Pillar 3 Disclosures

for the year ended 31 December 2017

COVENTRY Building Society

Contents

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

Tables

1. Overview

1.1 Background

This Pillar 3 document sets out disclosure requirements under the Capital Requirements Regulation (CRR) and Capital Requirements Directive (together referred to as CRD IV).

These are known as Pillar 3 disclosures because they complement the minimum capital requirements in Pillar 1 and the supervisory review process in Pillar 2. The Pillar 3 disclosures are aimed at promoting market discipline by providing information on risk exposures and the management of those risks.

CRD IV requires a concise risk statement approved by the management body which describes the institution's overall risk profile associated with the business strategy. The Society has a risk philosophy to be 'a below median risk mutual'. This is evidenced by its Common Equity Tier 1 capital ratio of 34.9% (2016: 32.2%), the highest reported by any top 20 lender[1] and conservative loan to value of its mortgage book, with a balance-weighted, indexed loan to value of 53.9% (2016: 54.6%). In addition, the Society experiences low levels of arrears, at 31 December 2017 0.23% of accounts were greater than three months in arrears (2016: 0.31%) compared with 0.82% for the market as a whole[2]. Additional information on the risks the Society is exposed to and how it manages these risks is included in this document and also within the Risk Management Report in the 2017 Annual Report & Accounts.

1.2 Policy and frequency of disclosures

The CRR requires the Society to adopt a formal policy to comply with Pillar 3 disclosure requirements and the European Banking Authority has issued guidelines on materiality, proprietary and confidential information and on disclosure frequency. The Board has put in place such a policy and confirm that no disclosures have been omitted as either being proprietary or confidential. The only omissions on materiality grounds are those required under Article 447 'Exposures in equities not included in the trading book'. The fair value of these is only £2.5 million (less than 0.006% of the Society's total assets) and is made up of shares in Visa Inc. and VocaLink Holdings Limited (see note 15 to the 2017 Annual Report & Accounts).

Pillar 3 disclosures are published on an annual basis concurrently with the Annual Report & Accounts in accordance with regulatory guidelines.

1.3 Verification

These disclosures have been reviewed by the Society's Board Audit Committee on behalf of the Board, and by Ernst & Young (the Society's external auditors), for compliance with Part Eight of the CRR. These disclosures have not been, and are not required to be subject to independent external audit, and do not constitute any part of the Society's financial statements.

1.4 Governance arrangements and remuneration

Disclosure requirements relating to governance arrangements under CRR Part Eight Article 435, and in particular the declaration approved by the Board of the adequacy on risk management arrangements, are included in the Directors' Report on Corporate Governance and Annual Business Statement within the 2017 Annual Report & Accounts published on the Society's website (www.thecoventry.co.uk/accounts2017).

The disclosures required under CRR Part Eight Article 450 and the Prudential Regulation Authority's (PRA) Remuneration Code are included in the Directors' Remuneration Report within the 2017 Annual Report & Accounts.

1. Source: CML Economics – 2016 top mortgage lenders (balance outstanding) – latest published CET 1 data, as at 28 March 2018.
2. Source: UK Finance data as at 31 December 2017.

1.5 Scope of disclosures

The Society is a European Economic Area (EEA) parent institution that is regulated by the PRA and Financial Conduct Authority (FCA). The CRD IV framework therefore applies to the Society and its subsidiary undertakings. Information on these subsidiaries is set out in note 16 to the 2017 Annual Report & Accounts. There are no differences between the basis of consolidation of the Group for accounting and CRD IV purposes in preparing the Pillar 3 disclosures.

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

- Godiva Mortgages Limited
- ITL Mortgages Limited

The Society does not foresee any practical or legal impediments to the transfer of capital resources or the repayment of liabilities between Coventry Building Society and the entities included in the Individual Consolidated basis. In previous years, Five Valleys Property Company Limited was also included in the Individual Consolidation but during 2017 all of its remaining investment properties were sold and the company ceased to trade.

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

1.6 European Banking Authority Guidelines on Pillar 3 disclosures

In December 2016 the European Banking Authority (EBA) published its final Guidelines on disclosure requirements under Part Eight which provide further guidance to institutions to comply with both the CRR and the updated BCBS Pillar 3 framework. In March 2017, the EBA published further Guidelines on key liquidity ratios and figures. Both sets of Guidelines apply only to Globally and Other Systemically Important Institutions.

The Society is not a Globally or Other Systemically Important Institution and taking account of its simple business model and low risk profile has chosen not to reflect the EBA Guidelines in 2017 disclosures other than abbreviated disclosures of the Liquidity Coverage Ratio (LCR) in Appendix 6.

1.7 IFRS 9 – Expected impact on impairment

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

2. Risk management policies and objectives

2.1 Overview

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

2.2 The Society's purpose and objectives

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

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

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

2.3 Principal risks

The Society's Principal risks are set out below.

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

In addition, the Society also has pension obligation risk in relation to the now closed defined benefit pension scheme. Pension obligation risk is not considered material to the Society.

Disclosures relating to market, liquidity and funding, conduct, operational, model and strategic risks are included in the Risk Management section of the 2017 Annual Report & Accounts and are not duplicated in this document. The required Pillar 3 asset encumbrance disclosures are included in Appendix 3 and Pillar 3 Liquidity Coverage Ratio (LCR) disclosures in Appendix 6. This document does, however, include additional credit risk information to that in the 2017 Annual Report & Accounts given that credit risk is the principal driver of the Society's Pillar 1 capital requirement. In order to provide the reader with a comprehensive overview of credit risk, the 2017 Annual Report & Accounts disclosures on credit risk are also included in this document.

2.4 Controlling and managing risk – overview

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

2.5 Risk strategy

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

Risk culture

Risk culture supports the Society in achieving its stated purpose and objectives. It is defined as the normal attitudes and behaviour exhibited by employees at all levels with regard to risk awareness, risk taking and risk management.

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

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

Board risk appetite

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

The Board has a risk philosophy to be a 'below median risk mutual' which also provides a backstop against the underlying risk appetite statements and limits. Where the Society can meet its strategic objectives and remain well within its risk appetite, the Board expects the Society to do so.

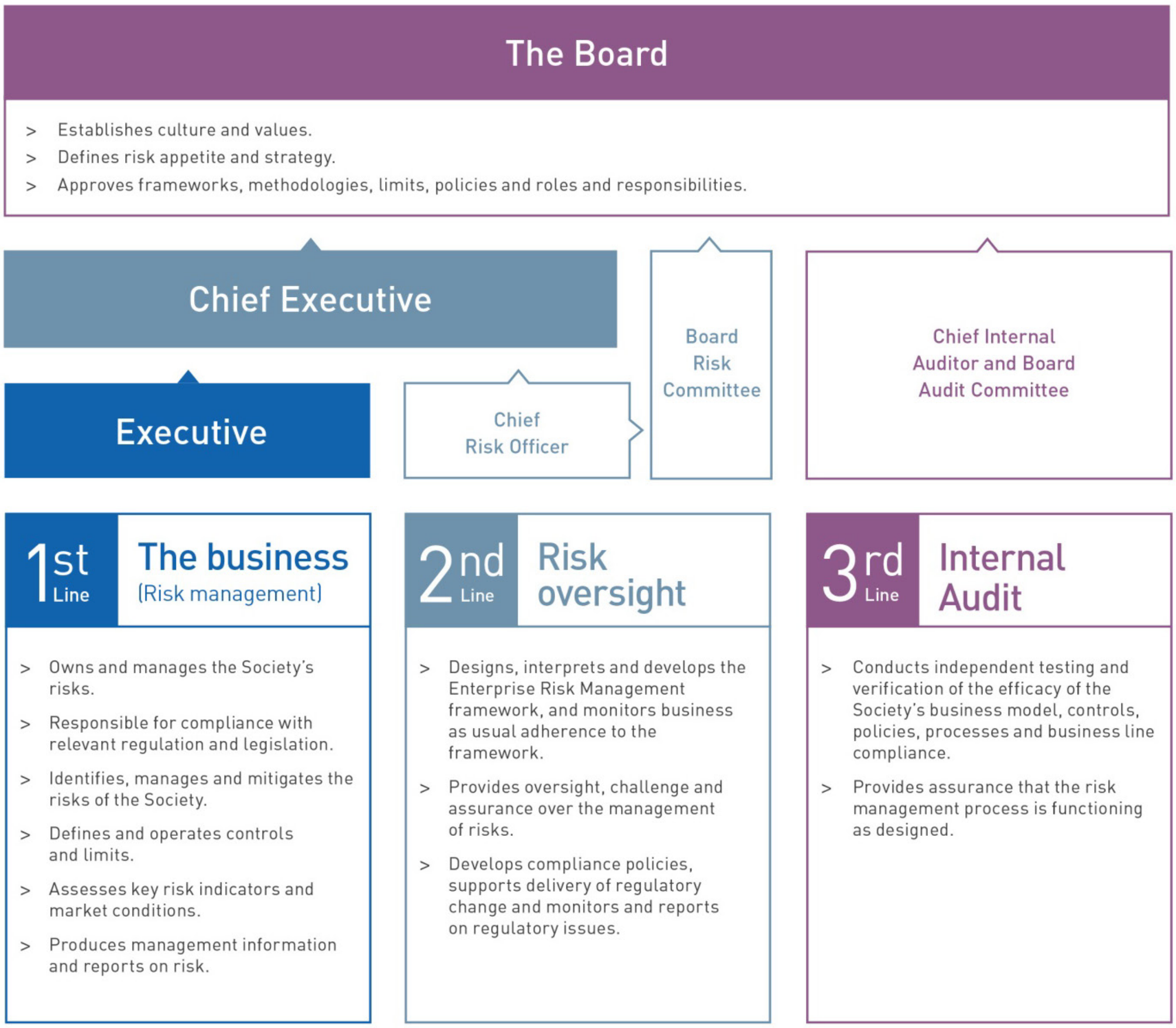
The Society's performance and adherence to Board limits is reviewed by the Executive Risk Committee (ERC), the Board Risk Committee (BRC) and the Board.

