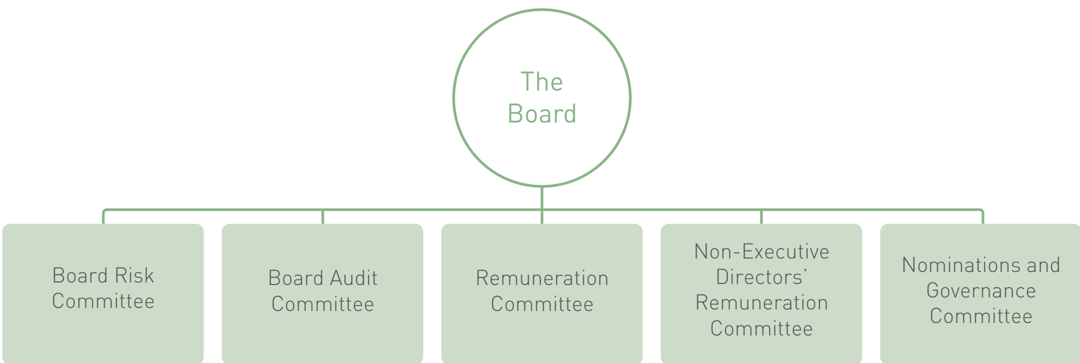
- The Board meets regularly and holds two strategy days each year outside the formal meeting cycle, which gives all directors an opportunity to contribute to the development of the Society's strategy.
- The non-executive directors meet, without executive directors present, at least once a year as required by the Code but in practice meet more frequently.
- The Chairman sets the tone of the Board meetings to ensure, amongst other things, that there is a culture of openness and constructive challenge from both non-executive and executive directors. This is assessed through the annual Board effectiveness review process.
- The Board has a formal schedule of matters that are reserved to it.
- Directors receive accurate, timely and clear information and it is the responsibility of the Chairman to ensure that this information is considered by the Board.
- The size, composition and diversity of the Board and the executive team are kept under review to ensure that there is adequate succession planning for executive and non-executive directors and that the Board has the appropriate skills and experience for the direction of the Society's activities. See page 70 relating to the Nominations and Governance Committee for further details.
- All directors have access to the advice and services of the General Counsel and Secretary, whose appointment is a matter for the Board. The General Counsel and Secretary is responsible for ensuring compliance with Board procedures and advising the Board, through the Chairman, on governance related matters.
- All directors have access to independent professional advice at the Society's expense, if needed, in order to fulfil their responsibilities as directors.
- The Board regularly discusses the culture of the Society and takes steps to oversee and assess the development of the culture of the Society.

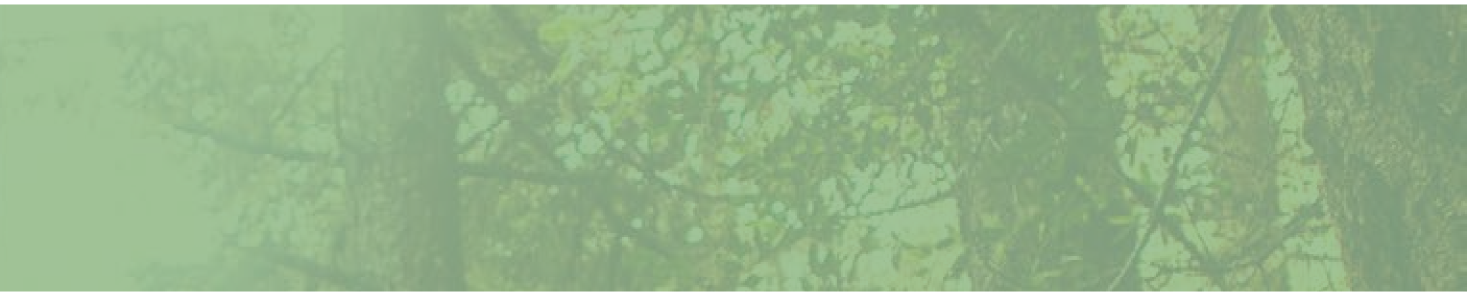
The main matters reserved to the Board are the matters detailed under The role of the Board on page 67. Other matters reserved to the Board include key appointments, approval of major projects and other major expenditure, the Society's main policies and delegation of matters to the Chief Executive.

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

Board Committees

The Board has established a number of Committees, as shown below:





Summaries of each Committee's remit and activities during the year are set out on the following pages. The terms of reference of each Committee are available on the Society's website (thecoventry.co.uk/corporategovernance) and from the General Counsel and Secretary on request. During the year, the terms of reference of all but one of the Committees were reviewed and updated where appropriate. The exception was the Non-Executive Directors' Remuneration Committee, which has a limited and self-explanatory remit. That Committee last reviewed its terms of reference in mid-2015 and will do so again in 2017.

Board Risk Committee

The Board Risk Committee met nine times during the year. The members of the Committee are:

Roger Burnell (Chairman of the Committee)
Janet Ashdown (until 1 July 2016)
Peter Ayliffe (from 1 July 2016)
Ian Geden
Glyn Smith (until 30 September 2016)

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

- Review and approve the Society's risk strategy, culture and principles, challenging as appropriate to ensure a risk culture that Puts Members First.
- Satisfy itself on the design and completeness of the Society's internal control and assurance framework, including the Enterprise Risk Management Framework (ERMF).
- Review key risk policies and frameworks, including principal risk appetite statements.
- Assure itself and the Board that current and potential risk exposures are being managed appropriately.
- Oversight of the Risk and Compliance functions, including their performance and independence.

The Committee Chairman reports to the Board after each meeting of the Committee.

In 2016, the Committee considered reports relating to the principal and emerging risks faced by the Society, which are set out in the Risk Management Report (pages 22 to 62). At each meeting it considered a detailed consolidated risk report from the Chief Risk Officer.

Other matters considered by the Committee during the year included:

- Reviewing the Society's operational resilience, including the Society's IT systems, information security and business continuity risks.
- Approving a framework for the management of model risk.
- Reviewing the Society's ERMF and recommending it for approval by the Board.
- Reviewing the recommendations of what risks should be constituted principal risks for the Society.
- Reviewing key policies linked to the Society's principal risks, including the Society's lending and treasury policies.
- Reviewing the Society's overall risk appetite and the risk appetites for each of the principal risks faced by the Society, including risk limits and tolerances.
- Reviewing and monitoring second line assurance over risk management across the Society.
- Reviewing the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP).
- Stress testing scenarios (including reverse and alternative stress testing).
- Considering reports from the Money Laundering Reporting Officer.

Board Audit Committee

Details of the Board Audit Committee are contained in the Board Audit Committee Report on pages 74 to 78.

Remuneration Committee

Details of the Remuneration Committee are contained in the Directors' Remuneration Report on page 90.

Non-Executive Directors' Remuneration Committee

Details of the Non-Executive Directors' Remuneration Committee are contained in the Directors' Remuneration Report on page 91.

Directors' Report on Corporate Governance cont.

Nominations and Governance Committee

The members of the Committee are:

Ian Pickering (Chairman of the Committee)
Peter Ayliffe
Bridget Blow (until 28 April 2016)
Roger Burnell
Ian Geden

The Committee is responsible for reviewing and making recommendations to the Board on matters relating to the structure, size, composition and ways of working of the Board. Its remit includes Board succession planning, overseeing the appointment of new directors and the appointment of non-executive and executive directors to committees of the Board.

The recruitment policy relating to the Board is that when vacancies on the Board are being filled, the Committee considers the skills, knowledge, experience and diversity (including gender) of existing members of the Board in order to consider the capabilities needed on each occasion. In identifying suitable candidates, the Committee shall:

- Conduct a thorough search/detailed review of the market either by using open advertising or the services of external advisors to facilitate the search.
- Consider candidates from a wide range of backgrounds.
- Consider candidates on merit and against objective criteria and with due regard for the benefits of diversity on the Board, including gender, taking care that appointees have enough time available to devote to the position.

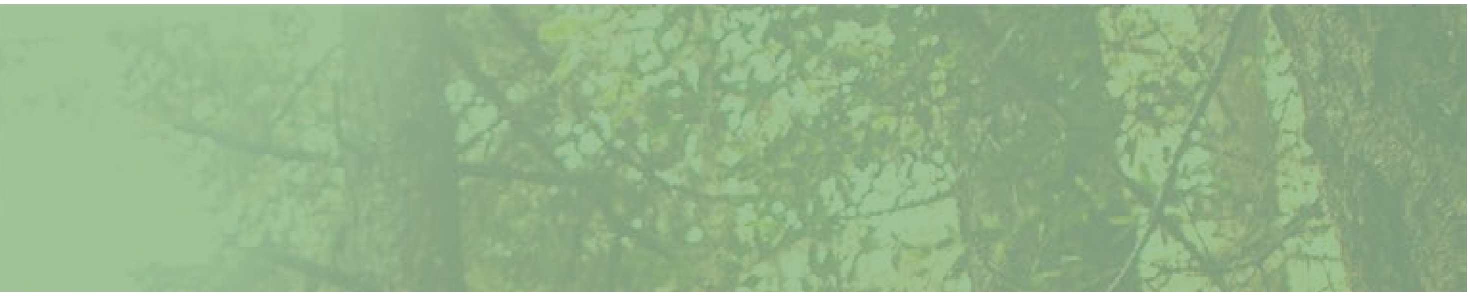
The Committee also takes an active role in other matters relating to the governance of the Society, such as reviewing the effectiveness of the Board and its Committees, reviewing the matters reserved to the Board, considering conflicts of interests, and reviewing governance related policies, including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

As part of its terms of reference, the Committee reviews diversity on the Board. It also recommends to the Board a target for the underrepresented gender on the Board in accordance with Article 88 of the Capital Requirements Directive. The Society's Board has set a target of 25% female directors by December 2017. The current percentage is 20%.

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

The Committee met seven times during the year. Among its activities in 2016 were:

- Overseeing the implementation of a number of policies to coincide with the introduction of SMR in early 2016.
- Reviewing the Society's Board Succession Plan with particular reference to ensuring appropriate recruitment of non-executive directors.
- Overseeing the recruitment of Catherine Doran and Alasdair Lenman as non-executive directors. Norman Broadbent and Russell Reynolds Associates, both specialist search firms, were engaged to assist the Society when Catherine Doran and Alasdair Lenman were appointed respectively. Russell Reynolds Associates does not have any other connection with the Society. Norman Broadbent has been selected by the Society to assist with the recruitment of a further new non-executive director.
- Overseeing the application of the various policies designed to ensure an effective Board, for example the Board Training Policy.
- Reviewing the matters reserved to the Board and the Board annual planner to ensure that matters were being considered or delegated appropriately.
- Reviewing directors' proposed external appointments to ensure they did not represent a conflict of interest or exceed the number of directorships permitted by the Capital Requirements Directive.
- Reviewing the respective roles of the Chairman and Chief Executive.
- Overseeing actions to improve the effectiveness of the Board and its Committees, including coordinating the 2016 effectiveness review and agreed follow-up actions.



Ongoing Board development

New directors complete a tailored induction programme that covers key aspects of the Society's business and regulatory environment, including meetings with senior management and branch visits. Established directors update their skills, knowledge and familiarity with the Society through a programme of training and branch and department visits. During the year, the whole Board received training on cyber security, diversity with particular reference to unconscious bias, directors' duties and corporate governance developments, as well as a number of topics specific to the Society's business. The Board's ongoing training and development needs are reviewed by the Nominations and Governance Committee and underpinned by a dedicated Board Training Policy.

Board and Board Committee attendance 2016

Name	Title	Number of Board meetings 13	Number of Board Risk Committee meetings 9	Number of Board Audit Committee meetings 6	Number of Remuneration Committee meetings 7	Number of Non-Executive Directors' Remuneration Committee meetings 1	Number of Nominations and Governance Committee meetings 7
Ian Pickering	Chairman	13			7	1	7
Peter Ayliffe[1]	Deputy Chairman from 29 April 2016	12	5	3			6
Janet Ashdown[2]	Non-executive Director	11	4	3	6		
Bridget Blow[3]	Deputy Chairman until 28 April 2016	5		2	3		3
Roger Burnell	Senior Independent Director	13	9	6			7
Catherine Doran[4]	Non-executive Director from 1 August 2016	3		2	2		
Peter Frost	Chief Operating Officer	13					
Ian Geden	Non-executive Director	13	9		7		7
Alasdair Lenman[5]	Non-executive Director from 1 November 2016	2		1			
John Lowe	Finance Director	13				1	
Mark Parsons	Chief Executive	13				1	
Glyn Smith[6]	Non-executive Director until 30 September 2016	10	6	5			

1. Transferred from the Board Audit Committee to the Board Risk Committee in July 2016. Maximum number of Board Risk Committee meetings was 5. Maximum number of Board Audit Committee meetings was 3.
2. Transferred from the Board Risk Committee to the Board Audit Committee in July 2016. Maximum number of Board Risk Committee meetings was 4. Maximum number of Board Audit Committee meetings was 3.
3. Retired from the Board in April 2016. Maximum number of Board meetings was 5. Maximum number of Board Audit Committee meetings was 2. Maximum number of Remuneration Committee meetings was 3. Maximum number of Nominations and Governance Committee meetings was 3.
4. Appointed to the Board in August 2016. Maximum number of Board meetings was 4. Maximum number of Board Audit Committee meetings was 2. Maximum number of Remuneration Committee meetings was 2.
5. Appointed to the Board in November 2016. Maximum number of Board meetings was 2. Maximum number of Board Audit Committee meetings was 1.
6. Resigned from the Board in September 2016. Maximum number of Board meetings was 11. Maximum number of Board Risk Committee meetings was 6. Maximum number of Board Audit Committee meetings was 5.

Review of Board effectiveness

The Board periodically reviews its own performance and that of its Committees. The Board reviewed its own performance and that of its Committees in 2016. Each Board Committee reviewed its own effectiveness by means of a self-assessment questionnaire and by undertaking an assessment of compliance with its terms of reference. Each Committee Chairman reported the outcome of this review to the Board.

The performance of the directors was appraised by the Chairman. The Chairman's performance review was led by the Senior Independent Director during 2016 taking into account the views of the rest of the Board.

The Board concluded that all were operating effectively, with the Nominations and Governance Committee taking the lead on implementing further improvements to the effectiveness of the Board and its Committees.

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

Directors' Report on Corporate Governance cont.

Annual re-election

The Board has considered the provisions of the Code relating to re-election of directors, and has decided for the 2017 AGM that it is in the best interests of members to submit the entire Board for annual re-election by the members. Accordingly all directors who were on the Board at the end of the 2016 AGM, with the exception of John Lowe and Janet Ashdown, have voluntarily submitted themselves for re-election and the Board has unanimously decided to recommend them for re-election by the members at this year's AGM. John Lowe and Janet Ashdown will retire from the Board at the end of the 2017 AGM and accordingly they will not stand for re-election.

Relations with members

One of the key responsibilities of the Board is to ensure that the views of the Society's members are understood and taken into account. This happens in a number of ways. In 2016, a number of Board members, both executive and non-executive directors, attended meetings of the Members' Council, which is a body of members who volunteer to provide their views directly to the Society's management. In addition, Board members attended member roadshows held in Oxford and Merry Hill. The Board also received updates on other measures taken to elicit the views of members and improve customer experience across the Society.

Non-executive directors also engage with the Society's members through attending the AGM. The Chairmen of all Board Committees are available to answer questions at the AGM.

All members who are eligible are encouraged to exercise their vote at the AGM by one of the following means: attending in person, sending a proxy to the meeting, voting by post, voting online, or in any branch. All means of voting other than in person at the meeting count as voting by proxy. All resolutions are taken on a poll to enable proxy votes to be counted and the Chairman indicates the level of proxies lodged on each resolution by announcing the numbers for and against the resolution and the number withheld. The proxy voting form explains the status of votes withheld. A separate resolution is proposed on each item, including a resolution to receive the Annual Report & Accounts. The Society employs Electoral Reform Services Limited to act as independent scrutineers and ensure the votes are properly received and recorded.

Culture

One of the principal responsibilities of the Society's Board is to set the right culture and values for the Society. The Society's culture, which can be best summarised as Putting Members First, was first endorsed by the Board in 2003 and has been regularly reviewed in the intervening period. Whilst it is important not to be complacent, the Society's record over the last 10 years, in terms of measures such as customer satisfaction, consistently low impairment, employee engagement and feedback from regulators, indicates that the culture of the Society has delivered good outcomes for members. Putting Members First underpins the Board's approach to members, its desire for the Society to remain independent and its commitment to mutuality. It is regularly discussed at Board level in a variety of contexts. As well as setting the Society's culture, the Board has a responsibility to ensure that the culture it considers appropriate for the Society is achieved in practice. It discharges this obligation through various activities, including receiving regular management information which provides insight into culture, consideration of specific agenda items with relevance to culture, and undertaking various activities outside formal Board meetings such as branch and departmental visits, to enhance its understanding of the Society's culture.

Diversity

In order to foster diversity and inclusivity within the Society and particularly within leadership roles, the Society has a number of development programmes in place for employees, including a mentoring programme to support senior managers as they develop towards executive roles, and a focus on internal mobility which serves to highlight opportunities and encourages employees to realise their potential. An equality, diversity and inclusion steering group takes the diversity agenda forward within the Society. Various initiatives focusing on underrepresented groups and increasing awareness of equality, diversity and inclusion have emerged and strong employee involvement has been seen. In addition, when working with recruitment providers to recruit executive and non-executive directors, providers are appointed who are experienced and successful in the identification of shortlists of candidates with diverse backgrounds.

Internal controls and risk management

The principal risk categories and how these are mitigated are described in greater detail in the Risk Management Report (see pages 22 to 62).

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

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

- Regular reports to the Board, through the Board Risk Committee, from the Risk function on the principal risks facing the Society and the adequacy of the controls in place to mitigate such risks. The Chief Risk Officer has an independent reporting line to the Board Risk Committee Chairman.
- Regular reports to the Board, through the Board Audit Committee, from the Internal Audit function in respect of its independent audits of risk management processes and the effectiveness of internal controls across the Society (further information can be found in the Board Audit Committee Report on page 77). The Chief Internal Auditor reports directly to the Board Audit Committee Chairman.
- An annual review of the effectiveness of the ERMF by the Chief Risk Officer, which is considered by the Board Risk Committee. This is subject to a third line review by the Internal Audit function, which is in turn considered by the Board Audit Committee.
- A consolidated risk report presented by the Chief Risk Officer at each Board meeting on key current and emerging risks and the efficacy of the controls and other mitigating actions in place to manage the risks.

The Board is able to confirm that a robust assessment of the principal risks facing the Society has been carried out, including those that would threaten its business model, future performance, solvency or liquidity.

The Board has carried out a review and is satisfied that during 2016 the Society maintained adequate risk management arrangements, taking into account its profile and strategy together with an adequate system of internal control, with regard to the requirements of the Code.

Board Audit Committee Report

Board Audit Committee

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

Roger Burnell (Chairman of the Committee from 1 October 2016)
Janet Ashdown (from 28 April 2016)
Catherine Doran (from 1 August 2016)
Alasdair Lenman (from 1 November 2016)

In addition, Glyn Smith served as Chairman of the Committee until 30 September 2016, and Bridget Blow and Peter Ayliffe served as members of the Committee until 28 April 2016 and 23 June 2016 respectively.

The Board is satisfied that Roger Burnell and Alasdair Lenman have recent and relevant financial services sector experience. Both are professionally qualified accountants.

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

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

The responsibilities of the Committee are in line with the provisions of the Financial Reporting Council (FRC) Guidance on Audit Committees. The main function of the Committee is to assist the Board in fulfilling its oversight responsibilities, and to ensure that the interests of the Society's members are properly protected, with specific regard to:

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

In 2016, the Committee met six times and focused on the following matters:

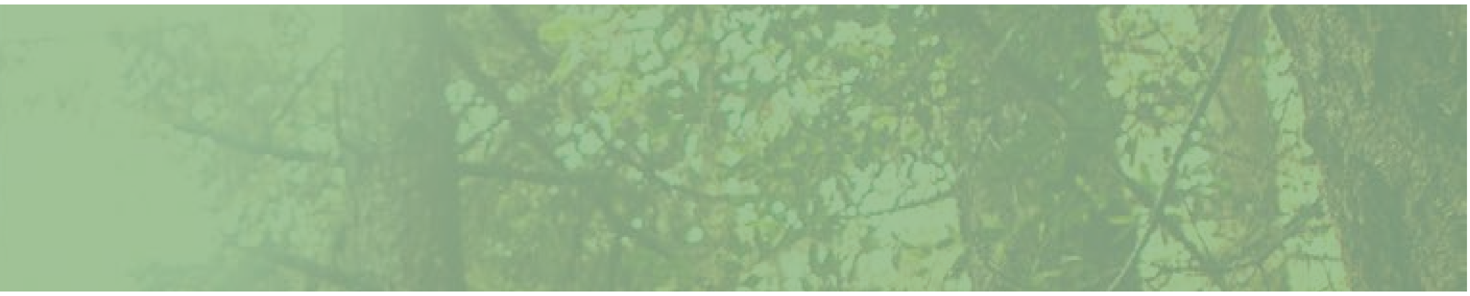
Preparation of financial statements and key areas of judgement

When assessing both the interim and full year 2016 financial statements, the Committee considered in detail areas subject to management judgement and received a report from the Finance Director on each area setting out the approach adopted, methodology, key assumptions and comparison with the prior year. Each of the reports presented to the Committee by management was subject to scrutiny by the external auditor. There were no significant disagreements between management and the external auditor. Note 2 to the accounts summarises material judgements and critical accounting estimates made in applying accounting policies, and the sensitivity of reported performance to these judgements and estimates is then set out in subsequent relevant notes. The areas reviewed included:

Effective Interest Rate (EIR) methodology

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

The Committee reviewed updated assumptions used for 2016, reflecting the latest experience, together with the impact on the EIR asset of higher levels of redemptions and expectations of future margin compression. The Committee concluded that the basis of calculation and value of the asset was appropriate. Further information can be found in note 3 to the accounts.



Impairment and forbearance

The Committee reviewed in detail the level of provision within the accounts and the range of impairment triggers considered by management. The Committee also considered the basis of calculation of individual and collective provisions, management overlays and details of the forbearance measures utilised by the Society and the approach used to calculate the likelihood and level of any future losses on such accounts. The sensitivity of the provision calculation to various assumptions was considered in light of economic conditions on a business as usual and a stressed basis, including an increase in the propensity of accounts to fall into default, and the impact of a fall in house prices. Noting the limited impact of this sensitivity analysis, the modest use of forbearance, the subsequent performance of assets subject to such measures and the low levels of mortgage arrears experienced, the Committee was satisfied with the adequacy of the provisions recorded within the balance sheet. Further information can be found in the retail credit risk section of the Risk Management Report and note 11 to the accounts.

Fair valuations for acquired assets

The Society acquired mortgage assets and retail savings through the merger with Stroud & Swindon Building Society in 2010 and mortgage assets as a result of a loan book purchased from Bank of Ireland in 2012. These items were initially recognised at fair value with subsequent recognition at amortised cost using an EIR methodology. Fair value techniques were used based on observable market data where available and, where not, the Society's internal models used for similar asset classes. The key fair value adjustments recognised were in respect of anticipated credit losses and interest shortfalls, where the yield was lower than corresponding levels in the market. The Committee considered the performance of the assets and the level of fair value adjustments that had been amortised through the Income Statement. Given the consistent performance of the assets, the Committee was satisfied that amortisation in the current period was appropriate. Further information can be found in note 3 to the accounts.

Derivatives and hedge accounting

The Committee reviewed the Society's use of derivatives and its approach to hedge accounting. Derivatives are used solely for risk management purposes, to manage either interest rate risk or foreign exchange risk, and are economically effective. The Committee reviewed the different types of hedging adopted by the Society, valuation techniques, sources of accounting ineffectiveness and the key movements during the year. The Committee noted that the Society's application of hedging strategies had remained unchanged during 2016. Whilst cognisant of the risks that can arise from the current accounting requirements, the Committee was satisfied that the approach adopted was appropriate and that the hedging activity undertaken was effective in mitigating the underlying risk. Further information can be found in note 1 to the accounts.

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

Accounting for investments in equity shares

The Society historically held two immaterial equity investments as a result of its dealings with Visa Europe Limited and VocaLink Holdings Limited (VocaLink).

During the year Visa Inc. acquired Visa Europe Limited, resulting in the Society recognising a gain in the Income Statement, and a preference shareholding in Visa Inc. Furthermore, as a result of the planned acquisition of VocaLink by MasterCard, the Society revalued the VocaLink holding in its financial statements, resulting in an increase in its fair value.

The Committee considered the accounting treatment and valuation of the investments and concluded that they were appropriate. Further information can be found in note 17 to the accounts.

Going concern and long-term viability

The Committee evaluated whether adopting the going concern basis of accounting was appropriate by considering a report presented by the Finance Director which covered profitability, the Strategic Plan, the Society's liquidity position, the availability of funding, regulatory capital considerations and forecast capital ratios. The report also referenced the detailed stress testing undertaken as part of the annual liquidity and capital adequacy assessments. The Committee also considered the Society's longer-term viability, taking account of the principal risks facing the Society, including those that could threaten the Society's business model, future performance, solvency and liquidity. Further information can be found on page 62 of the Risk Management Report.

Board Audit Committee Report **cont.**

Fair, balanced and understandable

The Committee considered whether the 2016 Annual Report & Accounts were fair, balanced and understandable. The Committee did this by satisfying itself that there was a robust process of review and challenge at different levels within the Society to ensure balance and consistency, which included:

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

The Committee also considered other information regarding the Society's performance presented to the Board during the year. After consideration of relevant information, the Committee concluded that it could recommend to the Board that the 2016 Annual Report & Accounts are fair, balanced and understandable.

New accounting standards

Regular updates and training on financial reporting developments were presented to the Committee during the year to enable it to provide effective oversight of the reporting and disclosures within the interim and full year accounts.

During the year, the Committee was updated on the progress of the project to implement International Financial Reporting Standard 9 *Financial Instruments,* which will ultimately replace International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* in 2018. The Committee was satisfied that the project was appropriately advanced at this stage.

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

The Society's internal control and risk management arrangements

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

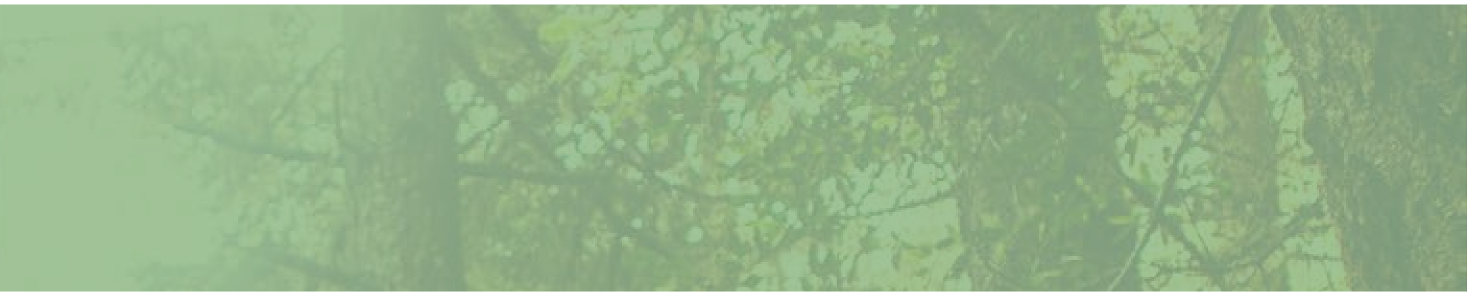
Extensive work completed during 2014 and 2015 has established the Society's formal and cohesive approach to risk management. Whilst recognising that the Society's low risk appetite and simple business model are important factors in mitigating risk, the framework implemented is designed to promote risk management and responsibility for risks throughout the Society.

Following implementation during 2015, efforts in 2016 have focused on embedding the revised framework into business as usual activity. These efforts were assessed through a risk management effectiveness assessment completed by Internal Audit during the final quarter of 2016. Internal Audit concluded that the risk management framework had been fully implemented and adopted by all areas of the Society and that work continued to mature the activities within day-to-day operations. The Committee reviewed Internal Audit's report on the Society's risk management effectiveness and concluded the overall risk management framework and arrangements to be effective.

Further information on the Society's approach to internal control and risk management is included on page 73 of the Directors' Report on Corporate Governance.

With respect to the Society's whistleblowing arrangements, the Committee received regular reports during 2016 on the revised whistleblowing policy that takes account of the Financial Conduct Authority's revised rules on whistleblowing, effective September 2016. The Committee was provided with a summary of the activities undertaken to enhance the Society's whistleblowing framework, including the establishment of a Whistleblowing Committee to provide senior level oversight of whistleblowing cases, development of new processes and training to support investigation procedures and reporting practices, and awareness education for all Society employees relating to reporting mechanisms and confidentiality expectations.

The Committee also considered an annual report on the operation of these arrangements and a thematic summary of concerns raised during 2016 and concluded that the arrangements were operating effectively, and there were no material matters of concern.



The activities of Internal Audit

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

The Committee received regular reports from the Chief Internal Auditor setting out the results of assurance activity related to Society operations and change initiatives, progress in delivery of the Internal Audit plan and the level of resources available. Significant findings and thematic issues identified were considered by the Committee, as well as management's response and the tracking and completion of outstanding actions.

In addition to approving the annual plan and budget, the Committee reviewed and approved amendments to the Internal Audit plan and resources throughout the year.

During the year, the Committee received a report from the Chief Internal Auditor detailing the results of a self-assessment of Internal Audit effectiveness. The report considered conclusions drawn from an evaluation against Internal Audit professional standards, internal quality assurance processes, stakeholder surveys and analysis to confirm that all actions associated with the 2014 independent external effectiveness review were now appropriately addressed. The Committee was satisfied that the Internal Audit function remains effective.

External auditor

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

Audit plan

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

Audit quality

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

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

The review also considered the FRC's Audit Quality Inspection Annual Report 2015/16 (May 2016) and the Audit Quality Inspection Report on Ernst & Young LLP (May 2016). In addition, the Committee requested representatives from Ernst & Young LLP to present their response to the FRC's findings. The Committee concluded that the external audit process was effective, and it was satisfied that there were no matters of concern with respect to the external auditor's independence or objectivity. The results of the assessment were shared with the lead audit partner so that areas for improvement could be addressed.

Taking into consideration the matters noted above, the Committee has recommended to the Board a resolution at the 2017 Annual General Meeting that Ernst & Young LLP be reappointed.

Board Audit Committee Report **cont.**

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

The Committee regularly reviews and monitors the Society's relationship with the external auditor to ensure that auditor independence and objectivity is maintained at all times. The Committee has developed a policy and framework which define unacceptable non-audit assignments, pre-approval of certain acceptable non-audit assignments and procedures for approval of other non-audit assignments. At no time does the external auditor audit its own work, make management decisions for the Society, create a conflict of interest or find itself in the role of advocate for the Society. The Committee keeps non-audit engagements under review and receives regular reports from the external audit partner confirming that adequate safeguards remain in place. Furthermore, the Society's policy and framework require that the external auditor should only be appointed if the threat to objectivity is clearly insignificant, unless appropriate safeguards can be applied to eliminate or reduce such threat to an acceptable level.

During 2016, the Society engaged the external audit firm to provide certain non-audit services. These engagements included work relating to IFRS 9 model validation, reviewing the Society's Pillar 3 disclosures, reviewing returns for the Funding for Lending Scheme, and assurance work in relating to the Society's debt issuances. All engagements complied with the policy set out above and the Committee received regular updates on the nature and cost of the engagements.

Details of the fees paid to the external auditor for audit and non-audit services are set out in note 9 to the accounts.

Future audit tender

Ernst & Young LLP and its predecessor firms have been the Society's auditors since 1930 when first appointed to audit the Coventry Permanent Economic Building Society's accounts. The lead audit partner rotates at least every five years and the current lead audit partner is due for rotation in 2018. In 2013, the Society tendered its external audit relationship in line with best practice including the most recent FRC guidance at that time. The UK Corporate Governance Code now requires that the audit contract be put out to tender every 10 years, with transitional provisions for compliance meaning that the contract must be re-tendered no later than 2020 for the 2021 year end audit.

In 2015, the Committee recommended to the Board that, subject to implementation of the European Union Directive, a tender of the external audit should commence in 2017 with respect to the 2018 audit. Ernst & Young LLP would not be invited to re-tender based on guidance under the new rules. However, as a result of the resignation of the former Committee Chairman, Glyn Smith, in September 2016 and the Finance Director's decision to retire from the Board with effect from the Annual General Meeting in April 2017, the Committee has amended this recommendation to the Board such that a tender of the external audit should be deferred to no later than 2020 with respect to the 2021 audit to maintain stability and provide continuity during a period of change.

The effectiveness of the Committee

The Committee carried out a review of its effectiveness during 2016, including an assessment of its work against its terms of reference, published guidance and best practice. The review was facilitated by the General Counsel and Secretary and considered questionnaires which were completed by both Committee members and regular attendees. The review concluded that the Committee had operated effectively throughout the year.

Roger Burnell
Chairman of the Board Audit Committee
23 February 2017

Directors' Remuneration Report

Dear Member

I am pleased to present the Remuneration Committee's annual report, including details of the directors' remuneration for 2016. There are two sections to the report: (1) a Remuneration Policy, which sets out the Society's remuneration policy for directors; and (2) the Annual Remuneration Report, which outlines how the policy was implemented in 2016.

Although not legally required to do so, the Society has prepared this report in line with legislation applicable to companies, and regulation on executive pay. If you are eligible to vote at the Annual General Meeting (AGM) you will have a vote on the Remuneration Policy and a vote on the Annual Remuneration Report. The Society is not required to submit the Remuneration Policy to a binding vote of members but has decided, on a voluntary basis, to do so on an advisory basis every three years (or earlier if changes are made to it). The vote on the Annual Remuneration Report is also advisory and the Directors' entitlement to remuneration is not conditional on it. However, in both cases the Remuneration Committee intends to take account of members' feedback and the Society remains committed to good corporate governance.

We understand that our approach needs to strike a balance between determining the right level of pay and controlling costs. The focus of our Remuneration Policy is to attract and retain people with the right skills, knowledge and attitude; from the directors who determine and lead the strategy, to the employees who provide excellence in our service delivery to you.

The Society's performance

The Society performed strongly in 2016, meeting key strategic objectives for the period. For further information, please see the Strategic Report (pages 2 to 62). We continue to deliver a strategy of long-term value for our members based on efficient operations, low risk lending and high quality service. This provides the basis for strong but appropriate levels of profitability to enable sustainable growth and provide a secure capital position.

Remuneration in 2016

Full details of the directors' remuneration, both the fixed and the variable elements, can be found in this report.

As we indicated in last year's report, we have reviewed the structure of our executive remuneration and made a material change during 2016 to the Society's variable remuneration schemes for executive directors and executive managers.

The Society has traditionally operated two variable remuneration schemes. The first is the annual Success Share bonus, which is linked to the achievement of strategic targets (both financial and non-financial) and is shared by all employees. The second was a Long Term Incentive Plan (LTIP), in which executive directors and executive managers were eligible to participate. In 2016 the Society replaced the LTIP with an annual Executive Variable Pay Plan (ExVPP). The remaining in-flight legacy LTIP (based on performance in the financial years 2015-2017) will conclude in 2017.

The Remuneration Committee believes that there are a number of benefits in moving to an annual executive scheme. Firstly, the design principles mean that performance measures will be reviewed and set each year to ensure they are always relevant to the Society's strategic objectives and market conditions. Secondly, the scheme's strategic performance measures have been designed as a balanced scorecard which brings a broader focus on member service, risk, people, and financial measures rather than using profit as a primary measure. The Committee considers this broader focus to be more appropriate for a mutual organisation. The ExVPP retains a long-term focus as awards arising from these plans will be subject to extended deferral periods and to malus (reduction) and clawback (repayment), complying with remuneration regulation.

For the performance period ending 31 December 2016, the annual Success Share bonus paid out to all employees at 14% (from a potential maximum of 20%) of base salary, and the ExVPP paid out at 39% (from a potential maximum of 60%) for executive directors and 19.5% (from a potential maximum of 30%) for executive managers. The legacy LTIP based on performance in the financial years 2014-2016 paid out at 25% (from a potential maximum of 40%) for eligible executive directors and 12.5% (from a potential maximum of 20%) for eligible executive managers.

2017 Remuneration Policy

The Remuneration Committee will continue to monitor the regulatory framework and market, making changes if required.

Ian Geden
Chairman of the Remuneration Committee
23 February 2017

Directors' Remuneration Report cont.

Remuneration Policy

This section informs members of the policy for the remuneration of both executive and non-executive directors.

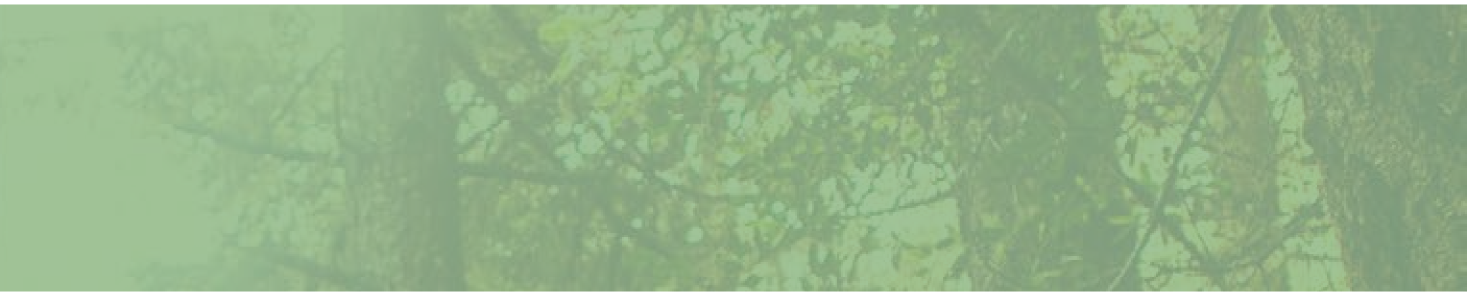
Link to strategy

The Society's Remuneration Policy is designed to ensure that executive directors' remuneration rewards directors for their responsibilities, performance and experience, taking into account market data. Remuneration packages aim to aid the recruitment, retention and motivation of high calibre individuals to lead and direct the Society and deliver continuously improving performance and long-term sustainability for our members.

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

The main elements of remuneration currently in place for executive directors are set out below:

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



Performance metrics

The Society's balanced scorecard contains 11 strategic measures which align to the Board-approved strategy. Further information on these measures is provided in the Strategic Report section on page 11.

These measures are weighted and grouped into four quadrants: Financial (40%), Member Service (20%), Risk and Projects (20%) and People (20%). When reviewing the variable pay schemes, the Committee considers target ranges taking into account plan targets, market forecasts and maintaining long-term sustainability. The nature of the balanced scorecard and inclusion of the above factors, including credit and risk limits, ensures that outperformance cannot be achieved through excessive risk taking and also considers member outcomes. The total award payable is dependent on the number of measures which are deemed to be above or below the target ranges, which in turn correlates with a range of award, within which the Committee will determine an award expressed as a percentage of base salary.

Legacy variable remuneration – Long Term Incentive Plan

The LTIP was replaced by the ExVPP in 2016. No LTIP was granted during 2016, although legacy grants under the 2015-2017 scheme remain active and will conclude in 2017. The LTIP is subject to malus and clawback conditions. For details of the LTIP, please refer to the Directors' Remuneration Report in the 2015 Annual Report & Accounts.

Variable remuneration

The following table shows the different levels of potential variable pay as a percentage of base salary for the executive directors:

	As a percentage of base salary		
Performance scenarios	Success Share %	ExVPP %	Total variable remuneration %
Minimum	0	0	0
On target	10	30	40
Maximum	20	60	80

The ExVPP on target and maximum scenarios for executive managers are half of those for executive directors.

The Committee believes it is essential that variable remuneration awards are not excessive. A regulatory fixed to variable pay cap of 100% is set out in the Capital Requirements Regulation and Capital Requirements Directive (CRD IV) framework, although it is possible for this to be extended to 200% with appropriate member approval. The Society's variable pay awards in respect of a financial year are currently limited to a maximum total of 80% of base salary (ExVPP and annual Success Share bonus combined), which is below the regulatory variable pay cap. Although the maximum opportunity under the ExVPP is higher than the 40% under the LTIP, this is offset by the move to a balanced scorecard and the level of stretch within the ExVPP targets has been designed to deliver a more consistent payment, and not to increase the long-term total cost to the Society. To protect the interests of members, the Committee may amend any award if it considers it appropriate in light of either the Society's overall performance or economic conditions or any other factor the Committee deems relevant, including individual and departmental performance.

Deferral and retention

Awards to executive directors and executive managers under the annual Success Share bonus, ExVPP and legacy LTIP are subject to deferral and retention rules, which aim to ensure a strong link between remuneration and the long-term interests of members. The deferral and retention arrangements differ depending on whether individual total remuneration relating to the performance year is above or below the PRA's 'de minimis' exemption. The exemption applies where total remuneration is below £500,000 and variable pay is less than 33% of total remuneration.

Directors' Remuneration Report **cont.**

Details of how deferral and retention apply under each scenario to variable pay schemes awarded from 2016 are set out below:

Above de minimis

For executive directors and executive managers above de minimis, 60% of their total variable pay (annual Success Share bonus and ExVPP) is subject to an extended deferral period of seven years. The deferred award is released in equal tranches on the third to seventh anniversaries of the assessment date after the end of the performance period.

Year of payment for 2016 performance period	Year 1 2017	Year 2 2018	Year 3 2019	Year 4 2020	Year 5 2021	Year 6 2022	Year 7 2023	Year 8 2024
Upfront/deferred payments	40%	–	–	12%	12%	12%	12%	12%

Below de minimis

For executive directors and executive managers below de minimis, 40% of the ExVPP is deferred until the second anniversary of the assessment date after the end of the performance period.

Year of payment for 2016 performance period	Year 1 2017	Year 2 2018	Year 3 2019
Annual Success Share bonus	100%	–	–
ExVPP upfront/deferred payment	60%	–	40%

For each of the annual payments indicated above, half of the awards are made in cash, with the other half retained in an equivalent share-like instrument for a further six months. During the retention period the retained payment can move both up and down in value. For the upward movement, the retained element will be indexed and increase in line with the Retail Prices Index to preserve the real terms value of the award. It can move down based on the performance of the Society, after the end of the performance period, and will reduce in the event that capital strength or profit declines significantly, as would be the case for a decline in the share price of a listed firm.

Malus and clawback

Arrangements for malus and clawback are in place for executive managers and directors, in compliance with the PRA's Remuneration Code and best practice.

	Malus	Clawback
What is it?	Malus is where the Remuneration Committee may decide to reduce or cancel any payment under the Society's variable pay schemes, before payment has been made.	Clawback is where the Society requires an individual to repay all or part of a variable pay award after payment has been made.
Which awards does it apply to?	Malus applies to payments that may be made under any variable pay schemes.	Clawback applies to payments made from variable pay scheme grants awarded since 2015. Awards are subject to clawback for up to seven years (extendable to 10 years for variable pay awards in respect of 2016 and beyond) and will continue to apply should a participant leave the Society.
When would this be used?	The Remuneration Committee may consider malus is appropriate in circumstances including but not limited to: • There is reasonable evidence of misbehaviour or material error by the executive. • The Society suffers a material downturn in its financial performance. • The Society suffers a material failure of risk management. • The imposition of any regulatory sanctions where the conduct of the executive contributed to the sanction.	The circumstances in which the Remuneration Committee may require clawback to be applied include: • Those detailed under malus. • By virtue of a material misstatement of the Society's financial results, the payment made under the variable pay arrangement was greater than it would have been but for the misstatement.

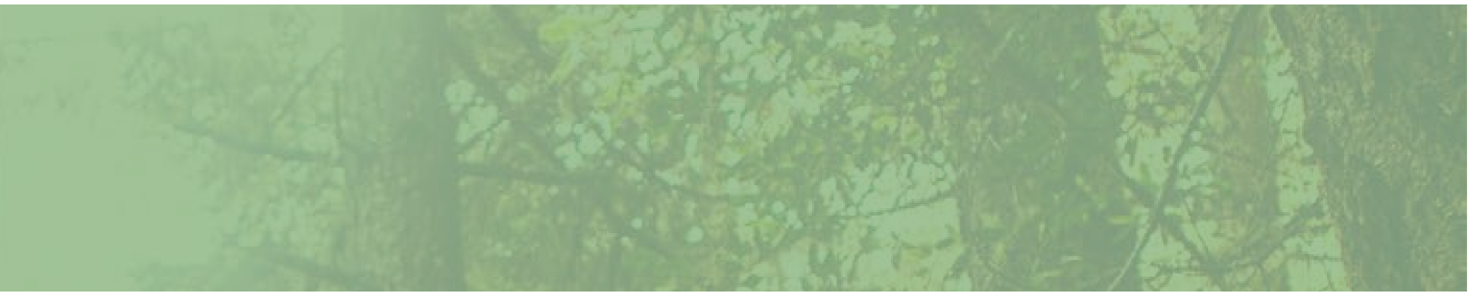
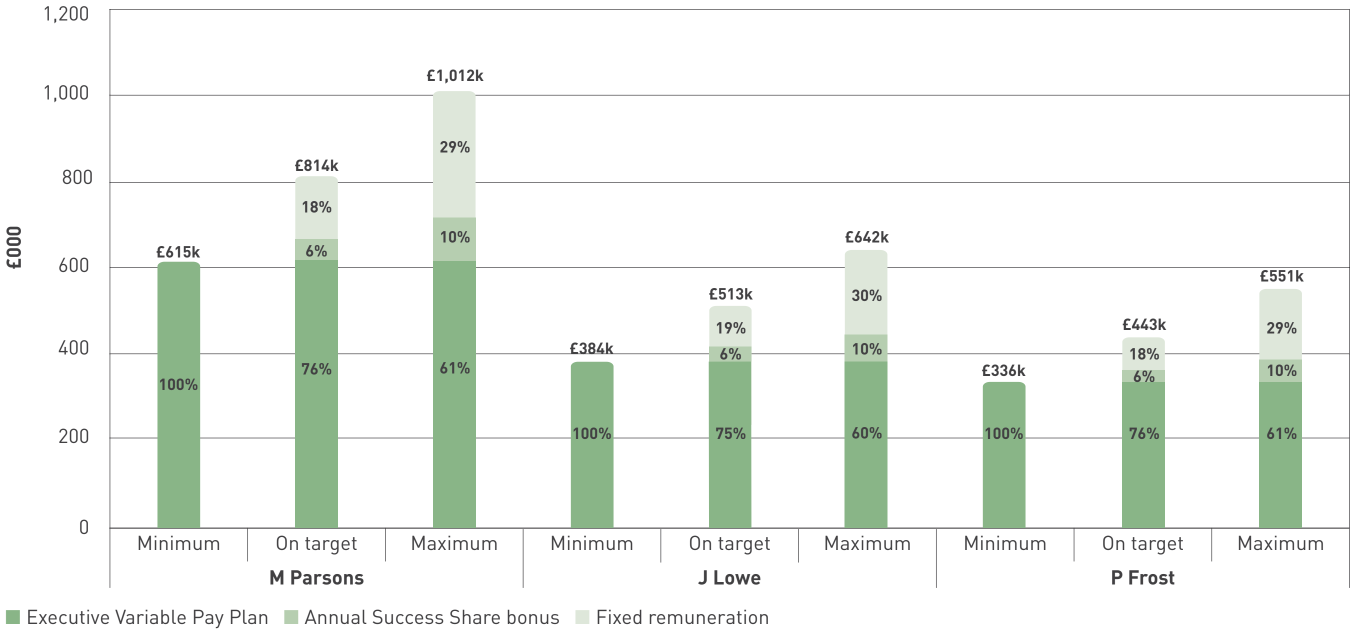


Illustration of the application of the Remuneration Policy

The graph below illustrates what the executive directors could earn under the Remuneration Policy based on 2016 remuneration levels and three potential performance scenarios – minimum, on target and maximum- under variable remuneration schemes granted in 2016. Only where Society performance considerably exceeds expectations, would a maximum award be generated. In applying the scenarios, fixed remuneration refers to current base salary, pension as a percentage of base salary and benefits paid over the course of the calendar year. Benefits figures are taken from those disclosed in the single figure table on page 86.



The retained element of the annual Success Share bonus and ExVPP is shown before any adjustment has been applied, and a proportion of the Success Share bonus and ExVPP is deferred as described on pages 81 and 82.

Directors' Remuneration Report **cont.**

Approach to new appointments

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

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

The Committee may also make awards on hiring an external candidate to compensate them for forfeiting any awards forgone from a previous employer. In the light of changing regulations from 2017, the Committee is reviewing its policy on such 'buyouts' and will always comply with regulatory requirements in effect at the time of making any awards of this nature.

Service contracts

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

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

All directors are subject to election by the Society's members at the AGM following their appointment by the Board.

Policy on payment for loss of office

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

Variable pay awards will be paid according to the leaver provisions within the scheme rules.

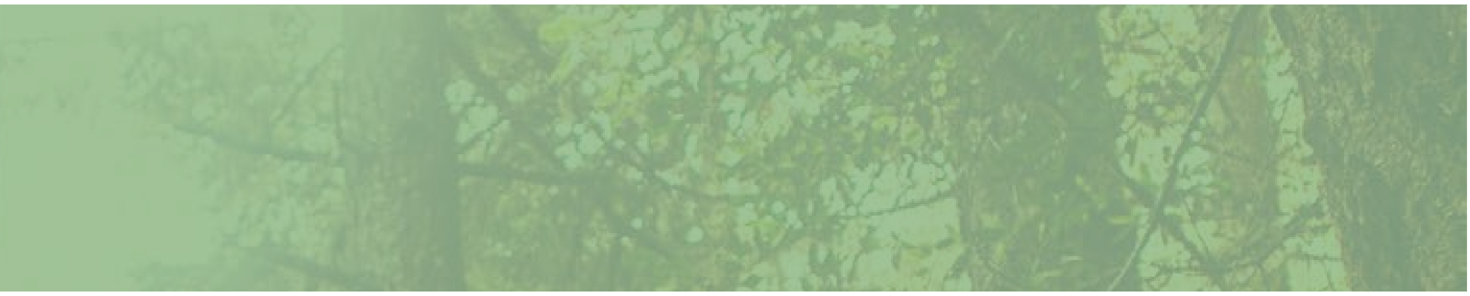
For the ExVPP and annual Success Share bonus, if an executive director ceases to hold employment during the performance period for any reason, that award will lapse.

If an executive director ceases to hold employment after the end of the performance period, any part of an award that has not been released will lapse unless the cessation is due to death, ill-health, injury/disability, retirement or any other reason as determined by the Committee.

Except for in the event of death, where any part of an award may be released as soon as practicable, following the date of cessation any deferral and retention requirements will continue to be applicable and amounts will be subject to any necessary adjustment as detailed on pages 81 and 82. Clawback rules would also continue to apply.