Three lines of defence

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

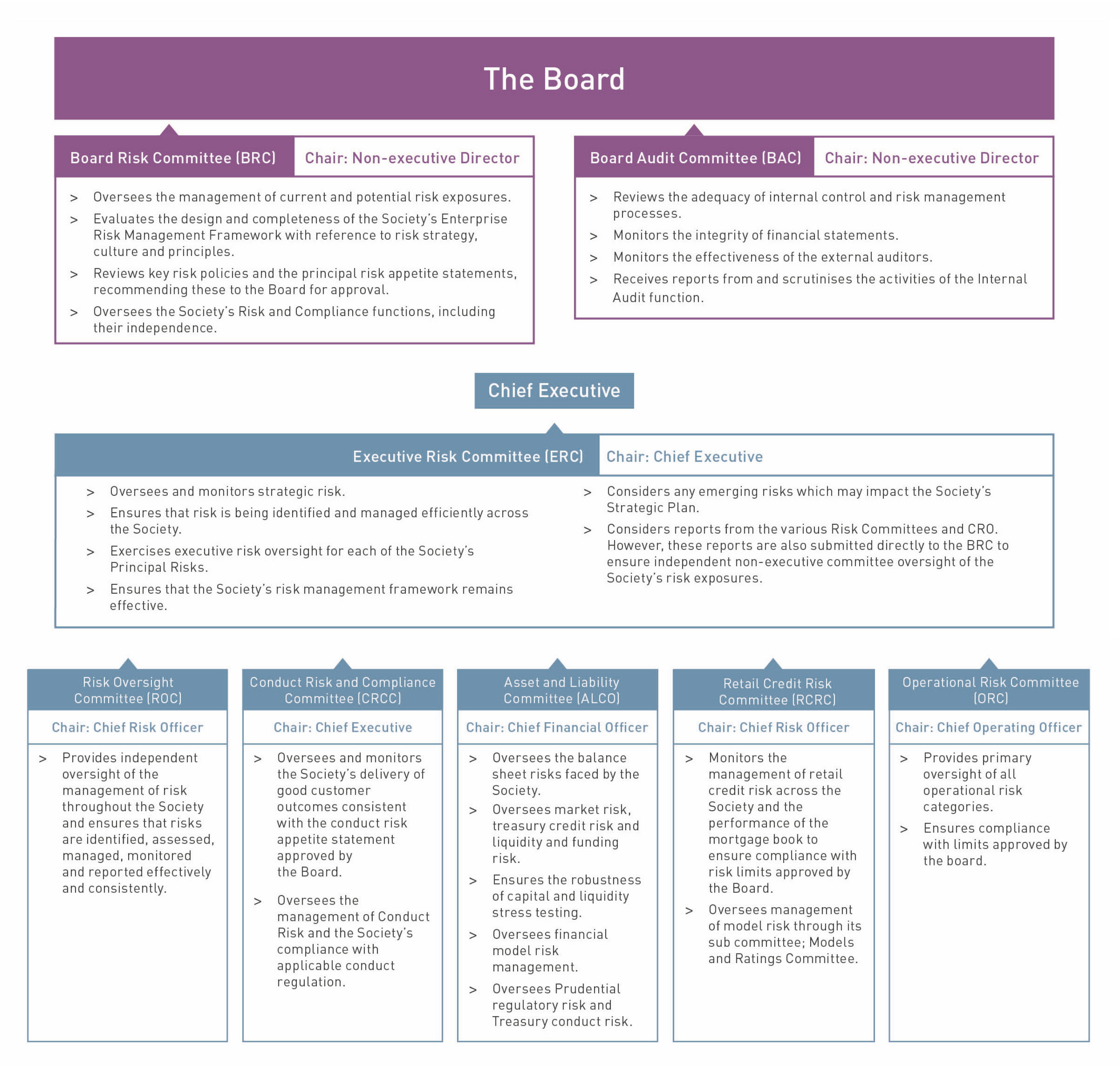
- First line of defence – risk management is primarily the responsibility of all managers and employees of the Society. Management has a responsibility to understand risks and to put in place controls or mitigating activities.
- Second line of defence – independent oversight is required to challenge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

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



2.6 Governance and control

The Society has established a number of committees to oversee and monitor risk. These include first line risk committees, which are responsible for each of the Society's risk categories, and a second line Risk Oversight Committee (ROC) which considers all risk categories. The Board delegates to the Board Risk Committee (BRC) the task of overseeing the Society's risk management arrangements as a whole. Further information on the Board Risk Committee and Board Audit Committee is included in the Directors' Report on Corporate Governance and in the Board Audit Committee Report respectively within the 2017 Annual Report & Accounts.



2.7 Risk management

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

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

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

Stress testing and planning

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

The stress testing that the Society undertakes is designed to:

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

ICAAP

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

ILAAP

The Internal Liquidity Adequacy Assessment Process (ILAAP) is the Society's assessment of its liquidity position and requirements, assessed against regulatory requirements and the Society's internal risk tolerance.

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

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

The ILAAP is reviewed by the PRA. Following this, the PRA provides Individual Liquidity Guidance which sets out the eligible liquidity that the PRA requires the Society to hold including any add-ons for liquidity risks that are not captured by the LCR. No PRA add-ons are required at this time. Throughout the year the Society has continued to meet all its internal and regulatory liquidity requirements.

Reverse stress testing

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

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.

Recovery and Resolution Plan

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

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

3. Capital resources

3.1 Total available capital and compliance with capital requirements

As at 31 December 2017 and throughout the financial year, the Society complied with capital requirements in force.

As explained in Section 1, there is a requirement to calculate and maintain regulatory capital ratios on both a Group basis and on an Individual Consolidated (or solo) basis. However, as there are no significant differences between the Group and Individual Consolidated basis, the capital information in this section is set out on a Group basis only and the term 'Society' is used as a reference for the Group.

The Society continues to use an Internal Ratings Based (IRB) approach for the vast majority of its retail credit risk exposures and a Standardised approach for other exposures and risks in order to calculate capital requirements.

Table 1 shows the composition of capital resources for the Society as at 31 December 2017 on a CRD IV basis on both a transitional and end-point basis (i.e. assuming all CRD IV requirements were in force with no transitional provisions permitted).

No transitional provisions apply to the Society's Common Equity Tier 1 (CET 1) capital and CET 1 ratio and there is therefore no difference between the end-point and transitional disclosures. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital ratios) include instruments that are grandfathered and are therefore disclosed on both a transitional and end-point basis. The transition period ends on 31 December 2021.

Table 1: CRD IV – transitional and end-point analysis

	Notes	Transitional 2017 £m	Transitional 2016 £m	End-point 2017 £m	End-point 2016 £m
Common Equity Tier 1 (CET 1)					
General reserve		**1,553.1**	1,376.1	**1,553.1**	1,376.1
Available-for-sale reserve		**5.7**	6.7	**5.7**	6.7
Cash flow hedge reserve		**20.3**	41.6	**20.3**	41.6
Common Equity Tier 1 prior to regulatory adjustments		**1,579.1**	1,424.4	**1,579.1**	1,424.4
Common Equity Tier 1 regulatory adjustments					
Prudent additional valuation adjustment	1	**(1.0)**	(1.3)	**(1.0)**	(1.3)
Intangible assets	2	**(40.8)**	(32.5)	**(40.8)**	(32.5)
Cash flow hedge reserve	2	**(20.3)**	(41.6)	**(20.3)**	(41.6)
Excess of expected loss over impairment	3	**(21.9)**	(17.1)	**(21.9)**	(17.1)
Pension fund surplus adjustment	2	**(14.2)**	(1.9)	**(14.2)**	(1.9)
Foreseeable distributions	4	**(9.3)**	(9.2)	**(9.3)**	(9.2)
Common Equity Tier 1 capital		**1,471.6**	1,320.8	**1,471.6**	1,320.8
Additional Tier 1 capital (AT 1)					
Permanent Interest Bearing Shares (PIBS)		**40.0**	40.0	**–**	–
Additional Tier 1 - Perpetual Capital Securities (PCS)		**396.9**	396.9	**396.9**	396.9
Total Additional Tier 1 capital		**436.9**	436.9	**396.9**	396.9
Total Tier 1 capital		**1,908.5**	1,757.7	**1,868.5**	1,717.7
Tier 2					
Collective provisions for impairment		**1.5**	4.3	**1.5**	4.3
Permanent Interest Bearing Shares (PIBS)	5	**–**	–	**40.0**	–
Subordinated debt		**25.0**	25.0	**–**	–
Total Tier 2 capital		**26.5**	29.3	**41.5**	4.3
Total capital		**1,935.0**	1,787.0	**1,910.0**	1,722.0
Risk weighted assets					
IRB approach					
Credit risk - retail exposures		**3,270.8**	3,175.0	**3,270.8**	3,175.0
Standardised approach					
Credit risk - retail exposures		**159.5**	180.4	**159.5**	180.4
Credit risk - liquidity book		**99.0**	110.8	**99.0**	110.8
Credit risk – other		**50.0**	52.4	**50.0**	52.4
Credit valuation adjustment risk		**46.8**	26.3	**46.8**	26.3
Operational risk		**587.0**	554.4	**587.0**	554.4
Total risk weighted assets		**4,213.1**	4,099.3	**4,213.1**	4,099.3
Capital ratios (as a percentage of risk weighted assets)	6				
Common Equity Tier 1		**34.9%**	32.2%	**34.9%**	32.2%
Total Tier 1		**45.3%**	42.9%	**44.3%**	41.9%
Total capital		**45.9%**	43.6%	**45.3%**	42.0%

Notes
1. A prudent valuation adjustment is applied in respect of assets and liabilities held at fair value.
2. Items do not form part of regulatory capital, net of associated deferred tax.
3. The expected loss over accounting provisions is deducted gross of tax.
4. Foreseeable distributions in respect of AT 1 securities (Perpetual Capital Securities) are deducted, net of tax.
5. During 2017, the Society concluded that its PIBS are eligible to be classified as Tier 2 capital on an end-point basis
6. CRD IV sets a minimum for Tier 1 capital of 6% of risk weighted assets (RWAs) of which CET 1 is required to be a minimum of 4.5% of RWAs. The total of Tier 1 and Tier 2 capital must be a minimum of 8% RWAs.