Other considerations when setting executive director remuneration

When approving executive director pay, the Committee will take into account remuneration paid to other employees across the Society, including the salary increases awarded and consideration of the Remuneration Policy as applied to the wider employee group. All eligible employees participate in the annual Success Share bonus scheme.



Non-executive directors

Non-executive directors receive a base fee and an additional fee for chairmanship of a Committee and/or holding the position of Senior Independent Director or Deputy Chairman and are reimbursed for reasonable expenses, paid in accordance with the Society's Rules.

These fees are set at a level that reflects the market and is sufficient to attract individuals with appropriate knowledge and experience to support the Society in progressing its strategy. The non-executive directors do not participate in any Society pension or bonus arrangements.

Fees are reviewed annually, taking into account market data, annual pay increases awarded to employees, the economic environment and the Society's performance.

Letters of appointment

Non-executive directors are appointed by letter of appointment for an initial term of three years, which is terminable with immediate effect if decided by the Board or with three months' notice from the non-executive director concerned. All non-executive directors are subject to election by the Society's members at the AGM following their appointment by the Board. If a non-executive director is not re-elected at the AGM, they will cease to be a director from the end of the AGM.

Consideration of member views

The Society has dialogue with members and welcomes feedback on executive and non-executive directors' remuneration. At the 2016 AGM, 93.6% of members voted in favour of the approval of the 2015 Annual Remuneration Report.

Annual Remuneration Report

This report informs members of the remuneration awarded to both executive and non-executive directors relating to 2016.

The total pay package earned by each executive director in respect of the years ended 31 December 2016 and 2015 are shown below.

The LTIP figure for 2016 is the amount earned in respect of the LTIP award granted in 2014 and based on performance for the three years ended 31 December 2016. The LTIP is a legacy arrangement which will run concurrently with the ExVPP until the historical LTIP awards conclude in 2017.

Total remuneration earned by each executive director

	Fixed remuneration			Variable remuneration				
Audited information	Base salary £000	Taxable benefit £000	Pension allowance[1] £000	Annual Success Share bonus £000	ExVPP £000	Legacy LTIP £000	Total (including legacy LTIP) £000	Total (excluding legacy LTIP) £000
2016								
Mark Parsons	493	19	99	69	194	96	970	874
John Lowe	320	12	48	45	126	75	626	551
Peter Frost	267	26	40	38	105	60	536	476
Total	1,080	57	187	152	425	231	2,132	1,901
2015								
Mark Parsons	475	19	95	57	n/a	–	646	n/a
John Lowe	309	16	43	37	n/a	104	509	n/a
Peter Frost[2]	255	79	35	31	n/a	88	488	n/a
Total	1,039	114	173	125	n/a	192	1,643	n/a

1. Pension allowance includes both contributions to the Group's defined contributory pension scheme and cash payments in lieu of contributions.
2. Peter Frost's taxable benefits include £52,000 for payments agreed under his contract of employment to enable his relocation to the Coventry area. No further relocation expenses are due.

The remuneration for Mark Parsons and John Lowe is above the de minimis threshold of £500,000 in respect of deferral and retention of the annual Success Share bonus and ExVPP. Consequently, Mark Parsons will receive a payment of £105,000 (40%) in 2017 with the remaining £158,000 (60%) being paid in tranches from 2020 onwards as per the arrangements detailed on pages 81 and 82. John Lowe will receive a payment of £68,000 (40%) in 2017 but will forfeit any future deferrals after leaving the Society.

The remuneration of Peter Frost is below the threshold and consequently will receive 100% of the annual Success Share bonus (£38,000) and 60% of the ExVPP, totalling £63,000 in 2017 with the remaining £42,000 payable in 2019.

As the LTIP is a legacy scheme, it is outside the scope of deferral and retention rules, and does not contribute to the £500,000 threshold.

Further information on individual remuneration elements: executive directors

Base salary 2016

The annual review of salaries conducted in April 2016 saw a 2% basic increase for all employees and an additional 1.5% where necessary to progress towards market levels. The executive directors received 3.5% in line with this approach. The table below sets out the current base salary for the Chief Executive, compared with the previous year:

Executive director	2016 £	2015 £	% increase
Mark Parsons	496,800	480,000	3.5%

Variable pay 2016

The Society performed strongly in 2016, meeting key strategic objectives for the period. Further information on the Society's performance can be found in the Strategic Report (pages 2 to 62). Performance against the balanced scorecard measures are summarised below:

Perfomance measure	Performance relative to target range
Financial:	
Mortgage balance growth	Above target
Savings balance growth	Above target
Cost to mean asset ratio	On target
Leverage ratio	On target
Risks and projects:	
Mortgage balances in arrears (%)	Above target
Liquidity Coverage Ratio	On target
Investment programme delivery	On target
Members:	
Experience Net Promoter Score®[1]	On target
Relationship Net Promoter Score®[1]	Above target
People:	
Employee engagement	On target
Community involvement	Above target

Given the performance outlined above, the Committee considered the level of variable awards which gave rise to:

- An annual Success Share bonus for all 2,323 eligible employees, including executive directors equivalent to 14% of base salary from a potential maximum of 20%.
- An ExVPP award to executive directors equivalent to 39% of base salary from a potential maximum of 60% and to executive managers of 19.5% of base salary from a potential maximum of 30%.

For executive directors and executive managers these amounts will be deferred as described on page 81 and 82.

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

Long Term Incentive Plan (2014-2016)

The Society met the scheme on-target threshold of £216.3 million profit (before Financial Services Compensation Scheme charges) in the final year of the scheme. This resulted in an award under the scheme of 25% of base salary for eligible executive directors and 12.5% of base salary for eligible executive managers. Base salary is set as the salary for each participant at the date of the original 2014 grant.

50% of the payments made under the LTIP will be retained in an equivalent share-like instrument for a further six months. This will be paid at the end of the retention period, subject to an adjustment as defined in the 2015 Annual Report & Accounts on page 76, and Committee discretion.

There were no LTIP grants in 2016 as the plan has been replaced by the ExVPP.

The maximum award levels under the variable plans awarded in 2016 compared with 2015 are shown below:

	Maximum award levels (% of base salary)			
	Success Share 2016 %	Success Share 2015 %	ExVPP 2016 %	LTIP 2015 %
Executive directors	20	20	60	40

Benefits and pension 2016

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

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

The Finance Director is an active member of the Group's defined contribution pension scheme, and reached his maximum annual allowance for pension contributions during the year. Subsequently pension contributions were made as cash payments equivalent to 15% of base salary.

The Chief Executive and Chief Operating Officer received cash alternatives in lieu of pension contributions equivalent to 20% and 15% of base salary respectively.

Remuneration elements in 2017

Base salary 2017

The base salaries for executive directors will be revised from April 2017 in line with the approach outlined in the Remuneration Policy.

Benefits and pension 2017

No changes are anticipated to the Society's approach to benefit and pension provision in 2017.

Variable pay 2017

The 2017 annual Success Share bonus scheme and ExVPP will be reviewed in line with business strategy and the impact of changes to relevant regulation such as the increase in retention period to one year for those exceeding the 'de minimis' rule. It is anticipated that there will be no other significant changes to variable pay arrangements for 2017. Details of the performance metrics for both variable pay plans will be provided in the 2017 Directors' Remuneration Report.

Payments to former directors (Audited information)

The Committee used its discretion and determined both the former Chief Executive David Stewart and former Deputy Chief Executive Colin Franklin to be eligible to receive a payment under the 2014-2016 LTIP pro rata to their period of employment with the Society. These payments are reflected in the table below. In 2016, Colin Franklin received a fee of £25,000 in relation to his role as Chairman of the pension trustees for the Society's defined benefit pension scheme.

Feike Brouwers resigned as an executive director on 31 March 2015. He continued in the role of Chief Risk Officer as an employee and commenced garden leave from 30 April 2015. Loss of office includes remuneration to the end of his garden leave (9 August 2015). All amounts relating to future annual Success Share bonus and LTIPs were forfeited.

Single total figure of remuneration for each former executive director

Audited information	Base salary £000	Taxable benefit £000	Pension allowance £000	Annual Success Share bonus £000	LTIP £000	Loss of office £000	Total £000
2016							
David Stewart[1]	–	–	–	–	9	–	9
Colin Franklin[2]	–	–	–	–	29	–	29
Total	–	–	–	–	38	–	38
2015							
David Stewart[1]	–	–	–	–	65	–	65
Colin Franklin[2]	–	–	–	–	47	–	47
Feike Brouwers	87	3	8	–	–	73	171
Remuneration as a director	64	2	6	–	–	–	72
Remuneration as an employee	23	1	2	–	–	73	99
Total	87	3	8	–	112	73	283

1. David Stewart's LTIP payments relate to the date up to which he ceased to be a director – 31 March 2014.
2. Colin Franklin's LTIP payments relate to the date up to which he ceased to be an employee – 15 June 2015.

There were no other payments made to former directors in relation to past service during the financial year ending 31 December 2016.

Recruitment remuneration

No new executive director was recruited during 2016.

Change in remuneration of director undertaking the role of Chief Executive

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

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

Relative importance of spend on pay

The following table sets out the percentage change in profit and overall spend on remuneration in the year ended 31 December 2016, compared with the year ended 31 December 2015:

	2016 £m	2015 £m	Percentage change %
Profit after tax	182.4	171.3	6.5
Employee remuneration costs	67.6	61.6	9.7

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

Total remuneration earned by each non-executive directors

	Base fees		Committee Chair fees		Taxable benefits		Total fees and taxable benefits	
Audited information	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000	2016 £000	2015 £000
Non-executive directors:								
Ian Pickering (Chairman)	141	136	–	–	6	6	147	142
Janet Ashdown	48	46	–	–	4	2	52	48
Peter Ayliffe (Deputy Chairman – from 29.4.16)	48	46	4	–	3	3	55	49
Bridget Blow (retired 28.4.16)	16	46	2	17	–	–	18	63
Roger Burnell (Chairman of the Board Risk Committee, Chairman of the Board Audit Committee – from 1.10.16, and Senior Independent Director – from 1.1.16)	48	46	22	13	–	–	70	59
Catherine Doran (appointed on 1.8.16)	20	n/a	–	n/a	1	n/a	21	n/a
Ian Geden (Chairman of the Remuneration Committee – from 1.1.16)	48	46	11	–	3	2	62	48
Alasdair Lenman (appointed on 1.11.16)	8	n/a	–	n/a	–	n/a	8	n/a
Glyn Smith (Chairman of the Board Audit Committee and Models and Ratings Committee – resigned 30.9.16)	36	46	18	23	5	5	59	74
Total	413	412	57	53	22	18	492	483

Directors' Remuneration Report cont.

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

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

The fees for non-executive directors were increased from January 2016. The table below sets out the fee levels for non-executive director roles which were in effect during the year compared with the previous year. Non-executive director fees are made up of a base fee, plus a Committee Chair fee as appropriate. The Chairman does not receive additional fees for roles carried out other than that of Chairman.

Non-executive director fees	2016 £000	2015 £000
Chairman	141	136
Base fee	48	46
Deputy Chairman	6	6
Remuneration Committee Chairman	11	10
Board Audit Committee Chairman	13	13
Board Risk Committee Chairman	13	13
Models and Ratings Committee Chairman	11	10
Senior Independent Director (if different from Deputy Chairman)	6	6

The fees for non-executive directors will be reviewed during 2017 and any increase backdated to 1 January 2017.

Taxable benefits

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

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

Details of the Remuneration Committee

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

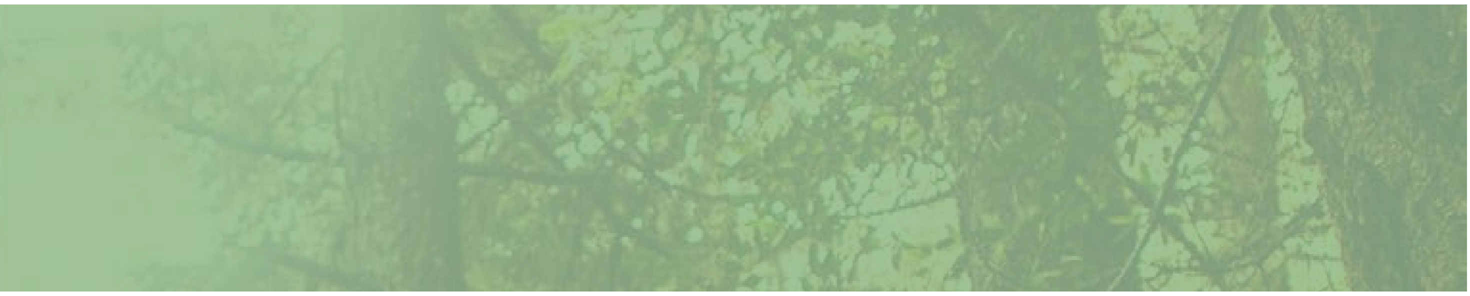
Ian Geden (Chairman of the Committee from 1 January 2016)
Janet Ashdown
Bridget Blow (until 28 April 2016)
Catherine Doran (from 1 August 2016)
Ian Pickering

The Remuneration Committee has delegated authority from the Board to:

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

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

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



Details of the Non-Executive Directors' Remuneration Committee

The members of the Committee are:

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

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

Non-executive directors do not participate in the Society's variable pay schemes.

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

Remuneration Committee advisors and fees

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

Deloitte LLP (Deloitte) was appointed by the Committee and is retained to provide independent advice to the Committee as required. Deloitte is a founding member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. As well as advising the Remuneration Committee, Deloitte also provided tax, internal audit, risk, liquidity and pension audit services to the Society during the year. The Committee is satisfied that the advice received is objective and independent and services provided by Deloitte are reviewed annually to ensure this continues to be the case. Deloitte's fees for providing advice to the Committee amounted to £56,400, (including VAT) for the year ended 31 December 2016.

Directors' Report

The directors have pleasure in presenting their Annual Report & Accounts for the year ended 31 December 2016.

Business objectives, future developments and key performance indicators

The Society's objectives and future plans are set out in the Strategic Report on pages 2 to 62 together with the Society's principal key performance indicators. The Strategic Report is included by reference within this Directors' Report.

Profit and capital

Profit before tax for the year ended 31 December 2016 was £239.1 million (2015: £216.0 million). The profit after tax transferred to the general reserve was £182.4 million (2015: £171.3 million).

Total Group reserves and equity at 31 December 2016 were £1,821.3 million (2015: £1,651.5 million). Further details on the movements on reserves and equity are given in the Group Statement of Changes in Members' Interests and Equity (page 104).

Gross capital at 31 December 2016 was £1,888.4 million (2015: £1,871.3 million), including £25.5 million (2015: £58.2 million) of subordinated debt, £41.6 million (2015: £161.6 million) of subscribed capital and £396.9 million (2015: £396.9 million) of Perpetual Capital Securities. The ratio of gross capital as a percentage of savings and borrowings at 31 December 2016 was 5.28% (2015: 5.90%) and the free capital ratio was 5.11% (2015: 5.77%). The Annual Business Statement gives an explanation of these ratios (see page 144).

Mortgage arrears

At 31 December 2016, there were 117 mortgage accounts more than 12 months in arrears (including those in possession) (2015: 141). The balance on these accounts totalled £17.0 million (2015: £21.3 million) and the value of these arrears was £1.2 million (2015: £1.9 million) or 0.004% (2015: 0.006%) of total mortgage balances. The mortgage arrears methodology is based on the Council of Mortgage Lenders' definition, which calculates months in arrears by dividing the arrears balance outstanding by the latest contractual payment.

Charitable and political donations

The Board approved donations of £1.4 million (2015: £1.9 million) to charitable organisations during the year. This included an amount of £1.3 million (2015: £1.7 million) to The Royal British Legion's Poppy Appeal and £70,000 (2015: £60,000) to the Coventry Building Society Charitable Foundation. In 2015 £140,000 was also donated to Cancer Research UK from the Society's Race for Life Bond.

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

Creditor payment policy

The Society's policy is to agree the terms of payment at the start of trading with suppliers and to pay in accordance with its contractual and other legal obligations. The Society's creditor days were 17 days as at 31 December 2016 (2015: 14 days).

Country-by-country reporting

The nature of activities of the Society are set out in the Strategic Report and for each of the Society's subsidiaries in note 18 to the accounts. All of the activities of the Society and its subsidiaries are conducted in the United Kingdom, and therefore 100% of the total income, profit before tax and tax shown in the Income Statement, as well as employee figures disclosed in note 10 to the accounts, are related to the United Kingdom. The Society and its subsidiaries have not received any public subsidies.

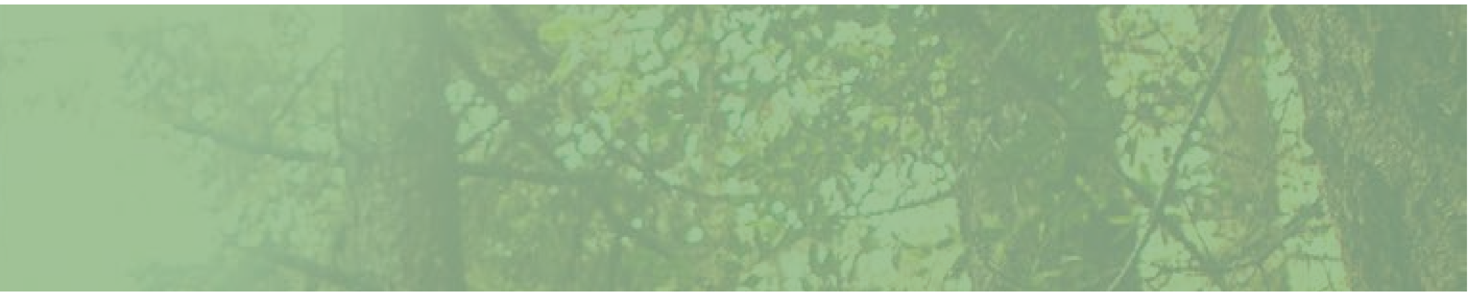
Risk management

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market, liquidity and funding, conduct, operational and business risk. The Group seeks to manage all the risks that arise from its activities and has established a number of committees and policies to do so. Details of these are set out in the Risk Management Report (pages 22 to 62) and the Directors' Report on Corporate Governance (pages 67 to 73).

Employees

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

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



The Society has invested significantly in developing its employees, and has a framework of training initiatives that provide career advancement and personal development opportunities at all levels of the organisation. It is committed to equal opportunities and encouraging diversity and fostering inclusion, and has policies in place to support the aspirations of applicants and employees, whatever their personal characteristics. Additional support is given to those who need it; for example, if someone has a disability the Society makes appropriate adjustments during the recruitment process so that they have an equal opportunity to perform to the best of their ability. Similarly, if someone becomes disabled during their employment with the Society, it will support them according to their individual needs, which may include retraining and redeployment.

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

For further information see the employees section (page 20) of the Corporate Responsibility Report.

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

The following statement, which should be read in conjunction with the statement of the auditor's responsibilities on page 100, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Directors' Remuneration Report, the Annual Business Statement and this Directors' Report.

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

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

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

- Select suitable accounting policies and apply them consistently.
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
- State whether they have been prepared in accordance with IFRS as adopted by the EU.
- Prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Group and Society will continue in business.

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

Directors' responsibilities in respect of accounting records and internal control

The directors are responsible for ensuring that the Group:

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

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

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

Directors' Report **cont.**

Directors' statement pursuant to the Disclosure and Transparency Rules

As required by the Disclosure and Transparency Rules of the Financial Conduct Authority, the directors have included a management report containing a fair review of the business and a description of the principal risks and uncertainties facing the Group. This information is contained principally in the Strategic Report (pages 2 to 62).

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

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

Directors' statement pursuant to the UK Corporate Governance Code

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

Details of the governance procedures which have been implemented to support this can be found on page 76 of the Board Audit Committee Report.

Directors' responsibilities in respect of going concern

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

The Society's business activities, together with the factors likely to affect its future development, performance, position, liquidity and capital structure are set out in the Strategic Report (pages 2 to 62). In addition the Risk Management Report includes further information on the Society's objectives, policies and processes for managing its exposure to credit, market, liquidity and funding, conduct, operational and business risks, along with details of its financial instruments and hedging activities.

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

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

Long term viability statement

In accordance with provision C.2.2 of the 2014 revision of the UK Corporate Governance Code, the directors have assessed the prospects of the Society over a longer period than the 12 months required by the 'going concern' provision considered above.

This information is included on page 62 of the Risk Management Report.

Directors

The directors who served during the year are set out in the Directors' report on Corporate Governance on pages 67 to 73.

The auditor

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

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

Ian Pickering
Chairman
23 February 2017

Financial Statements

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

For our full glossary please go to page **146**

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

Our opinion on the financial statements

In our opinion:

- the Group's and Society's financial statements ('the financial statements') give a true and fair view of the state of the Group's and Society's affairs as at 31 December 2016 and of the Group's and Society's profit for the year then ended;
- the Group and Society's financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union; and
- the Group and Society's financial statements have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the International Accounting Standards (IAS) Regulation.

What we have audited

Coventry Building Society's financial statements comprise:

Group	Society
Consolidated Statement of Financial Position as at 31 December 2016	Statement of Financial Position as at 31 December 2016
Consolidated Income Statement for the year then ended	Income Statement for the year then ended
Consolidated Statement of Comprehensive Income for the year then ended	Statement of Comprehensive Income for the year then ended
Consolidated Statement of Changes in Members' Interests and Equity for the year then ended	Statement of Changes in Members' Interests and Equity for the year then ended
Consolidated Statement of Cash Flows for the year then ended	Statement of Cash Flows for the year then ended
Related notes 1 to 37 to the financial statements	Related notes 1 to 37 to the financial statements

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Overview of our audit approach

Risks of material misstatement	• Revenue recognition and the risk of management override of internal control in relation to the Effective Interest Rate (EIR) method. • Hedge accounting and related fair value of Level 3 financial instruments. • Measurement of loan impairments relating to retail mortgages.
Audit scope	• We performed an audit of the complete financial information of the Group and Society. • Our Group audit scope included all of the Society's subsidiaries. Our audit did not involve any component teams.
Materiality	• Overall Group materiality of £14.2 million which represents 1% of members' interests and equity (excluding other equity instruments).

Our assessment of risk of material misstatement

We identified the risks of material misstatement described below as those that had the greatest effect on our overall audit strategy, the allocation of resources in the audit and the direction of the efforts of the audit team. In addressing these risks, we have performed the procedures below which were designed in the context of the financial statements as a whole and, consequently, we do not express any opinion on these individual areas.

Risk	Our response to the risk	Key observations communicated to the Board Audit Committee
Revenue recognition and the risk of management override of internal control in relation to EIR		
Interest income on mortgage loans is recognised using the EIR method of accounting. This is particularly important for mortgages with an initial fixed or discount rate period as IFRS requires that interest income is recognised using a constant yield over the estimated life of loans. As key judgements such as the expected life of each loan type and future interest rates change, the present value of these changes is recognised in the Income Statement by the Group.	We tested: • internal controls operated by the Group; • completeness and accuracy of data used in cash flow forecasts on a sample basis from source systems to models. We challenged assumptions on: • the expected lives of loans by comparing them to recent actual redemption behaviours; • future changes in yields to current market data and historical experience of mortgage yields. We performed sensitivity analysis over the EIR models to assess the significance of individual assumptions. We recalculated the EIR asset for a sample of loans and agreed the total EIR balance to the general ledger. We performed tests for the risk of management override of controls over the EIR process, including testing of journal entries including manual adjustments in relation to EIR.	The EIR model inputs and assumptions led to an EIR balance at 31 December which is within an acceptable range. We gained assurance from effective controls operated within the Group's processes, and the completeness and accuracy of data used within EIR models. We found that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger. We gained assurance that there was no evidence of management override of controls.
Hedge accounting and related fair value of Level 3 financial instruments		
The Group uses derivative financial instruments to manage its interest rate and foreign currency risk. The Group uses hedge accounting to reduce income statement volatility that would otherwise result from changes in the fair value adjustment of the Group's derivative financial instruments. Hedge accounting is complex and therefore inherently more susceptible to error, which could lead to incorrect measurement of hedge ineffectiveness in the Income Statement. Key judgements used in the valuation methodology for Level 3 hedging instruments include prepayment and mortality assumptions. These are unobservable data points and so present higher valuation risk.	We assessed the compliance of hedge accounting documentation with accounting standards. We tested controls over the valuation of hedging instruments, and engaged our in-house derivative valuation specialists to perform independent valuations for a sample of hedging instruments. We tested the completeness and accuracy of data used in the Level 3 hedging instruments model and challenged the prepayment and mortality assumptions. We tested valuations of hedged items on a sample basis. We tested that sources of ineffectiveness were appropriately identified, leading to appropriate hedge ineffectiveness being recorded in the Income Statement.	We confirmed that the Group's hedge documentation and the valuation of derivatives and hedged items that are within designated hedge relationships, and meet the requirements of the relevant accounting standards. For valuing collateralised derivatives the Group uses discount curves based on OIS rates, whilst for non-collateralised derivatives discount curves based on term LIBOR rates are used. We have gained assurance that the valuation of derivatives are materially correct as at 31 December 2016 through our independent recalculation of a sample of derivatives. As a result of our audit procedures we were satisfied that the Group's hedge accounting, and fair value of the Level 3 hedging instruments, has been fairly presented in the 2016 financial statements. We gained assurance from our testing on the completeness and accuracy of data and prepayment and mortality assumptions within the Level 3 valuation models. We gained assurance from our testing that the appropriate sources and amounts of hedge ineffectiveness have been identified and recorded in the general ledger.

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

Risk	Our response to the risk	Key observations communicated to the Board Audit Committee
Measurement of loan impairments relating to retail mortgages		
The measurement of loan impairments requires judgement about the probability of default, and the likely loss in the event of default. The loss in event of default depends on the value of the secured property, assumptions on forced sale discounts and the costs to sell.	We understood and tested key controls in relation to: • management's updates to assumptions and judgements used within models and overlays; • collective impairment models and the adjustments and overlays that are applied by management; and • impairment provisions in specific cases. Our substantive audit procedures over the collective provision model included assessing, challenging and substantiating the key assumptions, such as: • probabilities of default; • probabilities of possession given default; • collateral valuations; • costs of repossession; and • forced sale discounts. We assessed these assumptions through substantiating to historical data and with reference to our knowledge of the Society's portfolios, including testing for appropriate and accurate data. We tested portfolio data used within collective provision models for completeness of capture and accuracy of extraction from the Society's underlying systems. For a sample of retail mortgages we re-performed management's provision calculation using observed inputs from the Society's mortgage portfolios and external sources such as the Nationwide House Price Index. We tested model overlays for completeness, appropriateness of methodology and accuracy of calculation using our knowledge and experience across the industry.	The Group's impairment models and assumptions have led to adequate provisions for incurred losses being recorded as at 31 December. We note that the balance of the provision has decreased compared to prior year and remains lower than general industry averages due to the Society's conservative lending policies and the small number of customers in arrears. We gained assurance from our testing of the completeness and accuracy of data, review of assumptions and recalculation of individual provision amounts. We were satisfied that the Group had applied its impairment policies on a consistent basis with the prior year and that key assumptions determined by management were appropriate as at the balance sheet date.

In the prior year, our auditor's report included a risk of material misstatement in relation to the fair value adjustments which arose as a result of the merger in 2010 with Stroud & Swindon Building Society. Remaining fair value adjustments are immaterial in 2016, and therefore these matters were addressed in the context of our audit of the financial statements as a whole.

Our application of materiality

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

Materiality

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

We determined materiality for the Group to be £14.2 million (2015: £12.5 million), which is 1% (2015: 1%) of members' interests and equity (excluding other equity instruments). We believe that members' interests and equity (excluding other equity instruments) is an important overall indicator of the financial strength of the Group and we consider members' interests and equity to be an appropriate basis for materiality given the Group focuses on its mutual status above maximisation of profit generation. We exclude other equity instruments from our basis of materiality on the basis that the issuance of £400 million Additional Tier 1 capital securities has not materially changed the business of the Society.

Starting basis	› Total members' interests and equity £1,821.3 million
Adjustments	› Exclude: Other equity Instruments £396.9 million
Materiality	› Total £1,424.4 million › Materiality of £14.2 million (1% of Materiality basis)

Performance materiality

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

On the basis of our risk assessments, together with our assessment of the Group's overall control environment, our judgement was that performance materiality was 75% (2015: 75%) of our planning materiality, namely £10.7 million (2015: £9.4 million). We have set performance materiality at this percentage based upon our recent experience of auditing the Group, from which we concluded that there is a lower expectation of undetected misstatement due to the effective control environment and only minor audit differences resulting from our work. As a result, we determined that the higher of our permissible thresholds for our performance materiality was appropriate.

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

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

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Board Audit Committee that we would report to them all uncorrected audit differences in excess of £0.7 million (2015: £0.6 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

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

Scope of the audit of the financial statements

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

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 93, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Opinion on other matters prescribed by the Building Societies Act 1986

In our opinion:

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

Matters on which we are required to report by exception

ISAs (UK and Ireland) reporting	We are required to report to you if, in our opinion, financial and non-financial information in the Annual Report is: • materially inconsistent with the information in the audited financial statements; or • apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group acquired in the course of performing our audit; or • otherwise misleading. In particular, we are required to report whether we have identified any inconsistencies between our knowledge acquired in the course of performing the audit and the directors' statement that they consider the Annual Report & Accounts taken as a whole is fair, balanced and understandable and provides the information necessary for members to assess the entity's performance, business model and strategy; and whether the Annual Report appropriately addresses those matters that we communicated to the Board Audit Committee that we consider should have been disclosed.	We have no exceptions to report.
Building Societies Act 1986	We are required to report to you if, in our opinion: • proper accounting records have not been kept by the Society; or • the Society financial statements are not in agreement with the accounting records; or • we have not received all the information and explanations and access to documents we require for our audit.	We have no exceptions to report.
UK Corporate Governance Code	The Society prepares a Corporate Governance Statement in accordance with the Disclosure Rules and Transparency Rules of the Financial Conduct Authority and has chosen voluntarily to comply with the Code. We have reviewed, and reported to the Audit Committee on, compliance with the Code in respect of: • the Directors' statements in relation to going concern, set out on page 94, and longer-term viability, set out on page 62; and • the part of the Corporate Governance Statement on page 94 relating to the Company's compliance with the provisions of the UK Corporate Governance Code specified for our review.	We have nothing to report having performed our review.

Statement on the directors' assessment of the principal risks that would threaten the solvency or liquidity of the Society

ISAs (UK and Ireland) reporting	We are required to give a statement as to whether we have anything material to add or to draw attention to in relation to: • the Directors' confirmation in the Annual Report that they have carried out a robust assessment of the principal risks facing the entity, including those that would threaten its business model, future performance, solvency or liquidity; • the disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated; • the Directors' statement in the Annual Report about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and their identification of any material uncertainties to the entity's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements; and • the Directors' explanation in the Annual Report as to how they have assessed the prospects of the entity, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the entity will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.	We have nothing material to add or to draw attention to.

Steven Robb (Senior statutory auditor)
for and on behalf of Ernst & Young LLP,
Statutory Auditor
Leeds
23 February 2017

Income Statements

For the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Interest receivable and similar income	3	907.3	904.0	883.0	795.0
Interest payable and similar charges	4	(522.3)	(540.1)	(598.7)	(533.1)
Net interest income		385.0	363.9	284.3	261.9
Fees and commissions receivable	5	13.3	10.8	11.5	9.1
Fees and commissions payable	6	(8.9)	(6.6)	(7.0)	(5.4)
Other operating income	7	6.1	1.2	5.1	0.4
Net (losses)/gains from derivatives and hedge accounting	8	(1.0)	(0.3)	(1.9)	1.8
Total income		394.5	369.0	292.0	267.8
Administrative expenses	9	(134.5)	(124.5)	(125.2)	(116.2)
Amortisation of intangible assets	20	(9.1)	(7.5)	(9.1)	(7.5)
Depreciation of property, plant and equipment	21	(5.9)	(5.4)	(5.9)	(5.3)
Impairment credit on loans and advances to customers	11, 18	1.5	1.9	1.5	1.6
Provisions for liabilities and charges	27	(6.1)	(15.8)	(5.9)	(15.8)
Charitable donation to Poppy Appeal		(1.3)	(1.7)	(1.3)	(1.7)
Profit before tax		239.1	216.0	146.1	122.9
Taxation	12	(56.7)	(44.7)	(37.9)	(25.9)
Profit for the financial year		182.4	171.3	108.2	97.0

Profit for the financial year arises from continuing operations and is attributable to the members of the Society.

Statements of Comprehensive Income

For the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit for the financial year		182.4	171.3	108.2	97.0
Other comprehensive income					
Items that will not be transferred to the Income Statement:					
Remeasurement of defined benefit pension plan	22	(13.7)	11.1	(13.7)	11.1
Taxation	12	3.8	(2.2)	3.8	(2.2)
Effect of change in corporation tax rate	12	(0.3)	0.6	(0.3)	0.6
Items that may be transferred to the Income Statement:					
Available-for-sale investments:					
Fair value movements taken to reserves		33.5	(18.4)	33.5	(18.4)
Amount transferred to Income Statement	31	(26.7)	21.6	(26.7)	21.6
Taxation	12	(2.8)	–	(2.8)	–
Effect of change in corporation tax rate	12	0.2	–	0.2	–
Cash flow hedges:					
Fair value movements taken to reserves		213.6	(70.8)	144.0	(52.2)
Amount transferred to Income Statement		(198.2)	70.4	(138.7)	48.5
Taxation	12	(4.3)	0.1	(1.4)	0.8
Effect of change in corporation tax rate	12	0.7	(2.7)	0.3	(2.2)
Other comprehensive income for the year, net of tax		5.8	9.7	(1.8)	7.6
Total comprehensive income for the year, net of tax		188.2	181.0	106.4	104.6

The notes on pages 106 to 143 form part of these accounts.

Statements of Financial Position

As at 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Assets					
Cash and balances with the Bank of England	13	3,260.0	2,587.8	3,010.3	2,401.0
Loans and advances to credit institutions	14	213.5	235.8	213.5	235.8
Debt securities	15	1,354.3	1,551.7	1,354.3	1,477.7
Loans and advances to customers	16	32,881.6	29,411.0	21,384.8	19,646.3
Hedge accounting adjustment		144.5	78.1	144.5	78.1
Derivative financial instruments	26	354.2	173.0	256.0	116.3
Investment in equity shares	17	5.9	3.3	5.9	3.3
Investments in group undertakings	18	–	–	11,182.6	9,645.0
Intangible assets	20	32.5	16.3	32.5	16.3
Property, plant and equipment	21	35.7	32.9	35.7	32.9
Investment properties	21	0.2	2.6	–	–
Pension benefit surplus	22	2.5	14.2	2.5	14.2
Deferred tax assets	23	1.9	2.0	–	–
Prepayments and accrued income		9.1	5.7	9.1	5.5
Total assets		38,295.9	34,114.4	37,631.7	33,672.4
Liabilities					
Shares		28,054.3	25,355.8	28,054.3	25,355.8
Deposits from banks	24	2,937.5	1,809.9	2,887.7	1,809.9
Other deposits		7.0	3.0	7.0	3.0
Amounts owed to other customers		819.4	806.5	819.4	806.5
Debt securities in issue	25	3,978.1	3,716.6	3,746.9	3,492.5
Hedge accounting adjustment		158.7	121.0	132.7	86.7
Derivative financial instruments	26	366.7	353.5	366.7	332.8
Current tax liabilities		25.1	18.3	15.7	9.0
Deferred tax liabilities	23	13.7	10.1	9.3	8.2
Accruals and deferred income		28.5	23.6	23.7	19.1
Other liabilities		11.0	16.0	10.6	125.0
Provisions for liabilities and charges	27	7.5	8.8	7.3	8.8
Subordinated liabilities	28	25.5	58.2	25.5	58.2
Subscribed capital	29	41.6	161.6	41.6	161.6
Total liabilities		36,474.6	32,462.9	36,148.4	32,277.1
Members' interests and equity					
General reserve		1,376.1	1,222.3	1,051.2	971.6
Other equity instruments	30	396.9	396.9	396.9	396.9
Available-for-sale reserve	31	6.7	2.5	6.7	2.5
Cash flow hedge reserve		41.6	29.8	28.5	24.3
Total members' interests and equity		1,821.3	1,651.5	1,483.3	1,395.3
Total members' interests, liabilities and equity		38,295.9	34,114.4	37,631.7	33,672.4

The notes on pages 106 to 143 form part of these accounts.

Approved by the Board of directors on 23 February 2017 and signed on its behalf by

Ian Pickering
Chairman

Mark Parsons
Chief Executive

John Lowe
Finance Director

Statements of Changes in Members' Interests and Equity For the year ended 31 December 2016

Group	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2016	1,222.3	396.9	2.5	29.8	1,651.5
Profit for the financial year	182.4	–	–	–	182.4
Net remeasurement of defined benefit plan	(10.2)	–	–	–	(10.2)
Net movement in Available-for-sale reserve	–	–	4.2	–	4.2
Net movement in cash flow hedge reserve	–	–	–	11.8	11.8
Total comprehensive income	172.2	–	4.2	11.8	188.2
Distribution to Additional Tier 1 capital holders*	(18.4)	–	–	–	(18.4)
As at 31 December 2016	1,376.1	396.9	6.7	41.6	1,821.3
As at 1 January 2015	1,061.9	396.9	(0.7)	32.8	1,490.9
Profit for the financial year	171.3	–	–	–	171.3
Net remeasurement of defined benefit plan	9.5	–	–	–	9.5
Net movement in Available-for-sale reserve	–	–	3.2	–	3.2
Net movement in cash flow hedge reserve	–	–	–	(3.0)	(3.0)
Total comprehensive income	180.8	–	3.2	(3.0)	181.0
Distribution to Additional Tier 1 capital holders*	(20.4)	–	–	–	(20.4)
As at 31 December 2015	1,222.3	396.9	2.5	29.8	1,651.5

Society	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2016	971.6	396.9	2.5	24.3	1,395.3
Profit for the financial year	108.2	–	–	–	108.2
Net remeasurement of defined benefit plan	(10.2)	–	–	–	(10.2)
Net movement in Available-for-sale reserve	–	–	4.2	–	4.2
Net movement in cash flow hedge reserve	–	–	–	4.2	4.2
Total comprehensive income	98.0	–	4.2	4.2	106.4
Distribution to Additional Tier 1 capital holders*	(18.4)	–	–	–	(18.4)
As at 31 December 2016	1,051.2	396.9	6.7	28.5	1,483.3
As at 1 January 2015	885.5	396.9	(0.7)	29.4	1,311.1
Profit for the financial year	97.0	–	–	–	97.0
Net remeasurement of defined benefit plan	9.5	–	–	–	9.5
Net movement in Available-for-sale reserve	–	–	3.2	–	3.2
Net movement in cash flow hedge reserve	–	–	–	(5.1)	(5.1)
Total comprehensive income	106.5	–	3.2	(5.1)	104.6
Distribution to Additional Tier 1 capital holders*	(20.4)	–	–	–	(20.4)
As at 31 December 2015	971.6	396.9	2.5	24.3	1,395.3

* The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £7.2 million (2015: £5.2 million).

The notes on pages 106 to 143 form part of these accounts.

Statements of Cash Flows

For the year ended 31 December 2016

	Notes	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash flows from operating activities					
Profit before tax		239.1	216.0	146.1	122.9
Adjustments for:					
Impairment provisions and other provisions	11, 27	4.6	13.9	4.4	14.2
Depreciation and amortisation		15.0	12.9	15.0	12.8
Interest on subordinated liabilities and subscribed capital		11.7	16.4	11.7	16.4
Changes to fair value adjustment of hedged risk		(208.0)	65.7	(147.6)	41.5
Other non-cash movements		13.2	6.3	14.3	7.4
Non-cash items included in profit before tax		(163.5)	115.2	(102.2)	92.3
Loans to credit institutions		15.0	(59.3)	15.1	(55.8)
Loans and advances to customers		(3,469.3)	(2,449.1)	(1,737.4)	(1,628.6)
Prepayments, accrued income and other assets		(16.3)	10.0	(16.5)	9.8
Changes in operating assets		(3,470.6)	(2,498.4)	(1,738.8)	(1,674.6)
Shares		2,696.7	1,942.9	2,696.7	1,942.9
Deposits and other borrowings		1,144.4	680.3	1,094.6	680.3
Debt securities in issue		268.7	(7.3)	268.9	(7.6)
Accruals and deferred income and other liabilities		(7.5)	(19.0)	10.4	6.4
Changes in operating liabilities		4,102.3	2,596.9	4,070.6	2,622.0
Interest paid on subordinated liabilities and subscribed capital		(12.4)	(16.4)	(12.4)	(16.4)
Taxation		(41.7)	(43.1)	(41.7)	(43.1)
Net cash flows from operating activities		653.2	370.2	2,321.6	1,103.1
Cash flows from investing activities					
Purchase of investment securities		(143.6)	(273.4)	(43.5)	(59.2)
Sale and maturity of investment securities and equities		372.1	355.1	198.0	167.9
Proceeds from sale of properties		3.5	3.3	–	0.6
Repurchase of subordinated liabilities and subscribed capital		(152.7)	–	(152.7)	–
Purchase of property, plant and equipment and intangible assets		(34.6)	(20.1)	(34.6)	(20.1)
Net cash flows from investing activities		44.7	64.9	(32.8)	89.2
Cash flows from financing activities					
Loans to connected undertakings		–	–	(1,646.2)	(828.8)
Distribution paid to Additional Tier 1 capital holders		(25.6)	(25.6)	(25.6)	(25.6)
Repurchase and repayment of debt securities		(282.3)	(590.3)	(14.9)	(500.0)
Issue of debt securities		275.0	650.0	–	650.0
Net cash flows from financing activities		(32.9)	34.1	(1,686.7)	(704.4)
Net increase in cash		665.0	469.2	602.1	487.9
Cash and cash equivalents at start of year		2,542.5	2,073.3	2,355.7	1,867.8
Cash and cash equivalents at end of year		3,207.5	2,542.5	2,957.8	2,355.7
Cash and cash equivalents:					
Cash and balances with central banks	13	3,207.5	2,542.5	2,957.8	2,355.7

The notes on pages 106 to 143 form part of these accounts.

Notes to the accounts

1. Accounting policies

Basis of preparation

These accounts have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union; interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC); and with those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to organisations reporting under IFRS.

The accounts have been prepared on an historical cost basis, as modified by the revaluation of Available-for-sale debt securities and certain financial instruments which are measured at fair value. As stated in the Directors' Report, the directors consider that it is appropriate to continue to adopt the going concern basis in preparing the accounts. A summary of the Group's accounting policies is set out below.

Basis of consolidation

The assets, liabilities and results of the Society and its undertakings (the Group), which include subsidiaries and structured entities, are included in the financial statements on the basis of accounts made up to the reporting date.

The Group consolidates another entity from the date on which the Group: (a) has power over the entity; (b) is exposed to, or has the right to, variable returns from its involvement with the entity; and (c) has the ability to affect those returns through the exercise of its powers. The Group reassesses whether it controls an investee if facts and circumstances indicate that there are changes in one or more of these three elements. The Group deconsolidates subsidiaries from the date that control ceases.

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured vehicles are consolidated when the substance of the relationship indicates control. In making this judgement, the Group considers factors such as the purpose and design of the entity, size and exposure to variability of returns. and the nature of the relationship, including power over the structured entity.

The Society's investment in its subsidiaries is recognised in the Statement of Financial Position at cost less any provision for impairment in value. Upon consolidation, intra-group transactions, balances and unrealised gains and losses are eliminated.

Derecognition of financial assets and liabilities

The Group's policy is to derecognise financial assets only when the contractual right to the cash flows from the financial assets expire or where the Group transfers the financial assets to another party, provided the transfer of the assets also transfers the right to receive the cash flows of the financial assets, and the Group has also transferred substantially all the risks and rewards of ownership. Where the transfer does not result in the Group transferring the rights to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised, if the Group has also transferred substantially all the risks and rewards of ownership. There was one transaction in the prior year where financial assets were transferred to a structured entity and were derecognised. For further information see note 19.

The Group derecognises financial liabilities when the obligation is discharged, cancelled or has expired.

Changes in accounting policy

There were no new or amended standards or interpretations that had a significant impact on the preparation of the 2016 financial statements.

Future accounting developments

There are a number of standards, relevant to the Group's future reporting, that were not effective as at 31 December 2016 and have therefore not been applied in preparing these financial statements. Of these the most significant is IFRS 9 *Financial Instruments* which will lead to substantial changes in the accounting for financial instruments. This is described below, along with details of the other standards.

IFRS 9 Financial Instruments

IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement* and will be implemented in the financial statements for the year beginning 1 January 2018. The standard requires changes to the classification and measurement of financial assets and liabilities, the recognition of impairment, and also to hedge accounting.

Classification and measurement

Financial assets will be classified and measured based on the business model under which they are held and the characteristics of their contractual cash flows. Financial assets will be classified as either held at amortised cost, held at fair value through other comprehensive income or held at fair value through profit or loss. The Group's assets have been analysed and, it is expected that there will be a change in classification of some financial assets under IFRS 9; however these changes are not expected to have a significant impact on the financial statements. There are no significant changes to the classification and measurement of financial liabilities under IFRS 9.

Impairment of financial assets

IFRS 9 replaces the existing IAS 39 incurred loss approach with an expected credit loss approach resulting in earlier recognition of credit losses.

The IFRS 9 model has three stages. Entities are required to recognise a 12 month expected loss allowance on initial recognition (stage 1) and a lifetime expected loss allowance where there has been a significant increase in credit risk (stage 2) beyond what was expected at the time the initial assessment was made. The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology and involves quantitative measures such as forward looking probabilities of default that are derived from reasonable and supportable forecast of future economic conditions, as well as from other qualitative factors, and therefore requires significant management judgement. The stage 2 assessment is also supported by an objective 'back stop' measure of arrears. Stage 3 comprises of accounts in default.

These changes are likely to result in an increase in the Group's balance sheet impairment provision for credit losses relating to loans and advances to customers, but this is not expected to be material. The Group is currently developing the models necessary to implement this aspect of the standard, and will provide indicative guidance of the impact in the 2017 Annual Report. The impact on regulatory capital is also likely to be low given the Group uses an Internal Ratings Based approach for the majority of its retail mortgages. The requirement to transfer between stages and to incorporate forward looking information into the expected credit loss calculation is likely to result in impairment charges being more volatile when compared to the current IAS 39 model.

These changes are expected to have a limited impact on the Group's treasury assets due to the high credit rating of the Group's portfolio.

Hedge accounting

The hedge accounting requirements under IFRS 9 are designed to create a stronger link with financial risk management. A separate financial reporting standard will be developed on accounting for dynamic risk management (macro hedge accounting) and IFRS 9 allows the option to continue to apply the existing hedge accounting requirements of IAS 39 until this is implemented. The Group currently envisages taking up the option to continue to apply IAS 39 hedge accounting and therefore hedge accounting policies will be updated when the separate standard is finalised.

Implementation strategy

The Group's implementation strategy is to ensure a high quality proportionate implementation of the standard. Given the more complex modelling involved, changes will be required to governance, controls, models and business processes relating to credit loss provisioning. A period of internal dual reporting is planned in advance of the implementation date.

1. Accounting policies continued

Governance

The Group has an established IFRS 9 implementation programme with formal governance reporting to the Finance Director. Progress is reported regularly to the Board Audit Committee, and the credit loss modelling process has been overseen by the Models and Ratings Committee, which reports into the Retail Credit Risk Committee.

The programme has made good progress during 2016. The majority of the model build is now complete and robust testing of models will commence in early 2017 together with the development of management information and the embedding of business process changes. The required changes to systems and business processes are progressing well. Internal IFRS 9 reporting is then expected to occur throughout the second half of 2017.

The financial impact of IFRS 9 can only be quantified once models and systems allow the Group to provide reliable estimates and the expected impacts will be disclosed no later than in the financial statements for the year ended 31 December 2017.

In addition to IFRS 9, the following standards are relevant to the Group's future reporting and have not been applied in preparing these financial statements as they are not effective as at 31 December 2016:

Pronouncement	Nature of change	Periods beginning on or after
IFRS 15 *Revenue from Contracts with Customers*	IFRS 15 replaces IAS 18 *Revenue* and provides a new model for revenue recognition. Financial instruments are outside the scope of IFRS 15. The Group is currently assessing the impact IFRS 15 will have on its financial statements. However, given the nature of Group's activities it is not currently anticipated that IFRS 15 will have a significant impact for the Group.	1 January 2018
IFRS 16 *Leases*	IFRS 16 was issued in January 2016 and requires operating leases to be capitalised on the Statement of Financial Position as is currently the case for finance leases. The Group is currently assessing the impact that IFRS 16 will have on its financial statements.	1 January 2019 (subject to EU endorsement)

Securitisation and covered bond transactions

The Group has securitised certain mortgage loans by the transfer of the loans to structured entities controlled by the Group. The securitisations enable subsequent issuance of debt to investors, who gain the security of the underlying assets as collateral. The structured entities are fully consolidated into the Group accounts.

The transfers of the mortgage loans to the structured entities are not treated as sales by the transferring entity and are not derecognised. The continued recognition of the mortgage loans on the transferor's own Statement of Financial Position is because it retains the risks and rewards of the mortgage loans through the receipt of substantially all of the profits of the structured entities. For securitisations, in the accounts of the Society, the proceeds received from the transfer of mortgage loans are accounted for as a deemed loan repayable to the structured entity disclosed within other liabilities on the Statement of Financial Position.

For covered bonds the position is different, as the Society itself and not the structured entity issues the covered bonds and then lends the proceeds on back to back terms to the covered bond structured entity. Therefore, in the accounts of the Society, the loan to the structured entity and the consideration for the transfer of mortgage loans are not recognised separately as an additional asset and liability. This avoids the 'grossing up' of the financial statements that would otherwise arise.

The Group has also entered into issuances of debt to be used as collateral for central government schemes or for use in sale and repurchase agreements (repos) and similar transactions. Some or all of the issuances of debt may be retained by the Society (self-issued debt). Investments in self-issued debt and the equivalent deemed loan, together with the related income, expenditure and cash flows, are not recognised in the Society's financial statements. This avoids the 'grossing up' of the financial statements that would otherwise arise.

To manage interest rate risk, the Society enters into derivative transactions with the structured entities, receiving a rate of interest based on the securitised mortgages and paying a rate inherent in the debt issuances. In accordance with IAS 39, these internal derivatives are treated as part of the deemed loan and not separately measured at fair value because the relevant mortgage loans are not derecognised. Cash flows arising from these internal derivatives are accounted for on an accruals basis. All other derivatives relating to securitisations and covered bonds are treated as explained in the derivatives and hedging accounting policy (see pages 112 and 113).