Appendix 1 sets out this information in the template format published by the EBA in 'Implementing Technical Standard (ITS) 2013/01'.

CET 1 capital, Tier 1 capital and total capital have increased primarily as a result of retained profits for the year of £184.8 million. Despite the growth in the mortgage book of over 9%, total risk weighted assets have only increased by around 3% as a result of house price inflation reducing effective risk weights and continued low loan to value lending.

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

Table 2 shows the movement in capital during 2017. CET 1 capital is the same on an end-point and transitional basis. Additional Tier 1 (AT 1) and Tier 2 capital (and therefore total capital) are disclosed on a transitional basis.

Table 2: Regulatory capital flow statement

	£m
Common Equity Tier 1 capital at 1 January 2017	1,320.8
Retained profit for the year	184.8
Other changes to General reserves	(7.8)
Change in foreseeable distributions	(0.1)
Change in prudent valuation adjustments	0.3
Change in intangible assets	(8.3)
Change in Available-for-sale reserve	(1.0)
Change in expected loss over impairment	(4.8)
Change in pension fund surplus adjustment	(12.3)
Common Equity Tier 1 capital at 31 December 2017	**1,471.6**
Additional Tier 1 capital at 1 January 2017	436.9
Additional Tier 1 capital at 31 December 2017	**436.9**
Total Tier 1 capital at 31 December 2017	**1,908.5**
Tier 2 capital at 1 January 2017	29.3
Change in eligible collective provision for impairment	(2.8)
Tier 2 capital at 31 December 2017	**26.5**
Total regulatory capital at 31 December 2017	**1,935.0**

3.2 Tier 1 capital

Tier 1 capital comprises:

- General reserve;
- Available-for-sale reserve;
- AT 1 capital – Perpetual Capital Securities (PCS);
- AT 1 capital – Permanent Interest Bearing Shares (PIBS) (transitional basis only); and
- Adjustments as set out by the regulatory requirements governing capital resources – see Table 1.

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

The Society issued £400.0 million (£396.9 million net of issuance costs) of AT 1 capital to strengthen the leverage ratio in the form of marketable Perpetual Capital Securities in June 2014. These capital securities bear a discretionary distribution coupon of 6.375% and have no fixed repayment date although the Society retains the right to repay them in November 2019, with PRA approval. The capital securities are convertible into Core Capital Deferred Shares (the equivalent of common shares for a building society, with a capped return) if the Society's CET 1 capital ratio should fall below 7%.

3.3 Tier 2 capital

Tier 2 capital comprises:

- Subordinated debt (transitional basis only); and
- Collective provisions for impairment for Standardised exposures

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

Appendix 2 shows the key features of the Society's Tier 1 and Tier 2 capital instruments and more information can be found in notes 25, 26 and 27 to the 2017 Annual Report & Accounts.

3.4 Leverage ratio

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

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

In advance of this, the PRA has implemented the Financial Policy Committee's (FPC) direction to introduce a UK leverage ratio framework. This currently only applies to banks and building societies with retail deposits of £50 billion or more. The Society is not currently captured by this requirement but could be subject to the leverage ratio regime in line with proposed EU regulations. The Society's focus on low risk assets means that the leverage requirement will be more onerous than the CET 1 capital requirement and become the most binding capital requirement on the Society.

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

The UK leverage ratio requires a minimum ratio of 3.25%, of which a maximum of 25% may be met using high quality Additional Tier 1 capital. There are two additional buffers that have to be met using CET 1 capital only. These are a Supplementary Leverage Ratio Buffer (SLRB), which does not impact the Society, and a macro-prudential Countercyclical Leverage Buffer (CCLB). The levels of these buffers will be set to 35% of the corresponding risk weighted Systemic Risk Buffer (SRB) and Macro-prudential Countercyclical Buffer (CCyB) (see section 4.4 Regulatory capital buffers).

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

The maximum theoretical leverage ratio requirement for the Society is 4.15% when buffers are at their maximum. The Board is confident that the Society will continue to maintain leverage at these levels whether or not leverage is legally binding on the Society.

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

UK Leverage Ratio Framework

To be covered by 100% Common Equity Tier 1

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

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

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

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

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

In contrast with the growth in CET1, the leverage ratio has remained broadly static at 4.1% on the original basis and 4.6% on the modified basis (2016: 4.1% and 4.4% respectively) as the increase in eligible Tier 1 capital was matched by a 10.9% increase in leverage ratio exposures, largely driven by the growth in the mortgage book and a £1.4 billion increase in liquidity assets. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Table 3: Leverage ratio

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

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

The required leverage ratio disclosures using the European Banking Authority Templates published and subsequently adopted by the European Union in February 2016 are set out in Appendix 4.

4. Capital requirements

4.1 Pillar 1

4.1.1 Introduction

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

The Society manages its capital structure to ensure it continues to exceed minimum regulatory requirements and meets the expectation of other key stakeholders.

The Society employs a number of tools to support the management of capital. The Board is responsible for setting risk appetite with respect to capital and defines minimum levels of capital (by reference to capital ratios, leverage ratios and surplus over regulatory capital requirements) that it is willing to operate with. These are translated into specific risk metrics which are monitored by the Board Risk Committee, ERC and ALCO.

The Society also undertakes an annual Internal Capital Adequacy Assessment Process (ICAAP) to determine the level of capital required to support the Society's business objectives as part of the development of the Strategic Plan. Regular stress testing is also undertaken to enhance the understanding of any potential vulnerabilities to stressed market conditions or tail-risks and management actions that could be deployed to manage these. The ICAAP and stress testing are considered further in section 4.2 below.

4.1.2 Minimum capital requirement – Pillar 1

The Society's minimum capital requirement under Pillar 1 is the sum of the credit risk capital requirement and the operational risk capital requirement. Market risk is not included in the Pillar 1 requirement because the Society does not have a trading book and foreign exchange risk is negligible.

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

The operational risk capital requirement is calculated using the Standardised approach based on total income averaged over three years. The results of the calculation are well in excess of actual experienced losses, suggesting the approach is prudent.

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

Table 4: Minimum capital requirement – Pillar 1

	RWA		Minimum capital requirements	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Credit risk (excluding counterparty credit risk (CCR)	**3,528.6**	3,458.7	**282.3**	276.7
Of which standardised approach	**257.8**	283.7	**20.6**	22.7
Of which the advanced IRB approach	**3,270.8**	3,175.0	**261.7**	254.0
Counterparty credit risk (CCR)	**92.0**	76.0	**7.3**	6.1
Of which mark to market	**45.2**	47.7	**3.6**	3.8
Of which the standardised approach	**–**	2.0	–	0.2
Of which CVA	**46.8**	26.3	**3.7**	2.1
Securitisation exposures	**2.1**	2.8	**0.2**	0.2
Of which standardised approach (SA)	**2.1**	2.8	**0.2**	0.2
Operational risk	**587.0**	554.4	**46.9**	44.3
Of which standardised approach	**587.0**	554.4	**46.9**	44.3
Amounts below the threshold for deduction (subject to 250%) risk weight	**3.4**	7.4	**0.3**	0.6
Total	**4,213.1**	4,099.3	**337.0**	327.9

4.1.3 Minimum capital requirement – credit risk

The following table shows the composition of the minimum capital required for credit risk (excluding credit valuation adjustment) at 31 December 2017.

Table 5: Minimum capital requirement for credit risk

	Notes	2017 £m	2016 £m
Internal Ratings Based (IRB)			
Retail mortgages (prime secured against residential property)		**261.7**	254.0
Standardised exposure classes			
Mortgages and loans		**12.8**	14.4
Of which retail mortgages secured against residential property		**10.2**	11.1
Of which corporates (commercial lending)		**0.2**	0.3
Of which other retail (unsecured loans)		**1.7**	2.0
Of which past due		**0.7**	1.0
Treasury		**7.9**	8.9
Of which Institutions with short term credit assessments		**3.7**	4.0
Of which other Institutions	1	**4.0**	4.7
Of which securitisation positions		**0.2**	0.2
Other		**4.0**	4.2
Of which non-credit obligation assets (fixed assets and other)		**3.7**	3.6
Of which amounts below the threshold for deduction		**0.3**	0.6
Total minimum capital requirement Standardised		**24.7**	27.5
Total minimum capital requirement IRB and Standardised		**286.4**	281.5

Note:
1. Other institutions includes minimum capital requirement of £0.1 million (2016: £0.1 million) for covered bonds, £0.1 million for central clearing counterparties (2016: £nil) and £0.3 million (2016: £0.4 million) for equity.

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

The following table shows the movement in credit risk RWAs (excluding credit valuation adjustment) over 2017.

Table 6: Risk Weighted Assets (RWA) flow statement

	IRB mortgages		Standardised mortgages and loans		Treasury		Other		Total	
	RWA amount £m	Capital requirement £m	RWA amount £m	Capital requirement £m	RWA amount £m	Capital requirement £m	RWA amount £m	Capital requirement £m	RWA amount £m	Capital requirement £m
RWAs at 1 January 2017	3,175.0	254.0	180.4	14.4	110.8	8.9	52.4	4.2	3,518.6	281.5
Book size increase/(decrease)	273.2	21.9	(18.3)	(1.4)	23.5	1.9	(2.4)	(0.2)	276.0	22.2
Book quality improvement	(177.4)	(14.2)	(2.6)	(0.2)	(35.3)	(2.9)	–	–	(215.3)	(17.3)
RWAs at 31 December 2017	**3,270.8**	**261.7**	**159.5**	**12.8**	**99.0**	**7.9**	**50.0**	**4.0**	**3,579.3**	**286.4**

The increase in IRB RWAs attributable to book size is driven by growth of the Society's mortgage book. New lending is no longer being undertaken that would be rated under the Standardised approach.

The book quality improvement for both IRB and Standardised mortgages and loans primarily reflects decreasing loan to value ratios due to house price increases and improving performance of the underlying mortgages and loans.

The book size increase in treasury RWA assets predominantly reflects increased exposures to central banks and sovereigns but as these are zero risk weighted the capital required for the overall book size increase in minimal and has been more than offset by treasury book quality improvements.

4.2 Pillar 2

4.2.1 Introduction

The Pillar 2 capital requirement reflects the Society's ICAAP assessment and any capital add-ons from the supervisory review of those assessments. It is intended to ensure that firms have adequate capital to support all the relevant risks in their business. The Pillar 2 requirement is divided into capital held against risks not captured or not fully captured by Pillar 1 (Pillar 2a – see section 4.3) and risks to which a firm may become exposed under a severe but plausible stress.

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

The Board determines the level of capital required to support the Society's business objectives by undertaking an annual ICAAP and this is considered as part of the development of the Strategic Plan. In the ICAAP, the Society reviews its 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, the adequacy of risk arrangements and the capital resources it needs to support the risk exposures over the planning horizon. The ICAAP includes consideration of Pillar 1 and Pillar 2 requirements. From 2018, semi-annual stress testing will also be undertaken in line with regulatory guidelines

The calculation of the Pillar 2 requirement examines the Society's business plans in detail, subjecting them to economic and operational stresses over a five year planning horizon. The Society bases its capital stress tests on severe but plausible stressed scenarios specified by the regulator which reflect both low and high Bank of England Base Rates. These are overlaid with additional adverse effects to provide a Society-specific stress. In addition, a range of more severe stresses are considered in support of the overall capital assessment. Reverse stress testing is integrated into existing stress testing (see section 2.7).

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

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

The output from the ICAAP financial model, including stress results, is reviewed in detail by ALCO and by BRC before submission to the Board for formal approval.

Capital levels for the Society are reported to, and monitored by the Board regularly. The Society continues to be strongly capitalised and maintains capital substantially above current regulatory requirements. The Society's Common Equity Tier 1 ratio is the highest reported by any top 20 lender[1]. The Society's level of regulatory capital surplus will tend to be driven by non-risk based measures such as the leverage ratio and the minimum requirement for own funds and eligible liabilities (MREL) - see section 4.5. The impact of other potential regulatory reforms including the Basel Committee on Banking Supervision review of the Standardised approach for calculating credit risk capital requirements and the replacement of the Basel 1 floor is covered in section 4.6 Future regulatory developments.

4.3 Pillar 2A

The PRA issues the Society with Individual Capital Guidance (ICG – from 1 January 2018 to be known as Total Capital Requirement). Following a Supervisory Review process in the first half of 2016, the Society was issued with and ICG, which is currently 12.8% of risk weighted assets, or £539 million. This sets the minimum capital the Society must hold under Pillar 1 and Pillar 2A requirements and is driven by both balance sheet growth and risk factors determined by the PRA. The Society comfortably meets this requirement using CET 1 capital alone.

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

4.4 Regulatory capital buffers

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

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

CRD IV risk adjusted capital requirements

To be covered by 100% Common Equity Tier 1

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

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

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

Appendix 5 discloses information relevant for the calculation of the CCyB as at 31 December 2017 in accordance with Regulation (EU) 2015/1555.

1. Source: CML Economics – 2016 top mortgage lenders (balance outstanding) – latest published 1. Source: CML Economics – 2016 top mortgage lenders (balances outstanding) – latest published CET 1 data, as at 28 March 2018.

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

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

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

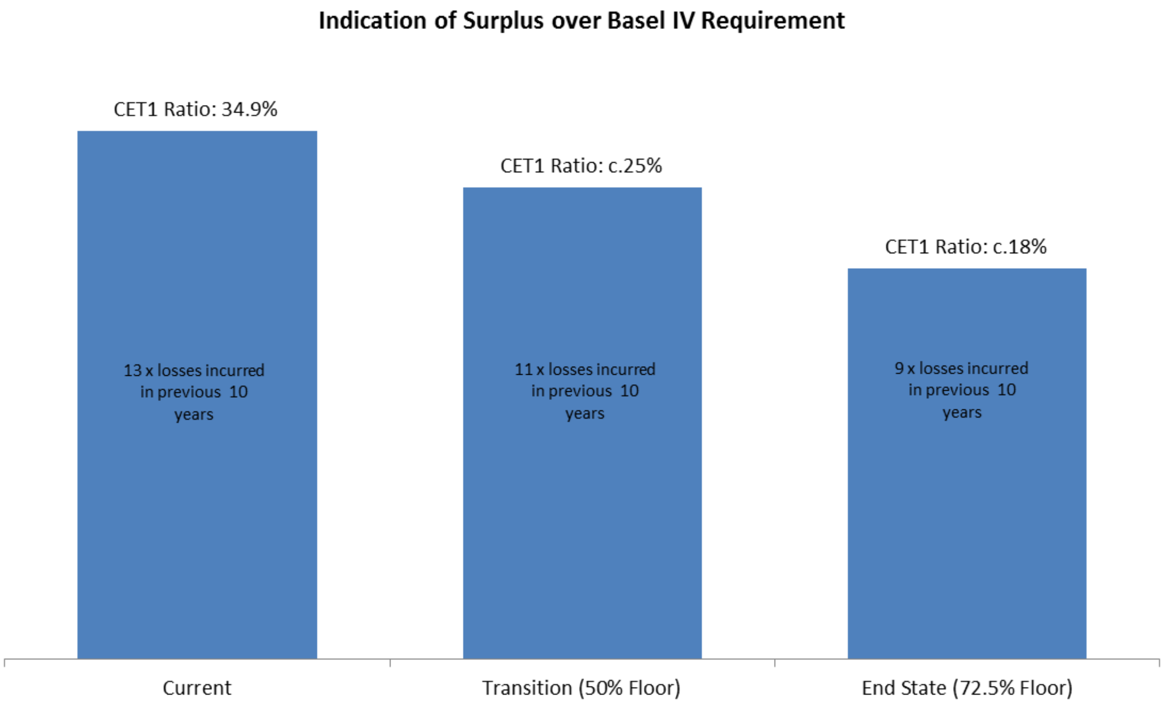
4.6 Future regulatory developments

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

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

The Society is still considering the impact of Basel 4 on its capital position, including local regulatory interpretations. The Society expects its risk based capital ratios assessed against the Basel 4 reporting requirements to show a significant reduction. However the Society is confident that it will continue to have a substantial capital surplus above regulatory minima.

The introduction of output floors under Basel 4 will not change the Society's risk profile or capital resources, but will remove much of the impact of the Society's low risk loan book from the updated capital calculations. The graph below sets out the Society's current expectations of how Basel 4 reforms would impact the reported CET 1 ratio if they were in place as at 31 December 2017 on both an initial transitional basis (50% floor in 2022) and end-state basis (72.5% floor from 2027)[1]. Even on an end state basis, the Society's surplus over the revised CET 1 ratio would be over nine times the aggregate credit losses incurred in the last ten years.



1. Indicative view and subject to final interpretation. Assumes non portfolio buy to let properties are assessed for capital as residential and not commercial exposures which is subject to local regulator confirmation.

5. Credit risk

5.1 Overview

5.1.1 Credit risk overview and exposures

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

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

5.1.2 Credit risk exposures

The exposures below are in respect of on balance sheet exposures only. Exposures are net of impairment provisions. The limited number of classes disclosed illustrates the Society's very simple business model. All retail credit risk exposures are in the United Kingdom. A distribution of this lending by region is provided in Table 11.

Table 7: Credit risk exposure

	Notes	**Average 1 January 2017 - 31 December 2017 £m**	**As at 31 December 2017 £m**	Average 1 January 2016 - 31 December 2016 £m	As at 31 December 2016 £m
Residential mortgages	1	**34,373.3**	**35,900.9**	31,106.9	32,845.6
Unsecured and other lending	1	**33.0**	**30.0**	39.4	36.0
Total retail credit risk exposures		**34,406.3**	**35,930.9**	31,146.3	32,881.6
Treasury:					
Central banks and sovereigns	1,2	**5,024.2**	**5,733.0**	4,067.9	4,315.4
Multilateral development banks (supranational bonds)	2	**–**	**–**	17.5	–
Financial institutions	1,2	**482.2**	**465.8**	472.9	498.6
Residential Mortgage Backed Securities (RMBS)	2	**12.2**	**10.7**	43.1	13.8
Total treasury credit risk exposures		**5,518.6**	**6,209.5**	4,601.4	4,827.8
Total credit risk exposures		**39,924.9**	**42,140.4**	35,747.7	37,709.4

Table 8a: Geographical distribution of credit risk 2017

As at 31 December 2017	Notes	**United Kingdom £m**	**Rest of Europe £m**	**Rest of the World £m**	**Total £m**
Residential mortgages	1	**35,900.9**	**–**	**–**	**35,900.9**
Unsecured and other lending	1	**30.0**	**–**	**–**	**30.0**
Total retail credit risk exposures		**35,930.9**	**–**	**–**	**35,930.9**
Treasury:					
Central banks and sovereigns	1,2	**5,733.0**	**–**	**–**	**5,733.0**
Financial institutions	1,2	**432.0**	**33.8**	**–**	**465.8**
Residential Mortgage Backed Securities (RMBS)	2	**10.7**	**–**	**–**	**10.7**
Total treasury credit risk exposures		**6,175,7**	**33.8**	**–**	**6,209.5**
Total credit risk exposures		**42,106.6**	**33.8**	**–**	**42,140.4**

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

Table 8b: Geographical distribution of credit risk 2016

As at 31 December 2016	Notes	United Kingdom £m	Rest of Europe £m	Rest of the World £m	Total £m
Residential mortgages	1	32,845.6	–	–	32,845.6
Unsecured and other lending	1	36.0	–	–	36.0
Total retail credit risk exposures		32,881.6	–	–	32,881.6
Treasury:					
Central banks and sovereigns	1,2	4,315.4	–	–	4,315.4
Financial institutions	1,2	488.2	1.4	9.0	498.6
Residential Mortgage Backed Securities (RMBS)	2	13.8	–	–	13.8
Total treasury risk credit exposures		4,817.4	1.4	9.0	4,827.8
Total credit risk exposures		37,699.0	1.4	9.0	37,709.4