Funding for Lending Scheme

The Society participated in the Funding for Lending Scheme (FLS), which provided Treasury bills in return for eligible collateral including approved mortgage portfolios, self-issued covered bonds and self-issued Residential Mortgage Backed Securities (RMBS). The Treasury bills received are repayable no later than four years from the date of drawing. FLS transactions do not involve the transfer of risk on the pledged collateral and hence fail the derecognition criteria under IAS 39. Therefore, for accounting purposes, the underlying collateral is retained on the Statement of Financial Position and the Treasury bills are not separately recognised.

Interest receivable and interest payable

For instruments measured at amortised cost the Effective Interest Rate (EIR) method is used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense over the relevant period. The EIR is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset.

In calculating the EIR, the Group estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees received and paid and costs borne that are an integral part of the EIR and all other premiums above or below market rates.

Interest income on Available-for-sale debt securities is included in interest receivable and similar income.

Fees and commissions

Fees and commissions receivable and payable that are not spread across expected asset lives under the EIR method are taken to income on an accruals basis as services are provided, or on the completion of an act to which the fee relates.

Taxation including deferred tax

Corporation tax on the profits for the year comprises current and deferred taxation.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the Statement of Financial Position date.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised or liability settled based on the tax rates and laws enacted or substantively enacted at the Statement of Financial Position date. Deferred tax assets and liabilities are offset when there is both a legally enforceable right and intention to settle on a net basis.

Corporation tax is charged or credited directly to the Statement of Comprehensive Income if it relates to items that are credited or charged to the Statement of Comprehensive Income, and to the Statements of Changes in Members' Interests and Equity if it relates to other equity instruments. Otherwise corporation tax is recognised in the Income Statement.

1. Accounting policies continued

Segmental reporting

The Group operates solely within the retail financial services sector and within the United Kingdom. As such, no segmental analysis is required.

Financial assets

The Group classifies its financial assets at inception into the following categories:

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Group's residential mortgage loans, unsecured lending and loans to credit institutions are classified as loans and receivables.

Loans are recognised when the funds are advanced to customers. Loans and receivables are carried at amortised cost using the EIR method less provisions for impairment.

Loans and receivables acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the opening amortised cost for acquired loans and receivables. Fair value adjustments are made to reflect both credit risk and interest yield associated with the acquired loan assets. Any discount between the amount due and the fair value is subsequently recognised in interest receivable and similar income using the EIR method, except for any specific credit impairment provisions which are either utilised against non-performing assets or released to interest receivable and similar income if assumptions around the future asset performance are revised.

Fair value through profit or loss

All derivatives are carried at fair value and are initially recognised at the trade date.

For those derivatives in fair value hedge accounting relationships and for any derivatives not in a hedge accounting relationship, gains and losses arising from changes in the fair values are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy (see pages 112 and 113).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in the Statement of Comprehensive Income as set out in the hedge accounting policy for cash flow hedges (see pages 112 and 113).

Available-for-sale

Available-for-sale assets are non-derivative financial assets that are designated as such or not classified into either of the two categories above. Available-for-sale assets comprise debt securities (e.g. certificates of deposit or government investment securities (gilts)) and investment in equity shares.

Available-for-sale assets are measured at fair value. The fair values of debt securities, in the majority of cases, are based on quoted market prices or prices obtained from market intermediaries. In cases where quoted market prices are not available, discounted cash flow valuations are used.

Investments in equity shares that do not have a quoted market price in an active market and whose value cannot be reliably measured are recognised at cost. This has been the case in respect of the Group's investment in VocaLink Holdings Limited in prior years. Due to the proposed acquisition of VocaLink by MasterCard, a fair value has been determined as at 31 December 2016 (see note 17).

Unrealised gains and losses arising from changes in fair value are recognised directly in the Available–for–sale reserve, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income Statement. Gains and losses arising on the sale of Available-for-sale assets, including any cumulative gains or losses previously recognised in the Available-for-sale reserve, are recognised in the Income Statement.

When a decline in the fair value of an Available-for-sale financial asset has been recognised directly in the Available-for-sale reserve and there is objective evidence that the asset is impaired, the cumulative loss recognised in the Available-for-sale reserve is removed and recognised in the Income Statement.

Impairment of loans and advances to customers

The Group assesses its loans and advances to customers for objective evidence of impairment at each Statement of Financial Position date. An impairment loss is recognised if, and only if, there is a loss event that has occurred after initial recognition and before the Statement of Financial Position date and has a reliably measurable impact on the estimated future cash flows.

Impairment is categorised as either individual impairment (where individual assets have been assessed for loss) or collective impairment (where losses are assessed as being present in a portfolio of loans, but they cannot be attributed to individual accounts). As well as loans that are individually or collectively identified as being impaired, recognition is also made of accounts where forbearance has been exercised and agreement has been reached with customers in financial difficulty to temporarily forgo some element of the payment due, or where other impairment indicators are present.

If there is objective evidence that an impairment loss on loans and advances to customers has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows.

Estimating future cash flows

Future cash flows are based on prudent assumptions about the value of the property representing the underlying security for the mortgage, workout costs that might be incurred in realising the value of the property (i.e. following repossession and sale), the likelihood of repossession and the time it takes to repossess and sell properties.

- All properties being used as security are valued at the outset of the loan and, if a further advance is made during the lifetime of the loan, at the time of the further advance.
- Once the value of the property has been established, the Nationwide Regional House Price Index is used to provide an updated estimate of the property's value, on a quarterly basis. If repossessed a current valuation is professionally undertaken.
- Assumptions are continuously updated to reflect the time taken to sell a repossessed property and the likely discount to the latest property valuation. Typically, the forced sale discount averages 28% of the property value.
- No assumptions are made as to the future value of properties beyond the estimation of a discount for the forced sale that results from a repossession of a mortgaged property.

Individual assessment of impairment

The identification of loans for individual assessment of impairment is via a days-past-due trigger being met or if, in the opinion of management, there is evidence that individually identifiable loans are impaired even if a days-past-due trigger has not yet been met. For example, a small number of customers have been declared bankrupt but continue to make their mortgage repayments as scheduled. These customers can be individually identified and therefore an individual assessment can be made as to the level of potential impairment.

The Group employs various models to assess the level of impairment. These include models to predict roll rates to default, the likelihood of possession given default, shortfalls in property values over loan balances after accounting for expected costs, the effects of forced sale, and updated valuations including via house price indexation. The assumptions in these models capture the differing experience of different mortgage types, and are updated regularly to reflect ongoing experience, with overlays to ensure appropriate judgement is reflected in the final assessment of impairment.

Collective assessment of impairment

A variety of collective impairment assessments have been made against segments of the mortgage book where there is objective evidence of an impairment event impacting that segment, but which cannot be individually attributed, or more generally where there is evidence of an increased risk of credit losses being present but, again, where the risks cannot be individually attributed. Examples of segments where collective assessments of impairment have been conducted include provisions held to collectively address the risk that, in a downturn, issues will emerge that will adversely affect the value and saleability of properties, something that would otherwise be masked in a growing housing market.

Notes to the accounts **cont.**

1. Accounting policies continued

Forbearance impairment assessment

Assessment has also been made of customers who are undergoing some measure of forbearance. Evidence-based results are used to identify potential forbearance indicators, measure the performance of accounts with these indicators and determine the level of impairment provision required.

Use of overlays

Management judgement is used to apply overlays to assumptions in cash flow forecasts. For instance, current point-in-time experience may be for an improvement in a particular roll rate, but if the longer-term view is that the risk remains higher than the short-term backwards looking experience used in the model, an overlay may be applied to reflect forward looking judgement of cash flows. An example is in values applied in the 'probability of possession from default' assumption. An overlay may be applied to the current short term experience of probability of possession to accommodate the fact that the likelihood of possession may increase in the event of an economic slowdown.

Recognition of post-impairment improvement

Impairment provisions are raised as the risk is recognised and measured. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, an appropriate amount of the previously recognised impairment loss is reversed by adjusting the impairment provision. The amount of the reversal is recognised in the Income Statement.

Write-off policy and recognition of post-loss recoveries

When a loan is not collectable, it is written off against the related provision for loan impairment (see note 11). Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are recorded in the Income Statement.

Sale and repurchase agreements

Securities sold subject to a commitment to repurchase them are retained on the Statement of Financial Position when substantially all the risks and rewards of ownership remain within the Group. The counterparty liability is included separately on the Statement of Financial Position, as appropriate. The difference between the sale and repurchase price is accrued over the life of the agreements using the EIR method.

Derivative financial instruments

The Group holds derivative financial instruments to manage the risks associated with its various fixed and capped rate assets, its fixed rate liabilities and its foreign currency transactions. In accordance with legislation and its treasury policy, the Group holds derivative financial instruments only for risk management and not for speculative or trading purposes.

All derivative financial instruments are carried at fair value. Derivatives are principally valued by discounting cash flows using yield curves that are based on observable market data. For collateralised positions the Group uses discount curves based on overnight indexed swap (OIS) rates and for non-collateralised positions the Group uses discount curves based on term LIBOR rates. In measuring fair value, separate adjustments are made for credit risk to the extent not already included in the valuation.

Hedge accounting

All derivatives entered into by the Group are for the purpose of providing an economic hedge. Where the documentation, eligibility and testing criteria set out in IAS 39 are met, the Group uses hedge accounting and designates the hedging derivative as either hedging fair value or cash flow risks.

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement under net (losses)/gains from derivatives and hedge accounting in the period in which the movement occurs together with the change in fair value of the hedged asset or liability that is attributable to the hedged risk (interest rate risk). This also applies if the hedged item is classified as an Available-for-sale financial asset.

Cash flow hedges

Changes in the effective part of any gain or loss on the derivative financial instrument hedging the variability in cash flows of a recognised asset or liability are recognised directly through the Statement of Comprehensive Income in the cash flow hedge reserve. In the periods in which the hedged item affects profit or loss, these changes in value are reclassified to the Income Statement in the line item affected by the hedged item. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. The hedged risks for cash flow hedges are interest rate risk and currency risk (euro to sterling).

Leases and contract purchase agreements

Where the Group enters into a lease that entails taking substantially all the risks and rewards of ownership of an asset, the agreement is treated as a finance lease. The asset is recorded on the Statement of Financial Position within property, plant and equipment and is depreciated over its estimated useful life. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the lease term and its useful life. Future instalments under such leases, net of finance charges, are included within other liabilities. Rentals payable are apportioned between the finance element, which is charged to the Income Statement at a constant annual rate, and the capital element, which reduces the outstanding obligation for future instalments.

All other leases are accounted for as operating leases and payments are charged to administrative expenses on a straight line basis over the period of the lease. Rents receivable are credited to other operating income on a straight line basis over the period of the lease.

Intangible assets

Software development costs and purchased software that is not an integral part of a related hardware purchase are recognised as an intangible asset if it is probable that the asset created will generate future economic benefits. Internally generated intangible assets are primarily related to development costs of internal systems which are capitalised if they satisfy the criteria of IAS 38. Amortisation of such assets is charged to the Income Statement on a straight line basis over the useful life of the asset commencing from the date the assets are ready for use. The useful life of computer software is estimated to be between three and eight years.

Computer software is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where this is the case the asset is written down immediately to the estimated recoverable amount based on a value in use calculation.

Investment properties and property, plant and equipment

Investment property is property held to earn rentals or for capital appreciation or for both, rather than for sale or use in the business. The Group recognises investment properties at cost less accumulated depreciation and any accumulated impairment. The carrying values of investment properties are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment. The carrying values of property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

An asset's carrying value is written down immediately to its recoverable amount if the asset's carrying value is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the net disposal proceeds with the carrying value of the asset and are included within the Income Statement.

Depreciation is provided on a straight line basis over the anticipated useful life of the asset as follows:

Freehold buildings (including investment properties)	Over a period of 50 years
Leasehold buildings	Shorter of remaining term of the lease and useful life
Equipment, fixtures, fittings and vehicles	Three to eight years

Notes to the accounts **cont.**

1. Accounting policies continued

Employee benefits

Pensions

The Group operates a defined benefit pension scheme and a defined contribution scheme for employees.

Contributions to the defined contribution pension scheme are recognised as an expense in the Income Statement as incurred, on an accruals basis.

The Group's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds. This calculation allows the net obligation of the scheme to be expressed as either a surplus or deficit, which is recognised as either an asset or a liability respectively in the Group's accounts at the Statement of Financial Position date. See note 22 for further details.

Gains or losses arising from the remeasurement of the defined benefit plan are recognised in full, in the year they occur, in the Statement of Comprehensive Income.

Other long-term employee benefits

The cost of bonuses payable 12 months or more after the end of the financial years in which they are earned is recognised in the year in which the employees render the related service and when there is an obligation to pay a bonus under the terms of the scheme.

Short-term employee benefits

The cost of short-term employee benefits, including wages and salaries, social security costs, bonuses payable within 12 months and healthcare, is recognised in the year of service.

Financial liabilities

Financial liabilities incorporate shares, bank and other deposits, amounts owed to other customers, debt securities in issue, derivative financial liabilities, subordinated liabilities and subscribed capital. The Group classifies its financial liabilities into the following categories:

Amortised cost

Financial liabilities (other than derivatives) are measured on an amortised cost basis. This represents the face value adjusted for any unamortised premiums, discounts and transaction costs directly attributable to the acquisition or issue. The amortisation is recognised in interest payable and similar charges using the EIR method.

Fair value through profit or loss

All derivatives are carried at fair value.

Gains and losses arising from changes in the fair values are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy (see pages 112 and 113).

For derivatives in cash flow hedge accounting relationships, the gains and losses arising from changes in fair value are initially recognised in the Statement of Comprehensive Income as set out in the hedge accounting policy for cash flow hedges (see page 113).

Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and the amount can be estimated reliably. For the Financial Services Compensation Scheme (FSCS) Levy, a provision is recognised when the levy is legally enforceable, in accordance with IFRIC 21 *Levies*.

Contingent liabilities are potential obligations from past events which shall be confirmed by future events. Contingent liabilities are not recognised within the Statement of Financial Position unless arising from a business combination.

Equity instruments

Issued financial instruments are classified as equity instruments where the contractual arrangements with the holder do not result in the Group having a present obligation to deliver cash, another financial asset or a variable number of equity instruments. Where the Group does have a present obligation the instrument is classified as a financial liability.

The proceeds of the issuance of equity instruments are included in equity. Costs incurred that are incremental and directly attributable to the issuance are deducted from the proceeds (net of applicable tax) and are not amortised.

Distributions to holders of equity instruments are recognised when they become irrevocable and are deducted, net of tax where applicable, from the general reserve.

Foreign currency translation

The consolidated financial statements are presented in pounds sterling, which is the functional currency of the Group.

Foreign currency transactions are translated into sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are retranslated at the rate prevailing at the Statement of Financial Position date. Foreign exchange gains and losses resulting from the retranslation and settlement of these items are recognised in the Income Statement.

Cash and cash equivalents

For the purposes of the statements of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non-restricted balances with central banks and loans and advances to credit institutions.

IFRS disclosure

For ease of reference, certain audited IFRS disclosures are included within the Risk Management Report as follows:

- Credit risk (pages 30 to 40).
- Market risk (pages 41 to 43).
- Liquidity and funding risk (pages 44 to 51).

A maturity analysis for all assets and liabilities is presented in a table, on pages 47 and 48.

Audited information is also included within the Directors' Remuneration Report on pages 86 to 89.

These disclosures, where marked as 'audited', are covered by the Independent Auditor's Report on pages 96 to 101.

2. Judgement in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the accounts. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgement and estimates are disclosed are in the following notes:

Area of significant judgement and estimate	Note
Mortgage EIR	3
Fair value adjustments in respect of acquired assets	3
Impairment provisions on loans and advances to customers	11
Valuation of Level 3 derivatives	34

Further information on key areas of judgement is included in the Board Audit Committee Report on pages 74 and 75.

Notes to the accounts **cont.**

3. Interest receivable and similar income

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
On loans fully secured on residential property	972.4	944.5	573.9	560.1
On other loans				
Connected undertakings	–	–	313.0	299.1
Foreign currency gain/(losses)	–	–	59.3	(21.9)
Other	2.2	2.5	1.5	1.7
	974.6	947.0	947.7	839.0
Interest and other income on debt securities	36.8	38.5	36.7	38.3
Interest and other income on other liquid assets	10.0	9.7	9.4	8.9
Net expense on financial instruments hedging assets	(113.0)	(90.4)	(113.0)	(90.4)
Foreign currency (losses)/gains	(1.1)	(0.8)	2.2	(0.8)
Total	907.3	904.0	883.0	795.0

Included within interest receivable and similar income is interest accrued of £2.6 million (2015: £3.4 million) for the Group and £1.5 million (2015: £2.1 million) for the Society on impaired loans and advances to customers.

Critical accounting estimates and judgements

The Group recognises interest on loans and advances to customers on the basis of their EIR (Effective Interest Rate). This is a constant rate that averages out the effect of incentives and fees across the expected life of the loan account. A critical assumption in the calculation is the expected life, as this determines the assumed period over which customers may be paying various differentiated interest rates. The calculation of the EIR uses assumptions on expected life that are based on the experience of similar products. These assumptions are monitored to ensure their ongoing appropriateness. Changes in the amortised cost balance arising from actual product life experience, differing from the assumed life, are periodically calculated and an adjustment made to the loan balance, with a corresponding adjustment to interest receivable and similar income. An increase in the redemption rate of a loan after the initial incentive period of 5% would result in a decrease in loans and advances to customers of £7.9 million, with a corresponding reduction to income in the Income Statement. Assumptions as to future market interest rates also affect the calculation. A relative decrease in the spread between Bank of England Base Rate and the Society Standard Variable Rate of five basis points per annum over five years would result in a decrease in loans and advances to customers of £7.5 million with a corresponding reduction to income in the Income Statement.

Where assets are acquired as a result of merger or via the purchase of mortgage portfolios, the Society is required to estimate the expected life and associated cash flows of the assets and amortise the fair value adjustments over this period. Similarly, the Society is required to estimate a suitable period to amortise the impact of any transactions where the transaction price differed from fair value. If different assumptions were made then the impact of these adjustments would be recognised over longer or shorter periods. The impact of increasing the length of these assumptions by one year would have reduced profits by £0.3 million.

4. Interest payable and similar charges

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Bank and customer				
Subordinated liabilities	3.9	4.2	3.9	4.2
Other	21.2	20.5	21.2	20.5
Debt securities in issue	122.7	117.1	114.3	110.5
Other borrowed funds				
On shares held by individuals	444.1	453.8	444.1	453.9
On other shares	0.1	0.1	0.1	0.1
On subscribed capital	8.5	12.2	8.5	12.2
On loans from connected undertakings	–	–	3.2	3.9
Net income on financial instruments hedging liabilities	(76.8)	(66.6)	(57.8)	(49.1)
Foreign currency (gains)/losses	(1.4)	(1.2)	61.2	(23.1)
Total	522.3	540.1	598.7	533.1

5. Fees and commissions receivable

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Mortgage related fees	5.2	4.8	3.4	3.1
General insurance commissions	5.8	4.2	5.8	4.2
Other fees and commissions	2.3	1.8	2.3	1.8
Total	13.3	10.8	11.5	9.1

6. Fees and commissions payable

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Banking fees	2.7	2.3	2.6	2.3
Other fees and commissions	6.2	4.3	4.4	3.1
Total	8.9	6.6	7.0	5.4

7. Other operating income

Other operating income of £6.1 million (2015: £1.2 million) for the Group and £5.1 million (2015: £0.4 million) for the Society includes £4.9 million relating to the gain on completion of the acquisition of Visa Europe Limited (Visa Europe) by Visa Inc. (see note 17). The Society has received upfront cash proceeds and preference shares, and will be eligible for future cash consideration in exchange for its share in Visa Europe.

8. Net (losses)/gains from derivatives and hedge accounting

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
(Losses)/gains on derivatives designated as fair value hedges	(52.9)	(1.2)	(44.6)	12.2
Movement in fair value of hedged items attributable to hedged risk	49.8	(1.4)	41.4	(14.8)
	(3.1)	(2.6)	(3.2)	(2.6)
Derivatives designated as cash flow hedges*	2.1	2.3	1.9	1.9
(Losses)/gains on other derivatives	–	–	(0.6)	2.5
Total	(1.0)	(0.3)	(1.9)	1.8

* Represents ineffectiveness on cash flow hedge relationships which will mature over a period of five years.

9. Administrative expenses

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Employee costs				
Wages and salaries	67.6	61.6	67.6	61.6
Social security costs	6.9	6.1	6.9	6.1
Pension costs				
Defined benefit plan (note 22)	(0.6)	(0.1)	(0.6)	(0.1)
Defined contribution plan	4.6	4.4	4.6	4.4
	78.5	72.0	78.5	72.0
Other expenses				
Loss on disposal of property, plant and equipment and intangibles	0.5	0.8	0.5	0.8
Premises and facilities	11.8	11.2	11.8	11.2
Information systems and project costs	17.1	14.2	17.1	14.2
Other	26.6	26.3	17.3	18.0
Total	134.5	124.5	125.2	116.2

The remuneration of the auditor, Ernst & Young LLP, is set out below:

Group and Society	2016 £m	2015 £m
Audit of the annual accounts	0.2	0.2
Audit related assurance services - subsidiary audits	0.1	0.1
Other non-audit services	0.1	–
Total	0.4	0.3

The Group's policy in relation to the use of its auditors on non-audit engagements sets out the nature of services they are generally precluded from performing. Further details on the Society's policy is included within the Board Audit Committee Report on page 78. All non-audit engagements provided by the Group's auditor are subject to pre-approval by either the Board Audit Committee or the Finance Director (on a limited delegated basis from the Board Audit Committee), depending upon the nature of the non-audit engagement.

10. Employee numbers

Group and Society	2016 Full time	2016 Part time	2015 Full time	2015 Part time
The average number of persons employed during the year (including executive directors) was:				
Head office and administrative centres	1,261	365	1,189	324
Branches	326	286	356	277
Total	1,587	651	1,545	601

The average number of employees on a full time equivalent basis was 1,994 (2015: 1,916) and all of these are employed within the United Kingdom.

11. Impairment provisions on loans and advances to customers

Impairment provisions have been deducted from the appropriate asset values on the Statement of Financial Position. The incurred loss element of the fair value adjustments arising from the merger with Stroud & Swindon Building Society in 2010 of £4.1 million (2015: £4.3 million) has been included within the opening and closing provisions in the tables below.

Group	Loans fully secured on residential property 2016 £m	Other loans 2016 £m	Total 2016 £m	Loans fully secured on residential property 2015 £m	Other loans 2015 £m	Total 2015 £m
At 1 January						
Individual impairment	9.4	4.3	13.7	11.7	4.4	16.1
Collective impairment	7.1	0.9	8.0	9.2	0.8	10.0
	16.5	5.2	21.7	20.9	5.2	26.1
(Credit)/charge for the year						
Individual impairment	(1.3)	(0.1)	(1.4)	(0.3)	0.1	(0.2)
Collective impairment	(0.1)	–	(0.1)	(1.8)	0.1	(1.7)
	(1.4)	(0.1)	(1.5)	(2.1)	0.2	(1.9)
Charge/(credit) set against fair value adjustment	0.2	–	0.2	(0.4)	–	(0.4)
Amounts written off	(1.9)	–	(1.9)	(1.9)	(0.2)	(2.1)
At 31 December						
Individual impairment	6.4	4.2	10.6	9.4	4.3	13.7
Collective impairment	7.0	0.9	7.9	7.1	0.9	8.0
Total	13.4	5.1	18.5	16.5	5.2	21.7

Society	Loans fully secured on residential property 2016 £m	Other loans 2016 £m	Total 2016 £m	Loans fully secured on residential property 2015 £m	Other loans 2015 £m	Total 2015 £m
At 1 January						
Individual impairment	4.8	3.8	8.6	6.6	3.9	10.5
Collective impairment	2.9	0.3	3.2	3.9	0.2	4.1
	7.7	4.1	11.8	10.5	4.1	14.6
(Credit)/charge for the year						
Individual impairment	(0.7)	(0.1)	(0.8)	(0.6)	(0.1)	(0.7)
Collective impairment	(0.3)	–	(0.3)	(1.0)	0.1	(0.9)
	(1.0)	(0.1)	(1.1)	(1.6)	–	(1.6)
Credit set against fair value adjustment	–	–	–	(0.1)	–	(0.1)
Amounts written off	(1.2)	0.2	(1.0)	(1.1)	–	(1.1)
At 31 December						
Individual impairment	2.9	3.9	6.8	4.8	3.8	8.6
Collective impairment	2.6	0.3	2.9	2.9	0.3	3.2
Total	5.5	4.2	9.7	7.7	4.1	11.8

When arriving at the impairment provision, the Group has considered accounts with forbearance and other potential impairment indicators. See pages 36 and 37 for further details.

11. Impairment provisions on loans and advances to customers continued

Critical accounting estimates and judgements

In accordance with the accounting policy described in note 1, impairment is measured as the difference between an asset's carrying amount and the present value of management's estimate of discounted future cash flows. Key assumptions include the probability of any account going into default, the probability of defaulting accounts progressing to possession and the eventual loss incurred in the event of forced sale or write-off. These assumptions are based on observable historical data and updated as management considers appropriate to reflect current conditions.

If average regional house prices were to fall by 10%, the estimated impact on the impairment provision would be an increase of £1.1 million, with a corresponding charge in the Income Statement. If the probability of defaulting accounts progressing to possession decreased by 5% the estimated impact on the impairment provision would be a decrease of £0.3 million, with a corresponding credit in the Income Statement.