The maturity of exposures is shown on a contractual basis:

Table 9a: Residual maturity of credit risk 2017

As at 31 December 2017	**Notes**	**Up to 12 months £m**	**1-5 years £m**	**5-10 years £m**	**More than 10 years £m**	**Total £m**
Residential mortgages	1	**2,667.0**	**9,267.0**	**9,518.3**	**14,448.6**	**35,900.9**
Unsecured and other lending	1	**2.2**	**6.6**	**7.5**	**13.7**	**30.0**
Total retail credit risk exposures		**2,669.2**	**9,273.6**	**9,525.8**	**14,462.3**	**35,930.9**
Treasury:						
Central banks and sovereigns	1,2	**4,883.8**	**657.0**	**192.2**	**–**	**5,733.0**
Financial institutions	1,2	**456.3**	**5.6**	**3.9**	**–**	**465.8**
Residential Mortgage Backed Securities (RMBS)	2	**–**	**–**	**–**	**10.7**	**10.7**
Total treasury risk credit exposures		**5,340.1**	**662.6**	**196.1**	**10.7**	**6,209.5**
Total credit risk exposures		**8,009.3**	**9,936.2**	**9,721.9**	**14,473.0**	**42,140.4**

Table 9b: Residual maturity of credit risk 2016

As at 31 December 2016	Notes	Up to 12 months £m	1-5 years £m	5-10 years £m	More than 10 years £m	Total £m
Residential mortgages	1	2,489.3	8,510.9	8,701.7	13,143.7	32,845.6
Unsecured and other lending	1	2.6	8.1	8.7	16.6	36.0
Total retail credit risk exposures		2,491.9	8,519.0	8,710.4	13,160.3	32,881.6
Treasury:						
Central banks and sovereigns	1,2	3,100.4	782.9	432.1	–	4,315.4
Financial institutions	1,2	487.2	7.4	4.0	–	498.6
Residential Mortgage Backed Securities (RMBS)	2	–	–	–	13.8	13.8
Total treasury credit risk exposures		3,587.6	790.3	436.1	13.8	4,827.8
Total retail credit risk exposures		6,079.5	9,309.3	9,146.5	13,174.1	37,709.4

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

5.2 Retail credit risk

5.2.1 Management of retail credit risk

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

Credit risk is overseen by the Retail Credit Risk Committee (RCRC) and ultimately the Board via the Committee hierarchy set out in section 2.6. To assist RCRC in this activity, a specialist retail credit risk department reporting to the Chief Risk Officer monitors exposure to credit risk and provides information to RCRC on a regular basis.

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

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

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

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

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

Additional information is available in the Retail credit risk section of the Risk Management Report in the 2017 Annual Report & Accounts.

Retail credit risk profile

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

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

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

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

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

Table 10: Credit risk profile

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

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

Residential mortgages: owner-occupier includes £264.5 million (2016: £287.9 million), less than 1% of the total gross balances, of 'equity-release mortgages', where the borrower is guaranteed that the amount recoverable by the Society at the end of the mortgage will not exceed the value of the property. The Society is therefore exposed to the risk that the value of the property at the time of redemption is lower than the loan including accumulated interest. The Society mitigated this risk by granting loans at a relatively low loan to value and has not offered new mortgages on this basis since 2009. The weighted average loan to value of the equity release book is 36.4%.

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

Table 11: Geographical distribution of residential mortgages

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

Loan to value and income multiples
The Society updates the estimated value of the mortgage portfolio on a quarterly basis using regional house price indices. The low loan to value profile of the mortgage book is a reflection of the Society's low risk approach to lending.

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

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

The loan to value distribution of the mortgage book as at 31 December 2017 has remained broadly stable as shown below.

Table 12: Total mortgage book loan to value (number of accounts)

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

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

The profile of gross lending in the year is shown below.

Table 13: Gross lending new business profile

Gross lending	2017 %	2016 %
Owner-occupier purchase	**33.8**	32.3
Owner-occupier remortgages	**28.2**	24.8
Owner-occupier further advances	**1.7**	1.3
Buy to let purchase	**7.0**	12.0
Buy to let remortgages	**28.8**	28.9
Buy to let further advances	**0.5**	0.7
Total	**100.0**	100.0
Average loan to value (balance weighted)	**59.8**	63.7

Extent and use of forbearance

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

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

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

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

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

Table 14: Forbearance

	2017 No of accounts	2017 Carrying value £m	2016 No of accounts	2016 Carrying value £m
Forbearance: Accounts past due				
Arrangements	**950**	**104.4**	1,263	136.3
Concessions	**44**	**5.2**	44	5.6
Term extensions[1]	**16**	**3.1**	18	2.8
Capitalisation of arrears[1]	**–**	**–**	1	0.1
Forbearance indicators: Accounts not past due				
Payment holidays granted by Collections department[1]	**438**	**52.0**	762	485
Term extensions[1]	**105**	**16.8**	84	12.6
Capitalisation of arrears[1]	**2**	**0.5**	6	0.5

Note:
1. Granted in the last 12 months.

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

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

5.2.2 IRB rating system

The Society has used the retail IRB approach since January 2008 to determine the required level of capital for the vast majority of its retail credit exposures. Across the Society, 99% of on balance sheet exposures as at December 2017 (2016: nearly 99%) were assessed on the IRB approach.

Capital is calculated using the Standardised approach on certain small legacy portfolios. No new lending has been originated on these products for a number of years (a drawdown facility is available for a small element of existing equity release customers).

The internal rating model and process

Three models provide the rating of credit risk:

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

Probability of default model

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

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

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

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

In addition, the application and behavioural scores also produce a point-in-time estimate of the probability of an account defaulting. The point-in-time estimates are compared with actual default rates to test the performance of the scorecards.

Loss given default model

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

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

Exposure at default (EAD) model

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

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

Comparison of impairment provisions with regulatory expected losses

Due to the different methodologies applied (see next paragraph), the amount of incurred credit losses provided for in the financial statements under International Financial Reporting Standards (IFRS – IAS 39) (£17.1 million at 31 December 2017, £18.5 million at 31 December 2016) differs from the amount determined from the expected loss models (£32.8 million at 31 December 2017, £33.9 million at 31 December 2016) that are used for regulatory purposes. The introduction of IFRS 9 from 1 January 2018 will bring an element of forward-looking assessment into the calculation of impairment allowances. However the Society still anticipates that IRB expected losses will exceed IFRS9 expected losses. The impact of IFRS 9 on the 1 January 2018 transition date is set out in section 1.7.

The IFRS impairment models use current (point-in-time) roll rates as the basis of estimating probability of default whereas the IRB model uses long run average PD estimates which in the current environment are higher than point-in-time default rates. The LGD model used for IRB expected losses is calibrated to downturn conditions (i.e. a peak-to-trough fall in house prices is assumed in the expected loss calculation). In the IFRS impairment model, current prices are used with no future house price movements being assumed.

Allocation of exposures to risk grades by the IRB rating system

The following table shows the Society's retail exposures under IRB.

Table 15: Allocation of exposures to IRB risk band

PD bands up to and including:	Exposure at default estimate 2017 £m	Average loss given default 2017 %	Average risk weight 2017 %	RWAs 2017 £m	Exposure at default estimate 2016 £m	Average loss given default 2016 %	Average risk weight 2016 %	RWAs 2016 £m
0.10	**27,724.6**	**14.5**	**5.0**	**1,375.5**	24,559.5	14.5	5.0	1, 224.5
0.20	**6,707.1**	**19.0**	**10.9**	**729.9**	6,671.0	18.8	10.6	704.4
0.30	**1,809.9**	**20.2**	**16.5**	**299.7**	1,971.3	20.6	16.8	332.2
0.50	**1,193.8**	**21.0**	**22.2**	**265.2**	1,193.6	20.7	21.8	260.1
1.00	**606.1**	**22.1**	**37.2**	**225.6**	553.9	23.3	39.7	219.9
3.00	**208.8**	**25.0**	**59.3**	**123.8**	211.5	25.9	60.6	128.2
9.99	**100.8**	**15.6**	**59.1**	**59.6**	100.8	17.1	63.0	63.6
99.99	**142.2**	**18.3**	**90.5**	**128.6**	171.8	19.2	94.5	162.4
In Default	**43.2**	**16.9**	**145.6**	**62.9**	50.6	18.4	157.4	79.7
Total	**38,536.5**			**3,270.8**	35,484.0			3,175.0

The PDs disclosed in the table above are on a point in time basis.

Treatment of undrawn exposures

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

At 31 December 2017, the value of undrawn exposures being rated under the IRB approach was £1,465.5 million (2016: £1,671.8 million).

5.2.3 Controls and governance

The Society has a comprehensive retail credit model governance framework which sets out policies and statements that govern IRB models throughout their life cycle.

The Retail Credit Risk Committee oversees management of model risk through its sub-committee, Models and Rating Committee (MRC). MRC is chaired by the Chief Financial Officer and includes in its membership the Chief Risk Officer and senior managers from the Prudential Risk and Compliance and Retail Credit Risk functions. Internal Audit also attends the MRC. MRC is responsible for ensuring that the retail credit risk model governance framework is operating effectively.

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

The second line risk function also undertakes an independent annual review of the IRB models and presents its findings to MRC.

MRC's review of IRB models includes:

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

As part of its third line responsibilities, Internal Audit undertakes an annual review of the effectiveness of the controls governing the use of IRB models.

Annually, a detailed self-assessment is undertaken of the regulatory requirements over IRB models, which includes assessment against the EU Capital Requirements Regulations and the PRA's supervisory statements and guidance. This self-assessment is undertaken by the first line Retail Credit Risk function and overseen by the second line risk function. Following this self-assessment, the Chief Risk Officer attests compliance with IRB regulatory requirements.