12. Taxation

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Current tax				
UK corporation tax	56.1	44.1	37.4	25.4
UK corporation tax – adjustment in respect of prior years	–	1.1	–	1.1
Total current tax	56.1	45.2	37.4	26.5
Deferred tax				
Current year	1.7	0.3	1.6	0.2
Adjustment in respect of prior years	(1.1)	(0.8)	(1.1)	(0.8)
Total deferred tax	0.6	(0.5)	0.5	(0.6)
Total	56.7	44.7	37.9	25.9

A detailed reconciliation between tax expense and the accounting profit multiplied by the UK standard corporation tax rate of 20.0% (2015: 20.25%) is as follows:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Profit before tax (PBT)	239.1	216.0	146.1	122.9
Tax at UK standard rate of corporation tax on PBT of 20.0% (2015: 20.25%)	47.8	43.7	29.2	24.9
Recurring items				
Surcharge on banking profits	9.4	–	9.4	–
Expenses not deductible for tax purposes – compensation payments to customers	0.4	0.2	0.4	0.2
Effect of rate change	0.1	0.4	–	0.4
Non-recurring items				
Adjustments in respect of prior years	(1.1)	0.3	(1.1)	0.3
Utilisation of capital losses for which credit not previously recognised	–	(0.1)	–	(0.1)
Other	0.1	0.2	–	0.2
Total	56.7	44.7	37.9	25.9

The Finance (No. 2) Act 2015 introduced legislation to impose a surcharge of 8% on taxable profits in excess of £25 million on banking companies, including building societies, from 1 January 2016. The surcharge only applies to the profits of the Society. As a result of the legislation, a surcharge of £9.4 million is included in the UK corporation tax charge of both the Group and the Society.

The effective tax rate for the year is 23.7% (2015: 20.7%) for the Group and 25.9% (2015: 21.1%) for the Society, which are significantly above the UK standard corporation tax rate of 20% (2015: 20.25%). The main reason for the differences for both the Group and the Society is the £9.4 million surcharge.

The Finance Act 2016 introduced legislation requiring the Society to publish its tax strategy. This will be made available on the Society's website during 2017. The strategy will cover the tax risks faced by the Society and how these risks are managed.

The tax on items reported through the Statements of Comprehensive Income is as follows:

Statements of Comprehensive Income	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Tax (credit)/charge on remeasurement of defined benefit pension plan	(3.8)	2.2	(3.8)	2.2
Tax charge on Available-for-sale movements	2.8	0.9	2.8	0.9
Recognition of capital losses for which credit not previously recognised	–	(0.9)	–	(0.9)
Tax charge/(credit) on cash flow hedges	4.3	(0.1)	1.4	(0.8)
Effect of change in corporation tax rate	(0.6)	2.1	(0.2)	1.6
Total	2.7	4.2	0.2	3.0

The tax on other items reported through the Statements of Changes in Members' Interests and Equity is as follows:

Statements of Changes in Members' Interests and Equity	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Tax credit on Additional Tier 1 capital distribution	(7.2)	(5.2)	(7.2)	(5.2)
Total	(7.2)	(5.2)	(7.2)	(5.2)

Further information relating to deferred tax is presented in note 23.

13. Cash and balances with the Bank of England

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Cash and balances with the Bank of England other than mandatory reserve deposits	3,207.5	2,542.5	2,957.8	2,355.7
Mandatory reserve with the Bank of England	52.5	45.3	52.5	45.3
Total	3,260.0	2,587.8	3,010.3	2,401.0

The £2,935.8 million (2015: £2,343.6 million) cash and balances with the Bank of England included in the Group liquidity resources table on page 45 excludes the £52.5 million (2015: £45.3 million) mandatory reserve with the Bank of England and £271.7 million (2015: £198.9 million) of cash held in accounts other than with the Bank of England (predominantly in the Group's covered bond and RMBS programmes).

14. Loans and advances to credit institutions

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Loans and advances to credit institutions have remaining maturities as follows:				
Accrued interest	–	0.1	–	0.1
Repayable on demand	213.5	235.7	213.5	235.7
Total	213.5	235.8	213.5	235.8

The Group liquidity resources table on page 45 excludes the above £213.5 million (2015: £235.8 million) held in collateral accounts with counterparties relating to interest rate swap agreements and sale and repurchase transactions.

15. Debt securities

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Available-for-sale:				
UK Government investment securities	1,328.9	1,432.8	1,328.9	1,358.8
Other listed transferable debt securities	25.4	118.9	25.4	118.9
Total	1,354.3	1,551.7	1,354.3	1,477.7
Movements during the year are analysed below:				
At 1 January	1,551.7	1,655.2	1,477.7	1,608.2
Additions	143.6	273.4	43.5	59.2
Maturities and disposals	(368.3)	(355.1)	(194.2)	(167.9)
Changes in fair value	27.3	(21.8)	27.3	(21.8)
At 31 December	1,354.3	1,551.7	1,354.3	1,477.7

A maturity analysis of the Group debt securities is included in a table on pages 47 and 48.

Pledged assets (Encumbrance) – Sale and repurchase transactions of debt securities

As part of its liquidity management, the Group enters into sale and repurchase agreements, whereby the Group sells but agrees to repurchase assets at a future date. UK Government investment securities have been sold under sale and repurchase agreements. These assets have not been derecognised as the Group has retained substantially all the risks and rewards of ownership. The Group is unable to use, sell or pledge the transferred assets for the duration of the transaction and remains exposed to any associated interest rate risk and credit risk of the assets. The sale and repurchase agreements are included within deposits from banks (see note 24).

	Pledged 2016 £m	Proceeds 2016 £m	Pledged 2015 £m	Proceeds 2015 £m
Available-for-sale:				
UK Government investment securities	1,328.9	1,320.8	850.1	851.1

The £25.4 million (2015: £627.6 million) of on-balance sheet debt securities included in the Group liquidity resources table on page 45 excludes £1,328.9 million (2015: £850.1 million) of pledged assets and £nil (2015: £74.0 million) held by the Group's covered bond and RMBS programmes as neither of these is available for use in the Group's day-to-day activities.

Although not included on the Statement of Financial Position, the Group has received FLS Treasury bills with a market value of £2,398.6 million (2015: £2,045.5 million). Subsequently, Treasury bills with a market value of £1,255.8 million (2015: £903.3 million) were pledged as part of sale and repurchase agreements for proceeds of £1,249.2 million (2015: £899.2 million) included in deposits from banks (see note 24).

Again, although not included on the Statement of Financial Position, the Group has received UK Government investment securities with a market value of £19.2 million (2015: £24.2 million) pledged by counterparties under interest rate swap agreements.

16. Loans and advances to customers

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Residential				
Owner-occupier mortgages	20,089.4	18,395.4	19,505.9	17,726.2
Buy to let mortgages	12,416.7	10,588.2	1,723.3	1,739.3
Near-prime mortgages	87.5	94.6	4.9	6.2
Self-certification mortgages	252.0	289.9	128.2	148.0
Other				
Commercial mortgages	2.8	3.8	0.6	0.7
Unsecured personal loans	33.2	39.1	21.9	25.9
Total	32,881.6	29,411.0	21,384.8	19,646.3

Maturity analysis

The remaining maturity of loans and advances to customers at the Statement of Financial Position date is as follows:

	Note	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
In not more than one year		2,493.3	2,294.2	1,553.9	1,485.8
In more than one year		30,406.8	27,138.5	19,840.6	18,172.3
		32,900.1	29,432.7	21,394.5	19,658.1
Impairment provision	11	(18.5)	(21.7)	(9.7)	(11.8)
Total		32,881.6	29,411.0	21,384.8	19,646.3

The maturity analysis is based on contractual maturity, not actual redemption levels experienced by the Group or Society.

Pledged assets – Loans and advances to customers

Certain loans and advances to customers have been pledged to the Group's asset backed funding programmes or utilised as whole mortgage loan pools with the Bank of England. The programmes have enabled the Group to obtain secured funding.

Loans and advances to customers pledged to support the programmes and the FLS, and the notes in issue are as follows:

		Notes in issue*			
2016	Mortgages pledged £m	Held by third parties £m	Held by the Group drawn £m	Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bond programme	4,872.7	1,847.8	1,400.0	–	3,247.8
Securitisation programme – Mercia No.1 plc	1,084.0	–	973.6	–	973.6
Securitisation programme – Offa No.1 plc	390.6	231.2	–	128.7	359.9
Whole mortgage loan pools**	3,602.1	–	1,010.1	2,592.1	3,602.2
Total	9,949.4	2,079.0	3,383.7	2,720.8	8,183.5

* Notes in issue exclude Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.

** The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under FLS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

16. Loans and advances to customers continued

2015	Mortgages pledged £m	Notes in issue* Held by third parties £m	Held by the Group drawn £m	Held by the Group undrawn £m	Total £m
Loans and advances to customers					
Covered bond programme	4,461.7	1,787.4	1,400.0	–	3,187.4
Securitisation programme – Leofric No.1 plc	424.4	224.1	–	37.5	261.6
Securitisation programme – Mercia No.1 plc	1,526.1	–	1,271.5	164.9	1,436.4
Whole mortgage loan pools**	3,385.7	–	–	3,385.7	3,385.7
Total	9,797.9	2,011.5	2,671.5	3,588.1	8,271.1

* Notes in issue exclude Z securitisation notes representing the first loss piece in the structure. All Class Z notes are held by the Group undrawn.
** The whole mortgage loan pools are pre-positioned at the Bank of England. Pools are pledged to the Bank of England when drawings are made directly against the eligible collateral, for example under FLS, subject to a 'haircut' as defined by the Bank of England. The amounts under notes in issue are the outstanding balances of mortgages.

Mortgages pledged are not derecognised from the Group or Society Statements of Financial Position as the Group has retained substantially all the risk and rewards of ownership. No gain or loss has been recognised on pledging the mortgages to the programmes.

Notes in issue and held by third parties are included within debt securities in issue (note 25).

Notes in issue, held by the Group and drawn include debt securities issued by the covered bond programme to the Society and those issued by the Mercia and Offa securitisation programmes, pledged as collateral.

Notes in issue, held by the Group and undrawn are other debt securities issued by the programmes to the Society, and mortgage loan pools that have been pre-positioned at the Bank of England but not utilised. These are held to provide collateral for potential future use in sale and repurchase agreements or central bank operations.

Notes in issue, and held by the Group are not recognised on the Group or Society Statements of Financial Position, thus preventing inappropriate grossing up of the Group and Society Statements of Financial Position.

Covered bonds

The Group established Coventry Building Society Covered Bonds LLP (LLP) in July 2008, initially in order to provide security for issues of self-issued covered bonds and subsequently for external issuances. As at 31 December 2016, the Society had in issue £2,800.0 million (2015: £2,800.0 million) and €500.0 million (2015: €500.0 million) of covered bonds; of which £1,400.0 million (2015: £1,400.0 million) was retained by the Group. In January 2017, the Society issued a further €500 million of covered bonds.

At the reporting date, the Society has overcollateralised the LLP as set out in the table above to secure the ratings of the covered bonds and to provide operational flexibility. As at 31 December 2016, the overcollateralisation includes additional mortgages pledged in anticipation of the €500 million covered bond subsequently issued in January 2017. From time to time, the obligation of the Society to provide collateral may increase due to the formal requirements of the programme and the value of the collateral would depend upon conditions at that time. The Society may also voluntarily contribute collateral to support the covered bond ratings, no such contributions were made during 2016 (2015: £nil).

During the period, the Society voluntarily repurchased £283.4 million (2015: £244.4 million) of mortgages from the LLP to maintain the quality of the pool and minimise the overcollateralisation requirement.

Securitisation – Leofric No.1 plc

Leofric No.1 plc (Leofric) was incorporated in November 2011. In May 2012, Leofric issued £933.5 million of listed debt securities secured against certain loans of the Society and its subsidiary Godiva Mortgages Limited, of which £133.5 million was retained by the Group. Under the terms of the securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme. The Group's obligations in respect of the Leofric securitisation vehicle were limited to transferring cash flows from the underlying assets.

The Leofric debt securities in issue were subject to a step-up and optional call date as at 28 November 2016. On that day, the Society and Godiva Mortgages Limited repurchased all £346.9 million of the remaining pledged mortgages from Leofric and Leofric then used the proceeds to repay all £169.0 million of debt securities in issue together with £215.5 million of Class Z notes held by the Group.

Securitisation – Mercia No.1 plc

Mercia No.1 plc (Mercia) was incorporated in October 2012 and in December 2012 Mercia issued £1,436.4 million of listed debt securities, all of which were retained by the Group. The Group's obligations in respect of the Mercia securitisation vehicle are limited to transferring cash flows from the underlying assets.

In March 2016, Godiva Mortgages Limited repurchased £462.8 million of the mortgages from Mercia and Mercia used the proceeds to reduce notes in issue by this same amount. As at 31 December 2016, listed debt securities totalled £973.6 million (2015: £1,436.4 million).

Securitisation – Offa No. 1 plc

Offa No. 1 plc (Offa) was incorporated in February 2016 and in March 2016 Offa issued £427.5 million of listed debt securities secured against certain loans of Godiva Mortgages Limited, of which £152.5 million was held by the Group. The Group's obligations in respect of the Offa securitisation vehicle are limited to transferring cash flows from the underlying assets.

Under the terms of the securitisation programme, the nominal amount of the debt securities is paid down to match the payment profile of the mortgages pledged to the programme. As at 31 December 2016, the nominal value of listed debt securities in issue had fallen to £360.3 million, of which £128.7 million was held by the Group.

The fair value of assets that have been pledged and their associated liabilities where recourse is limited to the underlying asset are presented in the table below:

	Fair value assets pledged 2016 £m	Fair value liabilities 2016 £m	Fair value net position 2016 £m	Fair value assets pledged 2015 £m	Fair value liabilities 2015 £m	Fair value net position 2015 £m
Securitisation programme – Leofric No.1 plc	–	–	–	424.4	264.4	160.0
Securitisation programme – Offa No. 1 plc	390.6	233.4	157.2	–	–	–

The above table excludes the Mercia securitisation programme as all the notes issued were retained by the Society.

17. Investments in equity shares

The investments in equity shares are in respect of Visa Inc. preference shares and VocaLink Holdings Limited ordinary shares.

In November 2015, Visa Inc. announced the proposed acquisition of Visa Europe to create a single global payments business under the Visa brand and the transaction completed in June 2016. In exchange for its single ordinary share in Visa Europe, the Society received upfront consideration in the form of cash (£3.8 million) and Visa Inc. preference shares, initially valued at £1.1 million. The upfront consideration of £4.9 million is included in Other operating income. The preference shares are convertible into Class A common stock of Visa Inc. at a future date subject to conditions including that the conversion rate may be reduced to cover certain litigation costs (primarily concerning the setting of interchange fees).

At 31 December 2016, the Visa Inc. preference shares have been recognised at a fair value of £1.4 million. In addition, the Society may receive deferred cash consideration in 2020 which is contingent on certain performance thresholds being met. A fair value of nil has been recognised for the deferred cash consideration. At 31 December 2015, the Visa Europe share was recognised at a fair value of £3.3 million.

Notes to the accounts **cont.**

17. Investments in equity shares continued

In July 2016, MasterCard announced the proposed acquisition of VocaLink Holdings Limited (VocaLink). In exchange for 90% of its VocaLink shares, the Society will receive upfront cash consideration. The Society will also receive a put option to sell its remaining 10% of VocaLink shares at three or five years from completion and MasterCard will have a call option at five years. In addition, the Society may receive deferred cash consideration in 2019 which is contingent on certain performance thresholds being met.

In accordance with its Available-for-sale accounting policy, the Society previously recognised its investment in VocaLink at cost (£0.1 million) as it did not have a quoted market price in an active market, and could not otherwise be reliably measured. At 31 December 2016, the shares have been recognised at a fair value of £4.5 million. A fair value of nil has been recognised for the deferred cash consideration. On completion of the transaction, the Society expects to recognise a gain in the Income Statement based on the upfront proceeds and a fair value for the deferred cash consideration at that time. Subject to regulatory approval, completion is currently expected to occur during 2017.

18. Investments in group undertakings

Society	Shares £m	Loans £m	Total £m
At 1 January 2016	8.0	9,637.0	9,645.0
Additions	–	1,537.2	1,537.2
Impairment credit	–	0.4	0.4
At 31 December 2016	8.0	11,174.6	11,182.6

The Society has the following consolidated subsidiary undertakings, all of which operate in the United Kingdom and are wholly owned by Coventry Building Society:

Subsidiary undertakings	Principal activity
Godiva Mortgages Limited	Mortgage lending
ITL Mortgages Limited	Mortgage lending and mortgage acquisition vehicle
Five Valleys Property Company Limited	Investment properties holding company
Coventry Financial Services Limited	Non-trading
Coventry Property Services Limited	Non-trading
Godiva Financial Services Limited	Non-trading
Godiva Housing Developments Limited	Non-trading
Godiva Savings Limited	Non-trading
Godiva Securities and Investments Limited	Non-trading

A structured entity is an entity in which voting or similar rights are not the dominant factor in deciding control. Structured entities are consolidated when the substance of the relationship indicates control in accordance with the accounting policy set out in note 1. The following structured entities are consolidated:

Consolidated structured entities	Principal activity
Coventry Building Society Covered Bond LLP	Mortgage acquisition and guarantor of covered bonds
Leofric No.1 plc	Funding vehicle
Mercia No.1 plc	Funding vehicle
Offa No. 1 plc	Funding vehicle

The nature and risks associated with the Society's investments in these entities (including obligations of financial support) are disclosed in note 16.

The registered office for Leofric No. 1 plc, Mercia No. 1 plc and Offa No. 1 plc is 35 Great St. Helen's, London EC3A 6AP, for Godiva Mortgages Limited and Five Valleys Property Company Limited is Oakfield House, Binley Business Park, Binley, Coventry CV3 2TQ and for all of the others is Oakfield House, PO Box 600, Binley Business Park, Coventry, West Midlands CV3 9YR.

19. Interest in unconsolidated structured entity

The Group completed a whole loan sale of its beneficial interests in £310.0 million of buy to let mortgages originated by its subsidiary Godiva Mortgages Limited to a third party in the final quarter of 2015 but continues to service the loan book.

It was concluded that it was appropriate to derecognise these assets under IAS 39 *Financial Instruments* and that there was no requirement to consolidate the results of the third party who purchased the loan under IFRS 10 *Consolidated Financial Statements*. Further information is included in the 2015 Annual Report & Accounts note 18 on page 118.

The service fee is set on an arms-length basis and on market terms. The fee of £0.7 million (2015: £0.1 million) is included in fees and commission income in the Income Statement.

20. Intangible assets

Group and Society	Externally acquired 2016 £m	Internally developed 2016 £m	Total 2016 £m	Externally acquired 2015 £m	Internally developed 2015 £m	Total 2015 £m
Cost						
At 1 January	9.3	22.6	31.9	7.2	20.8	28.0
Additions	3.5	22.0	25.5	3.8	5.7	9.5
Retirements	(0.7)	(2.1)	(2.8)	(1.7)	(3.9)	(5.6)
At 31 December	12.1	42.5	54.6	9.3	22.6	31.9
Amortisation						
At 1 January	4.7	10.9	15.6	3.8	8.3	12.1
Charge for the year	2.5	6.6	9.1	2.0	5.5	7.5
Retirements	(0.7)	(1.9)	(2.6)	(1.1)	(2.9)	(4.0)
At 31 December	6.5	15.6	22.1	4.7	10.9	15.6
Net book value at 31 December	5.6	26.9	32.5	4.6	11.7	16.3

Intangible assets consist entirely of externally acquired and internally developed software that is not an integral part of a related hardware purchase.

Internally developed assets at 31 December 2016 include £12.1 million (2015: £nil) of assets in course of construction. These assets relate mainly to the Society's investment in new systems platforms to meet the future needs of the business. To the extent that these new systems platforms are not yet ready for use by the business, no amortisation has been charged against these assets.

21. Property, plant and equipment

	Land and buildings				
Group and Society	Freehold £m	Long leasehold £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost					
At 1 January 2016	9.3	6.1	3.4	39.1	57.9
Additions	–	–	–	9.1	9.1
Disposals	–	–	(0.2)	(3.3)	(3.5)
At 31 December 2016	9.3	6.1	3.2	44.9	63.5
Depreciation					
At 1 January 2016	1.8	0.8	2.3	20.1	25.0
Charge for the year	0.1	0.3	–	5.5	5.9
Depreciation on disposals	–	–	(0.2)	(2.9)	(3.1)
At 31 December 2016	1.9	1.1	2.1	22.7	27.8
Net book value at 31 December 2016	7.4	5.0	1.1	22.2	35.7

Notes to the accounts **cont.**

21. Property, plant and equipment continued

Group and Society	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Equipment, fixtures, fittings and vehicles £m	Total £m
Cost					
At 1 January 2015	9.3	3.8	3.4	36.5	53.0
Additions	–	2.3	–	8.3	10.6
Disposals	–	–	–	(5.7)	(5.7)
At 31 December 2015	9.3	6.1	3.4	39.1	57.9
Depreciation					
At 1 January 2015	1.7	0.6	2.3	20.0	24.6
Charge for the year	0.1	0.2	–	5.0	5.3
Depreciation on disposals	–	–	–	(4.9)	(4.9)
At 31 December 2015	1.8	0.8	2.3	20.1	25.0
Net book value at 31 December 2015	7.5	5.3	1.1	19.0	32.9

Disposals relate to assets that were retired during the year.

Equipment, fixtures, fittings and vehicles includes assets held under finance leases as follows:

Group and Society	2016 £m	2015 £m
Net book value	2.6	2.1
Accumulated depreciation	1.2	0.9

The net book value of land and buildings occupied by the Group for its own activities is as follows:

Group and Society	2016 £m	2015 £m
At 31 December	13.2	13.7

Investment properties

Group	2016 £m	2015 £m
Cost		
At 1 January	2.8	5.6
Additions	–	–
Disposals	(2.6)	(2.8)
At 31 December	0.2	2.8
Depreciation		
At 1 January	0.2	0.4
Charge for the year	–	0.1
Depreciation on disposals	(0.2)	(0.3)
At 31 December	–	0.2
Net book value at 31 December	0.2	2.6

The fair value of the investment properties held by the Group as at 31 December 2016 was £0.2 million (2015: £3.6 million).

During the year, the Group disposed of 18 investment properties (2015: 17) with a carrying value of £2.4 million (2015: £2.5 million) for proceeds of £3.5 million (2015: £3.3 million). The net gain of £1.1 million (2015: £0.8 million) is disclosed in other operating income.

22. Pension scheme

The Society operates a funded defined benefit and a defined contribution pension scheme.

The Coventry Building Society defined benefit pension scheme (the Fund) is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are required to act in the best interest of the plan's beneficiaries. The appointment of the trustees is determined by the plan's trust documentation. It is policy that one third of all trustees should be nominated by the members of the pension fund. As at 31 December 2014, the date of the last full actuarial valuation, 1,833 current employees, former employees and former executive directors were members of the Fund.

The Fund is subject to the funding legislation outlined in the Pensions Act 2004 which came into force on 30 December 2005. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, set out the framework for funding defined benefit occupational pension plans in the UK.

The Fund typically exposes the Society to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the Statement of Financial Position and may give rise to increased charges in future periods. This effect would be partially offset by an increase in the value of the plan's bond and liability matching holdings. Additionally, caps on inflationary increases are in place to protect the plan against extreme inflation.

The pension scheme assets are predominantly invested in Liability Matching Funds (LMFs). These are leveraged pooled funds that are used to help manage interest rate and inflation risk. The investment policy of the LMFs can be summarised as follows:

- Each LMF relates to a single named benchmark gilt – the Fund holds units in the 2027, 2032, 2040, 2050 and 2062 index-linked gilt LMFs and the 2040, 2052 and 2060 fixed interest gilt LMFs.
- The LMFs will principally hold a combination of gilt sale and repurchase agreements (repos), gilt total return swaps and physical gilts.
- The fund manager will manage leverage (the amount of underlying cash and gilt collateral being held to support the derivative exposure) within the funds, aiming to keep the leverage of each individual fund within a particular range. If leverage increases too much then the manager will ask the Fund to pay in additional capital, and if leverage falls too low the manager will return capital to the Fund in order to increase the leverage.
- The fund manager aims to limit the exposure to each counterparty to 30% of each LMF's overall exposure.

For the purposes of IAS 19 *Employee Benefits (Revised)* the actuarial valuation as at 31 December 2014, which was carried out by a qualified independent actuary, has been updated on an approximate basis to 31 December 2016. There have been no changes in the valuation methodology adopted for this period's disclosures compared with the previous period's disclosures.

IAS 19 allows the Society to recognise a surplus as an asset, reflecting the Society's ability to recover a surplus either through reduced contributions in the future or through refunds from the Fund after the last benefit has been paid.

The cost of the Fund was assessed in accordance with the advice of a qualified actuary on the basis of valuations using the projected unit method. The main assumptions used in the valuations were:

I. An investment return pre-retirement of 0.45% (2015: 1.75%) per annum in excess of projected pre-retirement benefit increase.
II. An investment return post-retirement of -0.4% (2015: 0.85%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued prior to 6 April 2006 and 0.6% (2015: 1.75%) per annum in excess of guaranteed pension increases in respect of pensionable service accrued after 6 April 2006.

A full actuarial valuation was carried out as at 31 December 2014 in accordance with the scheme funding requirements of the Pensions Act 2004 and the funding of the scheme is agreed between the Society and the trustees in line with those requirements. This actuarial valuation showed a deficit of £11.5 million. The Society agreed with the trustees that it would aim to eliminate the deficit by 30 September 2019 by the payment of annual contributions of £1.4 million in respect of the deficit.