Credit models are used for more than regulatory capital purposes. An annual assessment of use of models is undertaken by the Retail Credit Risk function and reviewed by MRC. Examples of use include credit scores which are used to assist the New Lending function in its underwriting of mortgage applications, and behavioural information which is used to identify customers who are potentially vulnerable to financial stresses. Various components of the LGD model are also used in the impairment model.

5.2.4 IRB model performance over time

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

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

In order to provide an assessment of the accuracy of the PD and LGD models, point-in-time calibrations are used. For the PD model, the predicted default rate for accounts not in default at the start of the year is compared against the actual rate of default that emerged over the following twelve months. With respect to the LGD model, the actual losses incurred during 2017 are compared against the predicted loss on these accounts at the start of the year without the additional downturn parameters required in the regulatory capital calculation. The accuracy of the EAD estimate is calculated by comparing the balance of accounts that went into default during the year with the predicted balance 12 months prior to the account defaulting.

Point in time PD and LGD predictions against actual results are shown below. The ratio of estimated to actual EAD is also shown (a ratio of greater than 1 indicates that estimated EAD was greater than actual EAD).

Table 16: Actual Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD) against predicted

IRB retail mortgages	**Actual 2017 %**	**Predicted 2017 %**	Actual 2016 %	Predicted 2016 %
PD	**0.10**	**0.19**	0.11	0.21
LGD	**4.14**	**4.14**	4.54	4.55
EAD	**1.03**	**N/a**	1.03	N/a

Note: The PD model predicts defaults from performing (up-to-date) accounts, with a separate roll-rate model used to predict default from accounts already in arrears. The PD predictions shown above relate to performing accounts. Including non-performing accounts the actual PD was 0.17% (2016: 0.18%). As at 31 December 2017 the projected portfolio average long run PD was 0.48% (2016: 0.54%).

Predicted and actual PD and LGD rates have fallen, reflecting the continuing benign economic environment and the improved credit risk profile of the book. The point in time PD is conservatively above actual PD in both years and the model is under review to address some of this conservatism.

5.2.5 Credit risk mitigation

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

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

The initial value of the security is established by way of an internal physical inspection of the property and written report by a qualified Royal Institution of Chartered Surveyors (RICS) surveyor. An Automated Valuation Model (AVM) or drive-by valuation may be used for low loan to value owner-occupier re-mortgages and low loan to value further advances.

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

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

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

5.2.6 Impairment provisions – Assets held at amortised cost

The Society assesses its loans and advances to customers for objective evidence of impairment at each Balance sheet date. An impairment loss is recognised if there is a loss event that has occurred after initial recognition and before the Balance sheet date which has a reliably measurable impact on the estimated future cash flows.

Impairment is categorised as either individual impairment (where individual assets have been assessed for loss) or collective impairment (where losses are assessed as being present in a portfolio of loans, but they cannot be attributed to individual accounts). In addition, impairment losses are recognised for accounts where forbearance has been exercised and agreement has been reached with customers in financial difficulty to temporarily forgo some element of the payment due, or where other impairment indicators are present.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows.

Estimating future cash flows

Future cash flows are based on prudent assumptions about the value of the property representing the underlying security for the mortgage, costs that might be incurred in realising the value of the property following repossession and sale, the likelihood of repossession and the time it takes to repossess and sell properties.

- All properties used as security are valued at the outset of the loan and at the time of any further advance made during the lifetime of the loan.
- Once the value of the property has been established, the Nationwide Regional House Price Index is used on a quarterly basis to provide an updated estimate of the property's value. If repossessed a current valuation is professionally undertaken.
- Assumptions are continuously updated to reflect the time taken to sell a repossessed property and the likely discount to the latest property valuation.
- No assumptions are made as to the future value of properties beyond the estimation of a discount for the forced sale that results from a repossession of a mortgaged property.

Individual assessment of impairment

Loans are identified for individual impairment through a days-past-due trigger or if, in the opinion of management, there is evidence of impairment even if the days-past-due trigger has not yet been met, for example customers who have been declared bankrupt but continue to make their mortgage repayments as scheduled.

The Society uses financial models to assess the level of impairment. The assumptions in these models which capture experience of different mortgage types are updated regularly to reflect ongoing experience.

Collective assessment of impairment

Collective impairment assessments are made against segments of the mortgage book where there is objective evidence of impairment or where there is evidence of an increased risk of credit losses being present which cannot be individually attributed. Examples include provisions held to collectively address the risk that, in a downturn, issues will emerge that will adversely affect the value and saleability of certain types of properties that would otherwise be masked in a growing housing market.

Management judgment

Management judgement is used to apply overlays to assumptions in cash flow forecasts. For instance, current point-in-time experience may indicate improvement in a particular roll rate, but if the longer-term view is that the risk remains higher than that used in the model, an overlay may be applied to reflect the forward looking expectation of cash flows.

Recognition of post-impairment improvement

Impairment provisions are raised as the risk is recognised and measured. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, an appropriate amount of the previously recognised impairment loss is reversed and recognised in the Income Statement.

Write-off policy and recognition of post-loss recoveries

When a loan is not collectable, it is written off against the related provision for loan impairment. Such loans are written off after all normal collection options have been completed and the amount of the loss has been determined. Any subsequent recoveries of amounts previously written off is recorded in the Income Statement.

The following table shows the movement in impairment provisions during the year. The incurred loss element of the fair value adjustments arising from the merger with Stroud & Swindon Building Society in 2010 of £3.5 million (2016: £4.1 million) has been included within the opening and closing provisions.

Table 17: Movements in impairment provisions

	Loans fully secured on residential property 2017 £m	Other loans 2017 £m	Total 2017 £m	Loans fully secured on residential property 2016 £m	Other loans 2016 £m	Total 2016 £m
At 1 January						
Individual impairment	**6.4**	**4.2**	**10.6**	9.4	4.3	13.7
Collective impairment	**7.0**	**0.9**	**7.9**	7.1	0.9	8.0
	13.4	**5.1**	**18.5**	16.5	5.2	21.7
Charge/(Credit) for the year						
Individual impairment	**2.1**	**–**	**2.1**	(1.3)	(0.1)	(1.4)
Collective impairment	**(1.6)**	**(0.3)**	**(1.9)**	(0.1)	–	(0.1)
	0.5	**(0.3)**	**0.2**	(1.4)	(0.1)	(1.5)
(Credit)/Charge set against fair value adjustment	**(0.5)**	**–**	**(0.5)**	0.2	–	0.2
Amounts written off	**(0.9)**	**(0.2)**	**(1.1)**	(1.9)	–	(1.9)
At 31 December						
Individual impairment	**7.5**	**4.0**	**11.5**	6.4	4.2	10.6
Collective impairment	**5.0**	**0.6**	**5.6**	7.0	0.9	7.9
Total	**12.5**	**4.6**	**17.1**	13.4	5.1	18.5

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

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

Table 18: Analysis of Society arrears compared with UK Finance

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

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

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

Table 19a: Past due and impaired loans by loan to value 2017

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

Table 19b: Past due and impaired loans by loan to value 2016

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

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

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

Table 20a: Not impaired and impaired loans by segment 2017

As at 31 December 2017	**Not impaired** **Not past due** **£m**	 **Past due up to three months** **£m**	**Impaired** **Past due over three to six months** **£m**	 **Past due over six months or in litigation** **£m**	 **In possession** **£m**	**Impairment provision** **£m**	**Total** **£m**
Residential mortgages							
Owner-occupier	**21,491.6**	**172.0**	**29.4**	**18.9**	**2.5**	**(3.8)**	**21,710.6**
Buy to let	**13,831.2**	**62.3**	**5.4**	**4.7**	**2.3**	**(6.9)**	**13,899.0**
Non-traditional mortgages							
Residential near-prime	**51.5**	**17.6**	**4.3**	**3.4**	**0.4**	**(0.4)**	**76.8**
Residential self-certified	**189.2**	**19.5**	**3.7**	**3.5**	**–**	**(1.4)**	**214.5**
Commercial lending	**2.6**	**0.2**	**–**	**–**	**–**	**(0.8)**	**2.0**
Unsecured	**28.9**	**2.5**	**0.3**	**0.1**	**–**	**(3.8)**	**28.0**
Total	**35,595.0**	**274.1**	**43.1**	**30.6**	**5.2**	**(17.1)**	**35,930.9**

Table 20b: Not impaired and impaired loans by segment 2016

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

Movement in impaired loans

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

Table 21: Movement in impaired loans

	Traditional residential mortgages **Owner-occupier** **£m**	 **Buy to let** **£m**	**Non-traditional mortgages** **Residential near-prime** **£m**	 **Residential self-certified** **£m**	 **Commercial lending** **£m**	**Unsecured** **£m**	**Total** **£m**
Impaired at 1 January 2017	61.2	13.1	11.7	11.1	–	0.7	97.8
Classified as impaired during the year	64.0	19.0	11.3	11.4	–	0.7	106.4
Transferred from impaired to unimpaired	(67.8)	(18.8)	(14.6)	(14.2)	–	(0.5)	(115.9)
Amounts written off	(0.6)	(0.3)	–	(0.2)	–	–	(1.1)
Charged to impaired loans	1.2	0.4	0.3	–	–	–	1.9
Repayments and other movements	(7.2)	(1.0)	(0.6)	(0.9)	–	(0.5)	(10.2)
Impaired at 31 December 2017	**50.8**	**12.4**	**8.1**	**7.2**	**–**	**0.4**	**78.9**

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

5.3 Treasury credit risk

5.3.1 Management of treasury credit risk

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

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

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

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

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

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities. The on balance sheet accounting values by reference to Moody's ratings are shown below. Over 99% of the Society's treasury assets have an investment grade.