Notes to the accounts **cont.**

22. Pension scheme continued

During 2012 the decision was taken to close the pension scheme to future service accrual. Consequently there were no contributions in respect of members' pensionable salaries during 2016 (2015: nil); however the Society contributed £1.4 million in line with the deficit recovery plan. The best estimate of contributions to be paid by the Society to the plan in 2017 is £1.4 million. The Society met and continues to meet the expenses of the plan and levies to the Pension Protection Fund.

The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is then deducted from the fair value of plan assets and the net surplus is presented on the Statement of Financial Position as shown below:

Group and Society	2016 £m	2015 £m
Present value of funded obligation	(211.9)	(169.1)
Fair value of plan assets	214.4	183.3
Funded status/Pension benefit surplus	2.5	14.2

	2016			2015		
	Present value of obligation £m	Fair value of plan assets £m	Total £m	Present value of obligation £m	Fair value of plan assets £m	Total £m
As at 1 January	(169.1)	183.3	14.2	(184.5)	186.1	1.6
Included within administrative expenses:						
Interest (expense)/income	(6.4)	7.0	0.6	(6.6)	6.7	0.1
Included within other comprehensive income:						
Remeasurements:						
Return on plan assets (excluding amounts in the Income Statement)	–	28.2	28.2	–	(6.4)	(6.4)
(Losses)/gains from changes in financial assumptions	(41.9)	–	(41.9)	17.5	–	17.5
	(41.9)	28.2	(13.7)	17.5	(6.4)	11.1
Other contributions and payments:						
Employer contributions	–	1.4	1.4	–	1.4	1.4
Benefit payments	5.5	(5.5)	–	4.5	(4.5)	–
	5.5	(4.1)	1.4	4.5	(3.1)	1.4
As at 31 December	(211.9)	214.4	2.5	(169.1)	183.3	14.2

The major categories of plan assets are:

	Plan assets at 31.12.2016 £m	Plan assets at 31.12.2015 £m
Quoted		
Corporate bonds and liability matching	139.2	114.7
Diversified growth funds	24.5	27.0
Direct lending	7.2	–
Cash	1.7	1.5
Unquoted		
Corporate bonds and liability matching	23.2	22.0
Property	18.6	18.1
Total	214.4	183.3

The principal actuarial assumptions used are as follows:

Weighted average assumptions used to determine benefit obligation at	31.12.2016 %	31.12.2015 %
Discount rate	2.70	3.85
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	3.25	3.10
Rates of inflation (Consumer Price Index)	2.25	2.10

Weighted average assumptions used to determine net pension cost for the year ended	31.12.2016 %	31.12.2015 %
Discount rate	3.85	3.60
Rate of pensionable salary increase	–	–
Rates of inflation (Retail Prices Index)	3.10	3.00
Rates of inflation (Consumer Price Index)	2.10	2.00

	31.12.2016		31.12.2015	
Weighted average life expectancy for mortality tables used to determine benefit obligation at	Male	Female	Male	Female
Member age 60 (current life expectancy)	26.9	29.0	26.8	28.9
Member age 45 (life expectancy at age 60)	28.2	30.5	28.1	30.4

The assumptions on mortality are determined by the actuarial tables known as S2PXA with CMI 2015 projections with a 1.25% per annum long-term improvement rate (2015: S2PXA with CMI 2015 projections with a 1.25% per annum long-term improvement rate).

The Group has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension fund surplus and changes in these assumptions could affect the reported surplus. The sensitivity of the defined benefit obligation to changes in the weighted principal assumptions is:

Impact on present value of obligation:	Change in assumption	Increase in assumption %	Decrease in assumption %
Discount rate	0.25%	(4.9)	5.2
Rates of inflation (Retail Prices Index and Consumer Price Index)	0.25%	4.3	(4.0)
Life expectancy	1 year	3.1	(3.1)

The sensitivities noted above relate to isolated changes in assumptions, in reality it is likely that assumptions will be related to each other and impact simultaneously.

The average duration of the defined benefit obligation at the period ending 31 December 2016 is 22 years.

23. Deferred tax

Deferred tax assets and liabilities are attributable to the following items:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Deferred tax assets				
Transfer of engagements – fair value adjustments	1.9	2.0	–	–
Total	1.9	2.0	–	–
Deferred tax liabilities				
Cash flow hedges	14.2	10.0	9.7	7.9
Defined benefit pension plan surplus	0.6	3.6	0.6	3.6
Transfer of engagements – fair value adjustments	0.2	0.2	0.2	0.2
Investment in equity shares	1.5	0.9	1.5	0.9
Available-for-sale	1.3	–	1.3	–
Excess of depreciation over capital allowances	(3.1)	(3.2)	(3.1)	(3.1)
Provisions	(0.6)	(0.4)	(0.6)	(0.4)
IFRS transitional fair value adjustments	(0.1)	(0.1)	–	–
Capital losses	(0.3)	(0.9)	(0.3)	(0.9)
Total	13.7	10.1	9.3	8.2

The Group considers that sufficient future taxable trading profits will be available to utilise the Group's trading deferred tax assets and the Group has therefore recognised such deferred tax assets where they have arisen.

In respect of carried forward capital losses the Group and Society have recognised a deferred tax asset of £0.3 million (2015: £0.9 million), where it is expected that the losses will be offset against future capital gains. As at 31 December 2016 both the Group and Society had no carried forward capital losses, where no deferred tax asset has been recognised (2015: £1.5 million, Society £1.2 million).

The Finance (No. 2) Act 2015 introduced two reductions to the standard rate of corporation tax to 19% from 1 April 2017 and 18% from 1 April 2020. The Finance Act 2016 introduced a further 1% reduction to the standard rate of corporation tax to apply from 1 April 2020 to 17%. Accordingly the deferred tax balances at 31 December 2016 reflect these future reductions.

24. Deposits from banks

A maturity analysis for the Group's deposits from banks is included in a table on pages 47 and 48. The Group and Society balances are identical.

As at 31 December 2016, deposits from banks were £2,937.5 million (2015: £1,809.9 million). This includes £2,570.0 million (2015: £1,750.3 million) in respect of sale and repurchase agreements, of which £1,249.2 million (2015: £899.2 million) relates to off-balance sheet Treasury bills and £1,320.8 million (2015: £851.1 million) relates to on-balance sheet UK Government investment securities (see note 15).

25. Debt securities in issue

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Certificates of deposit	156.5	87.7	156.5	87.7
Medium-term notes	1,742.6	1,617.4	1,742.6	1,617.4
Covered bonds	1,847.8	1,787.4	1,847.8	1,787.4
Residential Mortgage Backed Securities	231.2	224.1	–	–
Total	3,978.1	3,716.6	3,746.9	3,492.5

Debt securities in issue are repayable from the Statement of Financial Position date in the ordinary course of business as follows:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Accrued interest	38.5	38.4	38.3	37.9
Other debt securities in issue with residual maturity repayable:				
In not more than one year	573.2	90.1	573.2	90.1
In more than one year	3,366.4	3,588.1	3,135.4	3,364.5
Total	3,978.1	3,716.6	3,746.9	3,492.5

In March 2016, Offa No. 1 plc issued £275.0 million of Residential Mortgage Backed Securities to third parties and in November 2016 Leofric No. 1 plc repaid all of the remaining £169.0 million of notes held by third parties.

26. Derivative financial instruments

Derivative financial instruments are held for risk mitigation purposes and are designated as hedging derivatives under the terms of IAS 39. The tables below analyse derivatives between those designated as hedging instruments and those which, whilst in economic hedging relationships, are not designated as hedging instruments. Contractual/notional amounts indicate the amount on which payments flows are derived at the Statement of Financial Position date and do not represent amounts at risk.

Foreign exchange losses of £196.1 million have been recognised in the Income Statement relating to the principal amount of financial instruments held at amortised cost. This is offset by £196.1 million of foreign exchange gains on derivative financial instruments held at fair value.

	2016			2015		
Group	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m	Contract/notional amount £m	Fair value assets £m	Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate swaps	22,818.0	226.8	363.1	20,593.4	173.0	262.6
Derivatives designated as cash flow hedges:						
Interest rate swaps	764.0	–	3.6	–	–	–
Cross currency swaps*	1,340.4	127.4	–	1,340.4	–	90.9
Total derivatives	24,922.4	354.2	366.7	21,933.8	173.0	353.5
Derivatives have remaining maturities as follows:						
In not more than one year	8,382.6	39.0	18.4	5,715.0	9.0	13.2
In more than one year	16,539.8	315.2	348.3	16,218.8	164.0	340.3
Total derivatives	24,922.4	354.2	366.7	21,933.8	173.0	353.5

* Cash flows are expected to occur over a five year period (2015: six) in respect of both Group and Society cross currency swaps.

Notes to the accounts **cont.**

26. Derivative financial instruments continued

Society	2016 Contract/ notional amount £m	2016 Fair value assets £m	2016 Fair value liabilities £m	2015 Contract/ notional amount £m	2015 Fair value assets £m	2015 Fair value liabilities £m
Derivatives designated as fair value hedges:						
Interest rate swaps	22,068.0	175.9	363.1	19,843.4	113.8	262.6
Derivatives designated as cash flow hedges:						
Interest rate swaps	764.0	–	3.6	–	–	–
Cross currency swaps*	946.1	78.2	–	946.1	–	70.2
Other derivatives:						
Interest rate basis swaps	650.0	1.9	–	650.0	2.5	–
Total derivatives	24,428.1	256.0	366.7	21,439.5	116.3	332.8
Derivatives have remaining maturities as follows:						
In not more than one year	8,382.6	39.0	18.4	5,715.0	9.0	13.2
In more than one year	16,045.5	217.0	348.3	15,724.5	107.3	319.6
Total derivatives	24,428.1	256.0	366.7	21,439.5	116.3	332.8

* Cash flows are expected to occur over a five year period (2015: six) in respect of both Group and Society cross currency swaps.

For valuing collateralised derivatives the Group uses discount curves based on OIS rates, whilst for non-collateralised derivatives discount curves based on term LIBOR rates are used.

In addition to the above, the Society also has intra-group interest rate swaps with the subsidiaries that operate the Group's covered bond programme. Under these agreements, the Society receives the interest income of the subsidiaries' mortgage books and pays LIBOR on the same basis as the subsidiaries' interest expense. These swaps have a nominal principal amount of £4,307.2 million (2015: £4,839.3 million) and are accounted for on an accruals basis in accordance with IAS 39; see note 1 for further details.

27. Provisions for liabilities and charges

Group	FSCS 2016 £m	Other provisions 2016 £m	Total 2016 £m	FSCS 2015 £m	Other provisions 2015 £m	Total 2015 £m
At 1 January	7.0	1.8	8.8	7.8	0.7	8.5
Charge for the year	4.3	1.8	6.1	14.1	1.7	15.8
Provisions utilised	(6.9)	(0.5)	(7.4)	(14.9)	(0.6)	(15.5)
At 31 December	4.4	3.1	7.5	7.0	1.8	8.8

The Society position differs by £0.2 million (2015: £nil) to the Group in relation to other provisions which are held in subsidiaries of the Society.

FSCS levy provision

All deposit-taking institutions that are members of the UK Financial Services Compensation Scheme (FSCS) are required to contribute to the costs of the FSCS in safeguarding the deposits of savers in financial institutions. The Society is, and continues to be, a member of the FSCS. Contributions to the FSCS are calculated according to a prescribed formula using the retail savings balances of all deposit-taking institutions who are members of the FSCS. As at 31 December 2016, the Group held a provision of £4.4 million with respect to the estimated FSCS levy for the period 2016/17. The FSCS provision is expected to be utilised in September 2017.

Other provisions

Other provisions have also been recognised in respect of circumstances that may give rise to various customer claims including Payment Protection Insurance (PPI) redress. The charge in the year reflects the delay in the introduction of a deadline for PPI claims, which is expected to be set by the Financial Conduct Authority (FCA) during 2017. In addition, there has been a charge of £0.6 million in relation to compensation that may be due to customers impacted by a recent FCA publication on the calculation of monthly payments for customers in arrears, see page 14 for further information.

The Group has no contingent liabilities to report.

28. Subordinated liabilities

Group and Society	2016 £m	2015 £m
Subordinated liabilities owed to note holders are as follows:		
Fixed rate subordinated notes 2016 – 12.25%	–	7.1
Fixed rate subordinated notes 2021 – 6.12%	–	10.1
Fixed rate subordinated notes 2022 – 6.469%	–	15.5
Fixed rate subordinated notes 2026 – 6.327%	10.2	10.2
Fixed rate subordinated notes 2032 – 7.54%	15.3	15.3
Total	25.5	58.2

All the subordinated liabilities are denominated in sterling. The notes are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, with the prior consent of the Prudential Regulation Authority (PRA).

The subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members, other than holders of Permanent Interest Bearing Shares (PIBS) and Perpetual Capital Securities (PCS), as to principal and interest.

During 2016 the Society, with the consent of the PRA, repurchased all £15.5 million of the Fixed rate subordinated notes 2022 – 6.469%, all £10.1 million of the Fixed rate subordinated notes 2021 – 6.12% and all £7.1 million of the Fixed rate subordinated notes 2016 – 12.25%.

29. Subscribed capital

Group and Society	Call date	2016 £m	2015 £m
Subscribed capital owed to permanent interest holding members is as follows:			
Permanent Interest Bearing Shares 1992 – 12 1/8%	n/a	41.6	41.5
Permanent Interest Bearing Shares 2006 – 6.092%	June 2016	–	120.1
Total		41.6	161.6

Interest is paid in arrears on £40.0 million PIBS at the rate of 12 1/8% per annum in half yearly instalments. The PIBS are only repayable in the event of the winding up of the Society.

The 2006 PIBS were repaid in full in June 2016 with the consent of the PRA.

PIBS rank equally with each other and PCS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than holders of PCS) as to principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

30. Other equity instruments

In June 2014, the Society issued £400.0 million of new PCS capital (£396.9 million net of issuance costs and associated tax). These instruments rank equally with each other and PIBS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS) as to principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.375% per annum. The rate will reset on 1 November 2019 and every five years thereafter to the five year mid swap rate plus 4.113%. Coupons are paid semi-annually in May and November.

During 2016, coupon payments of £25.6 million (2015: £25.6 million), were approved and have been recognised (net of tax) in the Statement of Change in Members' Interests and Equity.

30. Other equity instruments continued

The instruments have no maturity date. They are repayable at the option of the Society in 2019 and on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an individual consolidated or a consolidated basis, falls below 7% they convert to Core Capital Deferred Shares (CCDS) at the rate of one CCDS for every £67 held.

The returns paid to investors on these securities are treated as an appropriation of profit after tax, reflecting their categorisation as equity instruments, and hence are not reflected within the Income Statement, but instead are distributed directly from the general reserve.

31. Available-for-sale reserve

Amounts within the Available-for-sale reserve are transferred to the Income Statement upon the disposal of debt securities, and where a fair value hedging relationship exists between the debt securities and a derivative instrument.

During the year a £21.8 million gain (2015: £21.6 million loss) was transferred to net (losses)/gains from derivatives and hedge accounting in the Income Statement with respect to hedge accounting adjustments relating to Available-for-sale debt securities in fair value hedge accounting relationships. A gain of £4.9 million (2015: £nil) was transferred to other operating income' (see note 7) in respect of the disposal of the equity investment in Visa Inc.

32. Financial commitments

Subject to the satisfaction of previously agreed loan to value ratios, the Group and Society are committed to the following undrawn mortgage loan facilities relating to equity release and flexible mortgage products:

	Group 2016 £m	Group 2015 £m	Society 2016 £m	Society 2015 £m
Undrawn mortgage loan facilities	66.5	74.7	54.2	59.5

In addition, the Group has also agreed but not contractually committed to advance £1,623.2 million (2015: £1,609.5 million) in respect of loans and advances to customers.

33. Capital and leasing commitments

Capital commitments

Group and Society	2016 £m	2015 £m
Capital expenditure contracted for but not provided for in the accounts	7.9	0.9

Leasing commitments

Future minimum lease payments under non-cancellable operating leases relating to land and buildings were as follows:

Group and Society	2016 £m	2015 £m
Amounts falling due:		
Within one year	3.0	3.2
Between one and five years	9.5	10.0
After five years	5.8	7.4
Total	18.3	20.6
Lease payments recognised as an expense in the period	4.4	4.3

34. Financial instruments – classification and fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted prices (unadjusted) in active markets for identical instruments.
- Level 2: valuation techniques for which all significant inputs are based on observable market data.
- Level 3: valuation techniques for which significant inputs are not based on observable market data.

Where applicable, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. For all other financial instruments the Group determines fair values using other valuation techniques.

The following table summarises the fair value of the Group's financial assets and liabilities measured at amortised cost on the face of the Group's Statement of Financial Position and the disaggregation by the fair value hierarchy.

The Society position is not materially different to that of the Group except for £11,496.8 million (2015: £9,764.7 million) of loans and advances to customers with a fair value of £11,468.3 million (2015: £9,767.9 million) which are held in subsidiaries of the Society.

2016 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	213.5	–	213.5	–	213.5
Loans and advances to customers	32,881.6	–	–	32,751.5	32,751.5
Financial liabilities					
Shares	28,054.3	–	–	28,257.3	28,257.3
Deposits from banks	2,937.5	–	2,936.4	–	2,936.4
Other deposits	7.0	–	7.0	–	7.0
Amounts owed to other customers	819.4	–	818.0	–	818.0
Debt securities in issue	3,978.1	4,173.8	13.8	–	4,187.6
Subordinated liabilities	25.5	–	29.2	–	29.2
Subscribed capital	41.6	79.4	–	–	79.4

2015 Group	Carrying amount £m	Fair value Level 1 £m	Fair value Level 2 £m	Fair value Level 3 £m	Fair value Total £m
Financial assets					
Loans and advances to credit institutions	235.8	–	235.8	–	235.8
Loans and advances to customers	29,411.0	–	–	29,327.1	29,327.1
Financial liabilities					
Shares	25,355.8	–	–	25,597.2	25,597.2
Deposits from banks	1,809.9	–	1,809.4	–	1,809.4
Other deposits	3.0	–	3.0	–	3.0
Amounts owed to other customers	806.5	–	806.4	–	806.4
Debt securities in issue	3,716.6	3,865.7	88.1	–	3,953.8
Subordinated liabilities	58.2	–	63.8	–	63.8
Subscribed capital	161.6	199.2	–	–	199.2

34. Financial instruments – classification and fair value measurement continued

Loans and advances to customers

The fair value of loans and advances to customers is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Conservative assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting estimated future cash flows are discounted at current market rates for those types of loans to determine a fair value. These fair values have been adjusted where necessary to reflect any observable market conditions at the time of valuation.

Customer shares and deposits

Shares and deposits from customers are valued in accordance with the cash flows projected from the contractual terms of the deposits. The fair value of shares and deposits that are available on demand approximates to the carrying value. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows from those deposits discounted at the current market rates for those types of deposit.

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer-dated liabilities are calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those liabilities where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate to the remaining term to maturity.

The following table summarises the fair value of the Group's financial assets and liabilities measured at fair value on the face of the Group's Statement of Financial Position and the disaggregation by fair value hierarchy and product type.

The Society position is not materially different to that of the Group except for £50.9 million (2015: £59.2 million) of interest rate swap assets and £49.2 million (2015: £20.7 million) of cross currency swap liabilities, which are held in subsidiaries of the Society, and a £1.9 million fair value asset (2015: £2.5 million fair value asset) relating to intercompany interest rate basis swaps that would only be disclosed in the Society.

2016 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	226.8	–	226.8
Cross currency swaps	–	127.4	–	127.4
Total	–	354.2	–	354.2
Debt securities				
UK Government investment securities	1,328.9	–	–	1,328.9
Other listed transferable debt securities	15.8	3.6	6.0	25.4
Total	1,344.7	3.6	6.0	1,354.3
Investment in equity shares				
Investment in equity shares	–	–	5.9	5.9
Total	–	–	5.9	5.9
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	298.1	68.6	366.7
Total	–	298.1	68.6	366.7

2015 Group	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets				
Derivative financial instruments				
Interest rate swaps	–	173.0	–	173.0
Total	–	173.0	–	173.0
Debt securities				
UK Government investment securities	1,432.8	–	–	1,432.8
Other listed transferable debt securities	102.2	9.7	7.0	118.9
Total	1,535.0	9.7	7.0	1,551.7
Investment in equity shares				
Investment in equity shares	–	–	3.3	3.3
Total	–	–	3.3	3.3
Financial liabilities				
Derivative financial instruments				
Interest rate swaps	–	207.1	55.5	262.6
Cross currency swaps	–	90.9	–	90.9
Total	–	298.0	55.5	353.5

Financial instruments recorded at fair value

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Level 1: Debt securities – Available-for-sale – Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2: Derivatives

Derivative products valued using a valuation technique with observable market inputs are interest rate swaps and cross currency swaps. The valuation techniques applied are swap models using present value calculations. The models incorporate various assumptions, including interest rate curves and foreign exchange spot and forward rates.

Level 2: Debt securities – Available-for-sale – Listed

Debt securities for which no market price or executable bid is available at the year end date are valued by one of two methods. Where there are recent market prices or executable bids for the security, these are used as the basis for establishing a year end price for valuation purposes. Otherwise, a security is priced based on its relative value to comparable bonds.

Level 3: Debt securities – Available-for-sale – Listed

The item included within Level 3 is a mortgage backed security. This is valued using the same valuation technique as Level 2 listed securities, namely by establishing a price based on its relative value to comparable bonds. The unobservable inputs relate to estimates of the likely timing of repayments and, hence, the weighted average life of the security. A change in price of ten basis points, which can be taken to represent the impact of repayment commencing (if positive) or being set back further (if negative), would change the value of the security by £0.8 million.

Level 3: Investment in equity shares – Available-for-sale – Unlisted

Details of the Level 3 Investment in equity shares are set out in note 17 and represent the Group's holding in Visa Inc. preference and VocaLink Holdings Limited shares. These shares are valued based on future cash consideration which the Group expects to receive on sale of these instruments, or the underlying market value. Currently deferred cash consideration has been assigned a value of nil.

Where appropriate, a discount is applied to the valuation to reflect marketability and other risks in relation to the instruments. A change in discount of 10% would result in the change in the carrying value of the investment of £0.8 million.

34. Financial instruments – classification and fair value measurement continued

Level 3: Derivatives

Critical accounting estimates and judgements

The items included within Level 3 are balance tracking swaps, which have remained in place during the year. These are valued using the same valuation technique as Level 2 derivatives, namely present value calculations based on market interest rate curves. The unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. Projected mortgage prepayment amounts are used in the modelling of the mortgage portfolio profile. A change of 10% in the prepayment rates used results in a £0.7 million change in the value of the swaps. As changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact the swap and hedged item equally, the net Income Statement and Statement of Financial Position impact would be negligible.

The following table analyses movements in the Level 3 portfolio for both the Group and the Society.

Group and Society	Investment in equity share 2016 £m	Debt securities 2016 £m	Derivative financial instruments 2016 £m	Investment in equity share 2015 £m	Debt securities 2015 £m	Derivative financial instruments 2015 £m
As at 1 January	3.3	7.0	(55.5)	–	7.3	(60.2)
Gains/(losses) recognised in the Income Statement						
Interest receivable and similar income	–	0.1	–	–	0.1	–
Interest payable and similar expense	–	–	(6.3)	–	–	(6.3)
Net unrealised gains/(losses) from derivative financial instruments	–	–	(13.1)	–	–	4.8
Gains/(losses) recognised in the Statement of Comprehensive Income						
Available–for–sale reserve fair value movement	1.9	(1.0)	–	–	(0.3)	–
Settlements	(4.9)	(0.1)	6.3	–	(0.1)	6.2
Transfers into Level 3 portfolio	5.6	–	–	3.3	–	–
As at 31 December	5.9	6.0	(68.6)	3.3	7.0	(55.5)

Transfers between fair value hierarchies

Transfers between fair value hierarchies occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and it must instead be valued using a method lower down the hierarchy. Transfers are considered to occur at the end of the reporting period for the purposes of this disclosure.

During 2016, one debt security valued at £3.3 million was transferred from Level 1 to Level 2 and two investments in equity shares valued at £5.6 million were transferred to Level 3. One of the transfers (£4.5 million as at 31 December 2016) was previously held at cost, as fair value could not be reliably measured. The second transfer arose from the sale of the investment in the Society's holding of Visa Europe. This resulted in the receipt of Visa Inc. preference shares, initially valued at £1.1 million (£1.4 million valuation as at 31 December 2016).

35. Offsetting financial assets and liabilities

The Group and Society do not have any financial assets or financial liabilities that are offset with the net amount presented in the Statements of Financial Position as IAS 32 *Financial Instruments – Presentation* conditions state that there should be both an enforceable right to set-off and the intention either to settle on a net basis or to realise the asset and settle the liability simultaneously. Neither of these conditions is met by the Group or the Society.

During the year the European Markets and Infrastructure Regulations introduced a requirement to clear derivatives in scope through a third party regulated central clearing counterparty to reduce systemic and operating risk. The Society became subject to mandatory clearing during November 2016. This new arrangement did not meet either of the conditions of IAS 32, and therefore amounts are not offset in the Statements of Financial Position.

The Group has entered into master netting arrangements such as International Swaps and Derivatives Association (ISDA) master agreements for its derivatives (other than derivatives held by Coventry Building Society Covered Bonds LLP). Credit Support Annexes (CSAs) are executed in conjunction with these ISDA master agreements, which typically provide for the exchange of collateral to mitigate net mark to market credit exposure.

The Group has also entered into Global Master Repurchase Agreements, including margin collateralisation arrangements, whereby outstanding transactions with the same counterparty can be settled net following a default or other predetermined event.