Table 22a: Treasury assets exposure value by rating 2017

As at 31 December 2017	**Aaa–Aa3 £m**	**A1–A3 £m**	**Baa1–Baa3 £m**	**Unrated[1] £m**	**Total £m**
Central banks and sovereigns	**5,733.0**	**–**	**–**	**–**	**5,733.0**
Financial institutions	**192.7**	**271.2**	**0.3[2]**	**1.6**	**465.8**
Residential mortgage-backed securities	**10.7**	**–**	**–**	**–**	**10.7**
Total	**5,936.4**	**271.2**	**0.3**	**1.6**	**6,209.5**

Table 22b: Treasury assets exposure value by rating 2016

As at 31 December 2016	Aaa–Aa3 £m	A1–A3 £m	Baa1–Baa3 £m	Unrated[1] £m	Total £m
Central banks and sovereigns	4,315.4	–	–	–	4,315.4
Financial institutions	183.9	311.6	1.4[2]	1.7	498.6
Residential mortgage-backed securities	13.8	–	–	–	13.8
Total	4,513.1	311.6	1.4	1.7	4,827.8

1. Unrated financial exposure comprises a single exposure to a building society.
2. Cash collateral held by counterparties under Credit Support Annexes (CSAs) in relation to derivative liabilities.

Capital for credit risk within the liquidity book is calculated using the Standardised approach. For central banks, sovereigns, and UK Financial Institutions with a residual maturity of less than three months, risk weights prescribed in CRD IV are used. At 31 December 2017, the exposure for UK Financial Institutions with a residual maturity of less than three months was £232.6 million (2016: £251.1 million) with a capital requirement of £3.7 million (2016: £4.0 million).

For covered bonds, RMBS and other Financial Institutions the Society uses credit ratings published by Moody's. Moody's is recognised as an eligible External Credit Assessment Institution (ECAI) for this purpose. The following table shows the exposure values and rating associated with each credit quality step.

Table 23: ECAI exposure values and ratings

	Moody's rating	Risk weight %	Exposure value 2017 £m	Minimum capital requirement 2017 £m	Exposure value 2016 £m	Minimum capital requirement 2016 £m
Retail Mortgage Backed Securities (RMBS)						
Credit quality step 1	Aaa-Aa3	20	**10.7**	**0.2**	13.8	0.2
Total RMBS			**10.7**	**0.2**	13.8	0.2
Covered bonds						
Credit quality step 1	Aaa-Aa3	10	**9.7**	**0.1**	9.9	0.1
Total covered bonds			**9.7**	**0.1**	9.9	0.1
Financial institutions						
Credit quality step 1	Aaa-Aa3	20	**80.9**	**1.3**	86.6	1.4
Credit quality step 2	A1-A3	50	**52.5**	**2.1**	54.1	2.2
Credit quality step 3	Baa1	50	**3.4**	**0.1**	9.8	0.4
Total financial institutions			**136.8**	**3.5**	150.5	4.0
Total			**157.2**	**3.8**	174.2	4.3

5.3.2 Counterparty credit risk mitigation

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

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

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

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

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

5.3.3 Counterparty credit risk - derivatives

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

Table 24: Derivative counterparty credit exposure

	Exposure value As at 31 December 2017 £m	Exposure value As at 31 December 2016 £m
Gross positive fair value of contracts	**306.5**	354.2
Netting benefits	**(95.1)**	(185.2)
Net credit exposure	**211.4**	169.0
Collateral held[1]	**(166.2)**	(124.0)
Net derivative credit exposure	**45.2**	45.0

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

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

For regulatory capital purposes, the Society measures derivative counterparty credit exposure values using the counterparty credit risk mark to market method. The net exposure value of derivatives at 31 December 2017, which includes uplifts for Potential Future Credit Exposure (PFCE) under this method, totalled £163.7 million (2016: £142.5 million).

Wrong way risk occurs when exposure to counterparty is adversely correlated with the credit quality of that counterparty. Hence, there is a tendency for the exposure to increase as the creditworthiness decreases. Wrong way credit risk can occur where transactions are collateralised by related party securities and the Society mitigates this by only accepting cash or UK government securities as collateral.

5.3.4 Impairment provisions – Treasury assets held at fair value (Available-for-sale assets)

As at 31 December 2017, the Society held £1,014.8 million (2016: £1,360.2 million) of Available-for-sale (AFS) assets. Unrealised gains and losses arising from changes in the fair value of assets which are AFS assets are recognised directly in the AFS reserve, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income Statement. For more information on AFS assets see notes 1 and 13 to the Annual Report & Accounts.

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

5.3.5 Securitisation

Purchased securitisation positions

The exposure values relating to the Society's ownership of Residential Mortgage Backed Securities (RMBS) and their associated risk weightings for capital purposes are included in Table 23 in section 5.3.1. All exposures comprise senior tranche RMBS.

Purchases and retention of RMBS are undertaken within a clearly defined credit risk policy and no purchases were made in 2017. RMBS are held as 'Available-for-sale' at fair value on the Society's balance sheet. If the assets are sold before maturity, a gain or loss would be recognised in the Income Statement. RMBS are regularly reviewed in line with article 406 of the Capital Requirements Regulations. Pricing and credit conditions are reviewed weekly and positions are stress tested quarterly against a 30% fall in house prices using Moody's published default frequencies for UK mortgages.

As at 31 December 2017, no purchased securitisation positions were past due or impaired (2016: none). The Society uses the Standardised approach for its purchased securitised positions.

Originated securitisations

The Society has securitised certain mortgage loans by transferring the loans to structured entities under the Mercia and Offa securitisation programmes. The programmes enable the Society to obtain secured funding or to create additional collateral which can be used to source additional funding.

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

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

The Society's obligations in respect of the Mercia and Offa securitisation vehicles are limited to transferring cash flows from the underlying assets and the Society and its subsidiaries are under no obligation to support any losses that may be incurred by the securitisation programmes or holders of the issued notes. The parties holding the notes in issue are therefore only entitled to obtain payment to the extent of the resources in the Mercia and Offa securitisation vehicles respectively.

As at 31 December 2017, Mercia and Offa do create a potential liquidity requirement for the Society due to legal covenants within the swap documentation which need to be fulfilled in the event of a downgrade of the Society. The cash flows from these legal covenants are in respect of amounts required to collateralise swaps and these are considered in the Society's internal assessment of its liquidity requirements. At 31 December 2017, the impact of a one notch downgrade would be to require collateral to be posted of £53.3 million and for a two notch downgrade a further £24.5 million would be required to be posted. The Society's covered bond programme gives rise to a similar liquidity risk and for a one notch downgrade the additional collateral required would be £129.4 million. No additional collateral would be required for a two notch downgrade.

Additional information on the Mercia and Offa programmes is contained in note 14 to the Annual Report & Accounts. This note also includes information on the Society's covered bonds.

Appendix 1: EBA Own Funds Disclosure Template

		Transitional CRD IV		End-point CRD IV	
		2017 £m	2016 £m	**2017 £m**	2016 £m
Common Equity Tier 1 (CET1) Capital: instruments and reserves					
2	Retained earnings	**1,553.1**	1,376.1	**1,553.1**	1,376.1
3	Accumulated other comprehensive income (and other reserves)	**26.0**	48.3	**26.0**	48.3
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	**(9.3)**	(9.2)	**(9.3)**	(9.2)
6	Common Equity Tier 1 (CET1) capital before regulatory adjustments	**1,569.8**	1,415.2	**1,569.8**	1,415.2
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
7	Additional value adjustments (negative amount)	**(1.0)**	(1.3)	**(1.0)**	(1.3)
8	Intangible assets (net of related deferred tax liability (negative amount)	**(40.8)**	(32.5)	**(40.8)**	(32.5)
11	Fair value reserves related to gains or losses on cash flow hedges	**(20.3)**	(41.6)	**(20.3)**	(41.6)
12	Negative amounts resulting from the calculation of expected loss amounts	**(21.9)**	(17.1)	**(21.9)**	(17.1)
15	Defined-benefit pension fund assets (negative amount)	**(14.2)**	(1.9)	**(14.2)**	(1.9)
28	Total regulatory adjustments to Common Equity Tier 1 (CET1)	**(98.2)**	(94.4)	**(98.2)**	(94.4)
29	Common Equity Tier 1 (CET1) capital	**1,471.6**	1,320.8	**1,471.6**	1,320.8
Additional Tier 1 (AT1) capital: instruments					
30	Capital instruments and the related share premium accounts	**396.9**	396.9	**396.9**	396.9
31	of which: classified as equity under applicable accounting standards	**396.9**	396.9	**396.9**	396.9
32	of which: classified as liabilities under applicable accounting standards				
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	**40.0**	40.0	**–**	–
36	Additional Tier 1 (AT1) capital before regulatory adjustments	**436.9**	436.9	**396.9**	396.9
44	Additional Tier 1 (AT1) capital	**436.9**	436.9	**396.9**	396.9
45	Tier 1 capital (T1 = CET1 + AT1)	**1,908.5**	1,757.7	**1,868.5**	1,717.7
Tier 2 (T2) capital: instruments and provisions					
46	Capital instruments and the related share premium accounts	**–**	–	**40.0**[1]	–
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	**25.0**	25.0	**–**	–
50	Credit risk adjustments	**1.5**	4.3	**1.5**	4.3
51	Tier 2 (T2) capital before regulatory adjustments	**26.5**	29.3	**41.5**	4.3
58	Tier 2 (T2) capital	**26.5**	29.3	**41.5**	4.3
59	Total capital (TC = T1 + T2)	**1,935.0**	1,787.0	**1,910.0**	1,722.0
60	Total risk weighted assets	**4,213.1**	4,099.3	**4,213.1**	4,099.3

1. Following further analysis during 2017, the Society has concluded that its PIBS are eligible to be classified as Tier 2 capital on an end-point basis.