Coventry Building Society Covered Bonds LLP does not enter into a master netting agreement due to the structure of the covered bonds programme. However, it has entered into a separate ISDA agreement in respect of each of the derivatives it has transacted with external counterparties. Each agreement includes a CSA which provides for full collateralisation of the swap exposure but for one of these full collateralisation only occurs when the counterparty credit rating falls below a certain threshold. The majority of the derivative financial instrument asset exposure in the table below relates to this latter arrangement. The counterparty has a credit rating of Aa2.

The table below shows the net exposure for derivative contracts after netting benefits and collateral and also for sale and repurchase agreements after collateral. The Group did not enter into securities lending or reverse sale and repurchase agreements during 2016.

2016 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	354.2	(185.2)	(124.0)	45.0
Total financial assets	354.2	(185.2)	(124.0)	45.0
Financial liabilities				
Derivative financial instruments	366.7	(185.2)	(171.8)	9.7
Sale and repurchase agreements	1,320.7	–	(1,320.7)	–
Total financial liabilities	1,687.4	(185.2)	(1,492.5)	9.7

2015 Group	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	173.0	(106.9)	(24.2)	41.9
Total financial assets	173.0	(106.9)	(24.2)	41.9
Financial liabilities				
Derivative financial instruments	353.5	(106.9)	(222.9)	23.7
Sale and repurchase agreements	851.1	–	(851.1)	–
Total financial liabilities	1,204.6	(106.9)	(1,074.0)	23.7

* As reported on the Statement of Financial Position.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

35. Offsetting financial assets and liabilities continued

2016 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	256.0	(185.2)	(55.6)	15.2
Total financial assets	256.0	(185.2)	(55.6)	15.2
Financial liabilities				
Derivative financial instruments	366.7	(185.2)	(171.8)	9.7
Sale and repurchase agreements	1,320.7	–	(1,320.7)	–
Total financial liabilities	1,687.4	(185.2)	(1,492.5)	9.7

2015 Society	Gross amounts* £m	Master netting arrangements £m	Financial collateral** £m	Net amount £m
Financial assets				
Derivative financial instruments	116.3	(106.9)	–	9.4
Total financial assets	116.3	(106.9)	–	9.4
Financial liabilities				
Derivative financial instruments	332.8	(106.9)	(222.9)	3.0
Sale and repurchase agreements	851.1	–	(851.1)	–
Total financial liabilities	1,183.9	(106.9)	(1,074.0)	3.0

* As reported on the Statement of Financial Position.
** The financial collateral disclosed is limited to the amount of the related financial asset or related financial liability.

For derivative financial assets, collateral received is in the form of both cash and UK Government investment securities. Where cash is received it is included as a liability within deposits from banks (see note 24). Where UK Government investment securities are received, these are not recognised on the Statement of Financial Position, as the Group does not obtain the risks and rewards of ownership (see note 15).

For derivative financial liabilities, collateral paid is in the form of cash and is included as an asset in loans and advances to credit institutions (see note 14).

For sale and repurchase agreements, collateral provided is predominantly in UK Government investment securities with the remainder in cash. Again, cash paid is included as an asset in loans and advances to credit institutions (see note 14). UK Government investment securities are not derecognised as the Group has retained substantially all the risks and rewards of ownership (see note 15).

Cash collateral held and cash collateral pledged are not restricted and are returned at the end of the contract.

36. Capital management

As at 31 December 2016, and throughout the year, the Group complied in full with the capital requirements that were in force. Further information on the Group's capital resources and capital management can be found on page 17 and pages 56 to 62.

37. Related party transactions

The Group is controlled by Coventry Building Society registered in England and Wales, which is also considered to be the ultimate parent.

	Group undertakings		Key management	
	2016 £m	2015 £m	2016 £m	2015 £m
Loans payable to the Society				
Loans outstanding as at 1 January	9,637.0	8,876.1	0.2	–
Loans issued during the year	1,537.2	760.9	–	0.4
Impairment credit	0.4	–	–	–
Repayments during the year*	–	–	(0.2)	(0.2)
Loans outstanding as at 31 December	11,174.6	9,637.0	–	0.2
Deposits payable by the Society				
Deposits outstanding at 1 January	109.0	176.9	3.0	2.9
Deposits received during the year**	–	–	0.6	1.0
Repayments during the year*	(109.0)	(67.9)	(1.0)	(0.9)
Deposits outstanding at 31 December	–	109.0	2.6	3.0
Net interest income/(expense)				
Interest receivable	313.0	299.1	–	–
Interest payable	(3.2)	(3.9)	–	–
Foreign currency gains/(losses)	59.3	(21.9)	–	–
Total	369.1	273.3	–	–
Other income and expenses				
Fees and expenses paid to the Society	8.8	7.8	–	–

* Includes loans and deposits for key management on retirement.
** Includes existing deposits for key management on appointment.

Interest on outstanding loans and deposits accrues at a transfer price rate agreed between the Society and its subsidiaries.

Deposits payable by the Society to Group undertakings relate to amounts owing to the Society's structured entities, in accordance with the accounting policy set out in note 1. These intercompany balances have been presented within other liabilities on the Statement of Financial Position.

Transactions with key management personnel

Transactions with key management personnel are on the same terms and conditions applicable to members and other employees within the Group. The Board of directors are considered to be the only 'key management' for the purposes of the related party transactions disclosures under IAS 24 *Related Party Disclosures*. No director has any interest in the shares or debentures of any connected undertaking of the Society. See pages 86 to 89 for information on Directors' remuneration for 2016.

In accordance with Section 68 of the Building Societies Act 1986, the Society maintains a register of loans falling within Section 65 made to directors and connected persons. A statement containing requisite particulars of such transactions may be inspected by members at the Society's Annual General Meeting (AGM) or at the Principal Office of the Society during the period 15 days prior to the AGM.

Transactions with related undertakings

Transactions are entered into with related parties in the normal course of business. These include loans, deposits, and the payment and recharge of interest and administrative expenses.

Annual Business Statement

For the year ended 31 December 2016

1. Statutory percentages

	2016 %	Statutory limits %
Lending limit	1.9	25.0
Funding limit	21.6	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 as amended by the Building Societies Act 1997.

The lending limit measures the proportion of the business assets not in the form of loans fully secured on residential property and is calculated as (X-Y)/X where:

X = business assets, being the total assets of the Group plus loan impairment less liquid assets, intangible assets and property, plant and equipment. The value of X used is the value at 31 December 2016.

Y = the principal value of, and interest accrued on, loans owed to the Group which are fully secured on residential property. The value of Y used is the value at 31 December 2016.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X-Y)/X where:

X = shares and borrowings, being the aggregate of:

I. The principal value of, and interest accrued on, shares in the Society.
II. The principal value of, and interest accrued on, the amounts deposited with the Society or any subsidiary undertaking, by banks, credit institutions and other customers.
III. The principal value of, and interest accrued on, the amounts of debt securities of the Society or any subsidiary undertaking.

The value of X used is the value at 31 December 2016.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals other than bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons that include bodies corporate. The value of Y used is the value at 31 December 2016.

2. Other percentages

	2016 %	2015 %
As a percentage of shares and borrowings:		
Gross capital	5.28	5.90
Free capital	5.11	5.77
Liquid assets	13.5	13.8
As a percentage of mean total assets:		
Profit for the financial year	0.50	0.52
Management expenses	0.41	0.42
Net profit as a percentage of total balance sheet	0.48	0.50

Shares and borrowings represents the total of shares, deposits from banks, other deposits, amounts owed to other customers and debt securities in issue.

Gross capital represents the aggregate of reserves, other equity instruments, subordinated liabilities and subscribed capital.

Free capital represents the aggregate of gross capital and collective impairment less intangible assets and property, plant and equipment.

3. Information relating to directors

Directors

Name (Date of birth)	Occupation	Other directorships and appointments	Date of appointment as a director of the Society
Ian Pickering, MA (Cantab), FCA (16.10.1955)	Company Director	Electrocab Limited	01.09.2005
Janet Ashdown, BSc (Hons) (05.07.1959)	Company Director	SIG plc Marshalls plc Nuclear Decommissioning Authority	18.09.2013
Peter Ayliffe, BA (Hons), FCIBS, CMgr (05.03.1953)	Company Director	The Pennies Foundation Monitise plc TruRating Limited	01.05.2013
Roger Burnell, BSc, FCA (08.04.1950)	Company Director	Clarence Mansions Management Company Limited	01.09.2008
Catherine Doran, BA (11.09.1956)	Company Director	Department for Environment, Food & Rural Affairs	01.08.2016
Peter Frost, BA (Hons) (27.10.1965)	Building Society Chief Operating Officer	Five Valleys Property Company Limited	01.11.2012
Ian Geden, BSc (Hons), FCII (08.07.1953)	Company Director	Faraday Underwriting Limited	01.09.2008
Alasdair Lenman, MA, ACMA (25.12.1969)	Company Director	Wellesley Security Trustees Limited Wellesley Secured Finance plc	01.11.2016
John Lowe, BA (Oxon), ACA (26.10.1972)	Building Society Finance Director	Arkose Funding Limited Coventry Financial Services Limited Coventry Independent Advice Service Limited Coventry Property Services Limited Five Valleys Property Company Limited Godiva Financial Services Limited Godiva Housing Developments Limited Godiva Mortgages Limited Godiva Savings Limited Godiva Securities and Investments Limited ITL Mortgages Limited	14.10.2010
Mark Parsons, BA (Hons), FCMA (24.10.1961)	Building Society Chief Executive	Godiva Mortgages Limited ITL Mortgages Limited	01.07.2014

Documents may be served on the above named directors at: Coventry Building Society, c/o Ernst & Young LLP, 1 Bridgewater Place, Leeds LS11 5QR.

In 2010 the Society appointed John Lowe (Finance Director) to the Board. A service contract has been entered into which is terminable by John Lowe on six months' notice and by the Society on one year's notice.

In 2012 the Society appointed Peter Frost (Chief Operating Officer) to the Board. A service contract has been entered into which is terminable by Peter Frost on six months' notice and by the Society on one year's notice.

In 2014 the Society appointed Mark Parsons (Chief Executive) to the Board. A service contract has been entered into which is terminable by Mark Parsons on six months' notice and by the Society on one year's notice.

4. Principal office

Coventry Building Society is a building society, incorporated and domiciled in the United Kingdom. The address of the principal office is: Economic House, PO Box 9, High Street, Coventry CV1 5QN.

Glossary

The following glossary defines terminology within the Annual Report & Accounts to assist the reader and to facilitate comparison with publications by other institutions:

Additional Tier 1 (AT 1) capital	Capital that meets certain criteria set out in CRD IV. In particular, the criteria require that upon the occurrence of a trigger event, the AT 1 capital instrument converts to Common Equity Tier 1 capital or the principal is written down on a permanent basis; or grandfathered instruments such as Permanent Interest Bearing Shares (PIBS).
Arrears	The financial value of unpaid obligations, which arise when contractual payments are not paid as they fall due.
Available-for-sale reserve (AFS)	The Available-for-sale reserve contains unrealised gains and losses arising from changes in the fair value of non-derivative financial assets that are categorised as Available-for-sale.
Average loan to value	The average of individual loan to values (simple average). The average loan to value of the residential mortgage book, weighted by balance (balance weighted). For indexed loan to value – see 'Indexed loan to value'.
Bank surcharge	An 8% surcharge on the profits of banking companies which was introduced from 1 January 2016 by the Finance (No.2) Act 2015.
Basel I floor	A 'floor', currently 80%, applied to the Basel I approach which had a fixed risk weighting for assets. The Basel I framework was issued in 1988 and set out recommendations on banking regulation made by the Basel Committee on Banking Supervision.
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.
Basis point	One hundredth of a percent (0.01 percent). Used when quoting movements in interest rates and yields on securities.
Brexit	The process of the UK leaving the European Union decided by the UK referendum on 23 June 2016.
Business risk	Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, geopolitical, regulatory or other factors. The Society considers strategic risk, the risk to delivering the Strategic Plan, to be a principal risk.
Buy to let mortgage	A mortgage secured on a residential property that is rented out to tenants.
Capital Conservation Buffer (CCoB)	A buffer for all banks that can be used to absorb losses while avoiding breaching minimum capital requirements. Phased in from January 2016 (0.625% from 1 January 2016, increasing to 2.5% by 1 January 2019).
Capital requirements	Amount of capital required to be held by the Group to cover the risk of losses and to protect against excessive leverage. The level is set by regulators and the firm's own assessment of its risk profile.
Capital Requirements Regulation and Capital Requirements Directive IV (CRD IV)	CRD IV is the European Union legislation (part regulation and part directive) which came into force from 1 January 2014 to implement Basel III, revising the capital requirements framework and introducing liquidity requirements, which regulators use when supervising firms.
Capital resources	Capital comprising the general reserve, Available-for-sale reserve, eligible Additional Tier 1 capital less all required regulatory adjustments.
Central clearing	The process by which parties to an OTC derivative contract replace this with a separate contract with a central counterparty, which takes over each party's positions under the original contract.
Certificates of deposit	Bearer-negotiable instruments issued on the receipt of a fixed term deposit at a specified interest rate.
Collateral	Security pledged by the borrower to the lender in case of default.
Collective assessment of impairments	Where impairment is identified within a portfolio that comprises assets with similar characteristics, but such impairment cannot be individually identified, a collective impairment assessment takes place using appropriate statistical techniques.
Common Equity Tier 1 (CET 1) capital	Common Equity Tier 1 capital comprises general reserves and the Available-for-sale reserve, less regulatory deductions. Common Equity Tier 1 must absorb losses on a going concern basis.
Common Equity Tier 1 ratio	Common Equity Tier 1 capital as a percentage of risk weighted assets.
Conduct risk	The risk that the Society's actions fail to deliver good customer outcomes. Conduct risk is a principal risk category.

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 PCS if the end-point CET 1 ratio, calculated on either an individual or consolidated basis, falls below 7%.
Council of Mortgage Lenders (CML)	A trade association for the residential mortgage lending industry.
Countercyclical Buffer (CCyB)	A buffer that can be varied over the financial cycle to match the resilience of the banking system to the scale of risk it faces. Individual banks' buffers will depend on the geographical composition of their exposures. Applies now but currently set at 0%.
Countercyclical Leverage Buffer (CCLB)	As a guiding principle, the FPC sets the CCLB rate at 35% of the risk weighted CCyB (ranges from 0% to 0.9%). Applies now but currently set at 0%.
Covered bonds	Debt securities that are backed by both the resources of the issuer and a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due. Within this class, the Society considers risks arising from retail credit risk and treasury credit risk to be individual principal risk categories.
Currency swap	An arrangement in which two parties exchange equivalent principal amounts of different currencies at inception and subsequently exchange interest payments on the principal amounts. At the maturity of the swap, the principal amounts are re-exchanged at the original rates, protecting the participants from changes in exchange rates.
Debt securities	Transferable instruments creating or acknowledging indebtedness. They include bonds, certificates of deposit and loan notes. The holder of a debt security is typically entitled to the payment of principal and interest, together with other contractual rights under the terms of the issue. Debt securities are generally issued for a fixed term and redeemable by the issuer at the end of that term. Debt securities can be secured on other assets or unsecured.
Debt securities in issue	Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.
Deferred tax asset/(liability)	Corporation tax recoverable (or payable) in future periods resulting from the carry forward of tax losses or unused tax credits from deductible (or taxable) temporary differences, between the accounting value of assets and liabilities and the tax base of those assets and liabilities.
Defined benefit obligation	The present value of expected future payments required to settle the obligations of a defined benefit pension plan resulting from past employee service.
Defined benefit pension scheme	A pension or other post-retirement benefit plan offering guaranteed benefits, usually as a fraction of the final salary.
Defined contribution plan	Pension or other post-retirement benefit plan where the employer's obligation is limited to its contributions to the fund.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
Effective Interest Rate (EIR)	The rate of interest income or expense that produces a level yield, either to maturity or to the next re-pricing date, equivalent to the projected cash flows on an instrument.
Effective tax rate	The tax charge in the Income Statement as a percentage of profit before tax.
Encumbered assets	Assets used to secure third party liabilities or otherwise pledged. This excludes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes.
End-point	Full implementation of CRD IV with no transitional provisions.
Enterprise Risk Management Framework (ERMF)	A Board approved framework which provides the context, guidance and principles needed for cohesive risk management activity across the Society and its subsidiaries.
European Banking Authority	An independent European Union authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector.
European Market Infrastructure Regulation (EMIR)	The EU regulation issued in 2012 to improve transparency and reduce the risk associated with the over the counter derivatives market and establish common rules to shift risk management from bilateral agreements to a central clearing process.
Eurozone	An economic and monetary union (EMU) of European Union member states that have adopted the euro (€) as their common currency and sole legal tender.
Expected loss	A calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a one year time period.

Glossary cont.

Exposure	The maximum loss that a financial institution might suffer if a borrower or wholesale counterparty fails to meet their obligations.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
Financial Ombudsman Service	The Financial Ombudsman Service provides an independent and impartial service to resolve individual complaints that consumers and financial institutions have been unable to settle themselves.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
Financial Services Compensation Scheme (FSCS)	The UK's compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every deposit taking firm authorised by the PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.
Fitch Ratings	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
Foreign currency risk	The risk of loss arising as a result of movements in exchange rates on investments or obligations in foreign currencies.
Free capital	The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers, less: property, plant and equipment; non-current assets held for sale; and intangible assets.
Funding for Lending Scheme (FLS)	An initiative by the Bank of England and HM Treasury to incentivise banks and building societies to boost their lending to UK households and small and medium sized enterprises, by providing funding to banks and building societies for an extended period.
General reserve	The general reserve is the accumulation of historical and current year profits and includes remeasurements of the defined benefit pension plan and distributions to holders of Perpetual Capital Securities (net of tax).
Government investment securities (gilts)	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.
Gross capital	The aggregate of reserves, other equity instruments, subscribed capital and subordinated liabilities.
Gross mortgage lending	The total of mortgage lending advanced during the year.
IFRIC	The International Financial Reporting Interpretations Committee. IFRIC interprets the application of IAS and IFRS and provides timely guidance on financial reporting issues not specifically addressed in IAS and IFRS, in the context of the International Accounting Standards Board framework.
IFRS/IAS	International Financial Reporting Standards/International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are more than three months in arrears or in possession. However, other indicators of impairment may result in provisioning for losses.
Impairment losses	The reduction in value that arises following an impairment review of an asset that determines that the recoverable amount is less than its carrying value.
Impairment provision	Provisions held against assets on the Statement of Financial Position. The provisions represent management's best estimate of losses incurred in the loan portfolio at the Statement of Financial Position/balance sheet date.
Indexed loan to value	Loan to value calculated on the basis of the latest property valuation being adjusted by the relevant House Price Index movement since that date.
Individual assessment of impairment	Impairment is measured specifically for assets that are individually identified as being impaired at the Statement of Financial Position/balance sheet date.

Individual Capital Guidance (ICG)	The minimum amount of capital the Society should hold as set by the PRA under Pillar 2 and informed by the Internal Capital Adequacy Assessment Process (ICAAP).
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.
Individual Liquidity Guidance (ILG)	Guidance from the PRA on a firm's required quantity of liquidity resources and funding profile.
Interest rate risk	Interest rate risk arises from the different interest rate characteristics of the Society's mortgages and savings products and from other financial instruments. The Society is subject to the risk that changes in interest rates will cause material variations in earnings because of differences between interest rates received and paid on mortgages and deposits respectively.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Ratings Based approach (IRB)	An advanced approach to measuring capital requirements in respect of credit risk under Pillar 1. The IRB approach may only be used with permission from the PRA.
ISDA	International Swaps and Derivatives Association is the global trade association for over-the-counter (OTC) derivatives and providers of the industry-standard documentation for derivative transactions.
Leverage ratio	A calculation brought in as part of CRD IV which measures the relationship between eligible Tier 1 capital and exposures to on and off-balance sheet items. The Society's calculation reflects constraints on the inclusion of AT 1 capital under the FPC's UK leverage ratio framework.
LIBOR	London Inter-Bank Offer Rate. A benchmark interest rate at which banks can borrow funds from other banks in the London interbank market.
Liquid assets	An amount as defined by the Building Societies (Accounts and Related Provisions) Regulations 1998. This comprises cash in hand, balances with the Bank of England, debt securities (including Government investment securities (gilts)), loans to credit institutions and other liquid assets.
Liquidity and funding risk	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the inability to access funding markets or to only do so at excessive cost and/or liquidity risk. Liquidity and Funding risks are principal risks of the Society.
Liquidity Coverage Ratio (LCR)	A measure brought in as part of CRD IV which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions. A binding minimum LCR of 80% applied to the Society from 1 October 2015, rising to 90% from 1 January 2017.
Liquidity resources	Assets held in order to manage liquidity risk. Liquidity resources comprises cash and balances with the Bank of England, UK Government securities and multilateral development banks, other securities and bank deposits and self-issued covered bonds, RMBS and Bank of England approved mortgage portfolios.
Loan to value	The amount of mortgage loan as a percentage of the value of the property.
Management expenses	The aggregate of administrative expenses, depreciation and amortisation.
Market risk	Market risk is the risk that the value of net interest income or market value derived from the Society's assets and liabilities may change adversely as a result of changes in interest rates or foreign exchange rates.
Medium-term notes	Securities offered by a company to investors, through a dealer, across a range of maturity periods.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.
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 Investor Services	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.

Glossary **cont.**

Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Net interest income	The difference between interest receivable on assets and similar income and interest paid on liabilities and similar charges.
Net interest margin	Net interest income as a percentage of average total assets.
Net Stable Funding Ratio (NSFR)	A ratio which assesses the amount of stable funding in place as a proportion of the on and off-balance sheet funding requirements of an institution. A minimum requirement for the NSFR is due to be set by 1 January 2018.
Operational risk	Operational risk is the risk of loss arising from inadequate internal processes, systems or people, or from external events. Operational risk is a principal risk category.
Overnight indexed swap (OIS) rate	A rate reflecting the overnight interest earned or paid in respect of overnight interbank loans, being typically SONIA for sterling loans. OIS is used to value collateralised interest rate derivatives.
Over-the-counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.
Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Pension fund surplus	The assets in a pension fund that are in excess of its liabilities.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. Under Basel III, PIBS are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Pillar 1/2/2A/3	Components of the Basel capital framework. Pillar 1 covers the minimum requirement, Pillar 2 covers supervisory review and Pillar 3 covers disclosures.
PRA Buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
PRA Remuneration Code	The PRA Remuneration Code came into force on 1 January 2011 to meet the remuneration provisions of the Capital Requirements Directive. The PRA's remit on remuneration is to make sure that pay practices in the firms it regulates do not encourage inappropriate risk taking and that firms do not pay out more than they can afford.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
PV200	Present Value 200. A calculation of the theoretical change in the net present value of financial instruments for a 200 basis point (2%) parallel shift in interest rates.
Redenomination risk	The risk that in the event that the euro ceases to be traded or a particular country leaves the euro, previously matched foreign exchange positions, designated in euros, become unmatched when these are exchanged for an alternative currency (valued against a local currency equivalent).
Residential Mortgage Backed Securities (RMBS)	Asset backed securities that represent interests in a group of residential mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Residual maturity	The remaining period to the contractual maturity date of a financial asset or financial liability.
Retail deposits	See Shares.
Risk appetite	The articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.

Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a structured entity which then issues securities (RMBS) backed by the assets. The Group has used residential mortgages as the loan pool for securitisation purposes.
Self-certified mortgage	An owner-occupier mortgage where the lending decision has been based on the borrower's declaration of their income and the applicant has been suitably verified.
Senior unsecured debt funding	Bonds issued by corporate bodies and financial institutions, which are not secured by any collateral and are not subordinated to any other liabilities of the issuer.
Shares	Funds deposited by a person in a retail savings account with the Society. Such funds are recorded as liabilities of the Society.
Shares and borrowings	The total of shares, deposits from banks, other deposits, amounts due to customers and debt securities in issue.
SONIA	A rate reflecting the interest earned or paid in respect of sterling overnight interbank loans.
Sovereign exposure	Exposures to governments and on account of cash balances and deposits with central banks.
Standardised approach	The basic method used to calculate capital requirements for credit and operational risk. In this approach the risk weighting used in the capital calculation is determined by specified percentages.
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 Buffers.
Systemic risk buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.
Term Funding Scheme (TFS)	The Term Funding Scheme (TFS) is a tool of the Monetary Policy Committee designed to reinforce the transmission of Bank of England Base Rate cuts to those interest rates actually faced by households and businesses by providing term funding to banks and building societies at rates close to Bank of England Base Rate.
Tier 1 capital	A component of regulatory capital comprising Common Equity Tier 1 and Additional Tier 1 capital.
Tier 2 capital	A component of regulatory capital comprising qualifying subordinated debt and eligible collective impairment allowances.
Trading book	A regulatory classification consisting of positions in financial instruments or commodities held by a bank with an intention to trade. The Society does not have a trading book.
UK Corporate Governance Code (the Code)	The code (formerly known as the Combined Code), issued by the Financial Reporting Council, that sets out standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders.
Underlying profit	The purpose of this measure is to reflect management's view of the Group's underlying performance with like for like comparisons of performance across years without distortion of one-off volatility and items that are not reflective of the Group's ongoing business activities.
Unencumbered assets	Assets readily available as collateral to secure funding. This includes loans and advances to customers that, although technically encumbered, are held in respect of undrawn self-issued notes under the Group's covered bond and securitisation programmes and are therefore readily available as collateral to secure funding.
Wholesale funding	Funding received from large businesses, financial institutions and sovereign entities.

Notes

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