		Transitional CRD IV		End-point CRD IV	
		2017 £m	2016 £m	**2017 £m**	2016 £m
Capital ratios and buffers					
61	Common Equity Tier 1 (as a percentage of total risk exposure amount)	**34.9%**	32.2%	**34.9%**	32.2%
62	Tier 1 (as a percentage of total risk exposure amount)	**45.3%**	42.9%	**44.3%**	41.9%
63	Total capital (as a percentage of total risk exposure amount)	**45.9%**	43.6%	**45.3%**	42.0%
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus systemically important institution buffer expressed as a percentage of risk exposure amount)	**5.75%**	5.125%	**5.75%**	5.125%
65	of which: capital conservation buffer requirement	**1.25%**	0.625	**1.25%**	0.625
66	of which: countercyclical buffer requirement				
67	of which: systemic risk buffer requirement				
67a	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer				
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)	**30.4%**	27.7%	**30.4%**	27.7%
Amounts below the thresholds for deduction (before risk weighting)					
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)	**1.7**	1.7	**1.7**	1.7
Applicable caps on the inclusion of provisions in Tier 2					
76	Credit risk adjustments included in T2 in respect of exposures subject to standardised approach (prior to the application of the cap)	**1.5**	9.1	**1.5**	9.1
77	Cap on inclusion of credit risk adjustments in T2 under standardised approach	**1.5**	4.3	**1.5**	4.3
Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2014 and 1 Jan 2022)					
82	Current cap on AT1 instruments subject to phase out arrangements	**40.0**	40.0	**–**	–
84	Current cap on T2 instruments subject to phase out arrangements	**25.0**	25.0	**–**	–

Appendix 2: Capital Instruments Key Features

1	Issuer	Coventry	Coventry	Coventry (Stroud & Swindon)	Coventry (Stroud & Swindon)
2	ISIN	XS1079786239	GB0002290764	N/a	N/a
3	Gov. law (sub)	English	English	English	English
	Regulatory treatment				
4	Trans. CRR rules	AT1	AT1	T2	T2
5	Post-transitional CRR rules	AT1	T2	Ineligible	Ineligible
6	Eligible at Group (G), Individual Consolidated (IC) or Society (S)	G; IC; S	G; IC; S	G; IC; S	G; IC; S
7	Instrument type (types to be specified by each jurisdiction)	Perpetual Capital Security	PIBS	Sub Debt	Sub Debt
8	Regulatory capital value (£m)	396,920,211	40,000,000	15,000,000	10,000,000
9	Nominal amount of instrument	400,000,000	40,000,000	15,000,000	10,000,000
9a	Issue price	100	100.749	100	100
9b	Redemption price	100	100	100	100
10	Accounting classification	Shareholders' equity	Liability - amortised cost	Liability - amortised cost	Liability - amortised cost
11	Date of issue	19-Jun-14	28-May-92	23-Aug-01	29-Aug-03
12	Perpetual or dated	Perpetual	Perpetual	Dated	Dated
13	Original maturity	No maturity	No maturity	23-Aug-32	29-Aug-26
14	Issuer call	Yes	No	Yes	Yes
15	Optional call date, contingent call dates and redemption amount	01/11/2019; par regulatory/tax call	N/a	23-Aug-27	29-Aug-21
16	Subsequent call dates, if applicable	5 yearly	N/a	N/a	N/a
	Coupons / dividends				
17	Fixed or floating dividend/coupon	Fixed to fixed	Fixed	Fixed to fixed	Fixed to fixed
18	Coupon rate and any related index	6.375%	12.125%	7.540%	6.327%
19	Existence of a dividend stopper	No	No	No	No
20a/b	Fully discretionary, partially or mandatory (in terms of timing)	Fully discretionary	Partially discretionary	Mandatory	Mandatory
21	Existence of step up or other incentive to redeem	No	No	Yes	Yes
22	Noncumulative or cumulative	Non-cumulative	Non-cumulative	N/a	N/a
23	Convertible or non-convertible	Convertible	Non-convertible	Non-convertible	Non-convertible
24	If convertible, conversion trigger(s)	Contractual - CET1 <7%	N/a	N/a	N/a
25	If convertible, fully or partially	Fully	N/a	N/a	N/a
26	If convertible, conversion rate	One for every £67 held	N/a	N/a	N/a
27	If convertible, mandatory or optional conversion	Mandatory	N/a	N/a	N/a
28	Specify output instrument	CCDS	N/a	N/a	N/a
29	Specify issuer of output instrument	Coventry	N/a	N/a	N/a
30	Write-down features	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in	Contractual: none; statutory: via bail-in
31-34	If w/d, trigger(s), full/partial, PWD/TWD	N/a	N/a	N/a	N/a
35	Instrument type immediately senior	Sub Debt	Sub Debt	Senior Unsecured	Senior Unsecured
36	Non-compliant transitioned features	No	Yes	Yes	Yes
37	If yes, specify non-compliant features	N/a	No contractual write-down or conversion	Step-up reset rate	Step-up reset rate

Appendix 3: Asset Encumbrance Disclosure Template

Templates A and C are as prescribed in EBA Guideline EBA/GL/2014/03 on disclosure of encumbered and unencumbered assets. The values disclosed for 2017 and for the comparative year are median values of monthly data on a rolling basis over the previous 12 months.

Template A - Assets

2017		Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
		010	040	060	090
010	**Assets of the reporting institution**	**7,858.0**		**31,369.7**	
030	Equity instruments	**–**	**–**	**2.2**	**2.2**
040	Debt securities	**–**	**–**	**1,008.1**	**1,008.1**
120	Other assets[1]	**–**		**500.2**	
2016					
010	**Assets of the reporting institution**	8,087.4		28,012.1	
030	Equity instruments	–	–	5.8	5.8
040	Debt securities	488.5	488.5	991.9	991.9
120	Other assets[1]	–		716.2	

Note:
1. Other assets include derivative financial assets; property plant and equipment; intangible assets; prepayments; deferred tax assets and pension benefit surplus and investment properties. These assets would not be available for encumbrance in the normal course of business.

Template B - Collateral received

The EBA Guideline allows competent authorities to waive the requirement to disclose Template B – Collateral received, and in Supervisory Statement SS11/14 (CRD IV11; compliance with the European Banking Authority's Guidelines on the disclosure of encumbered and unencumbered assets) the PRA waived the Template B requirements subject to a firm meeting certain criteria. The Society meets the criteria and therefore Template B is not disclosed.

Template C – Encumbered assets/collateral received and associated liabilities

2017		Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
		010	030
010	Carrying amount of selected financial liabilities	**4,537.9**	**5,737.9**
2016			
010	Carrying amount of selected financial liabilities	3,768.5	4,647.2

Template D – Information on importance of encumbrance

The most material sources of encumbrance for the Society are secured funding via the Society's covered bond and securitisation programmes which are supported by pledging mortgage assets. The Society has also utilised whole mortgage pools with the Bank of England to secure amounts drawn down under the Term Funding Scheme (TFS) and previously the Funding for Lending Scheme (FLS). Further detail on these activities is set out in note 14 to the 2017 Annual Report & Accounts. Assets are encumbered in accordance with the contractual requirements of these programmes. Furthermore, these programmes are continually assessed and a prudent buffer of over-collateralisation is voluntarily maintained for operational efficiency. The Society also pledges debt securities as collateral in sale and repurchase transactions – see note 13 to the 2017 Annual Report & Accounts.

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

In common with many other financial institutions, the Society began to make increasing use of secured funding from the start of the financial crisis with the establishment of its covered bond programme in 2008 and securitisation programmes (Leofric No. 1 plc in 2011 and Mercia No. 1 plc in 2012). In March 2016, the Society established a new Offa No. 1 plc securitisation programme and in November 2016 repaid all of the Leofric notes in issue on their call date.

Throughout 2017 the overall trend was for the level of encumbrance to decrease with in particular much lower levels of sale and repurchase (repo) agreements. Mortgage collateral previously supporting FLS treasury bills was also progressively switched to support TFS drawdowns. A comparison of the 2017 to 2016 median positions primarily reflects a lower level of repo.

The encumbered assets are predominantly all on the Society's own balance sheet other than around £1.2 billion of mortgage assets (2016: £1.4 billion) from its subsidiary Godiva Mortgages Limited and the liquid assets held within the Society's covered bond and securitisation programmes referenced above.

The over collateralisation of £1.2 billion in Template C (2016: £0.9 billion) predominantly represents over-collateralisation in respect of covered bonds, securitisations and whole mortgage pool operations.

A general description of the terms and conditions of the collateralisation agreements entered into for securing liabilities are available in the 2017 Annual Report & Accounts as follows; for sale and repurchase transactions of debt securities in note 13; for covered bonds, securitisation and whole mortgage pools in note 14; and for derivatives in note 23. The Society manages its levels of encumbrance in accordance with Board approved limits.

Appendix 4: Leverage Ratio – Disclosure Templates

Reference date	31 December 2017 (31 December 2016 for comparatives)
Entity name	Coventry Building Society
Level of application	Consolidated

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

		Applicable Amount	
		2017 **£m**	2016 £m
1	Total assets as per published financial statements	**42,572.5**	38,295.9
4	Adjustments for derivative financial instruments	**(94.4)**	(146.5)
5	Adjustments for securities financing transactions "SFTs"	**869.3**	793.9
6	Adjustment for off-balance sheet items (i.e. conversion to credit equivalent amounts of off-balance sheet exposures)	**736.8**	843.1
7	Other adjustments	**(192.6)**	(216.6)
8	**Total leverage exposure**	**43,891.6**	39,569.8

Template B - Table LRCom: Leverage ratio common disclosures

		CRR leverage ratio exposures 2017 £m	2016 £m
	On balance sheet exposures (excluding derivatives and SFTs)		
1	On-balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	**42,267.5**	37,949.5
2	(Asset amounts deducted in determining Tier 1 capital)	**(77.9)**	(52.8)
3	**Total on-balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)**	**42,189.6**	37,896.7
	Derivative exposures		
4	Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	**102.2**	113.4
5	Add-on amounts for PFE associated with all derivatives transactions (mark-to-market method)	**109.9**	94.3
7	(Deductions of receivables assets for cash variation margin provided in derivatives transactions)	**(116.2)**	(171.6)
11	**Total derivative exposures (sum of lines 4 to 10)**	**95.9**	36.1
	Securities financing transaction exposures		
14	Counterparty credit risk exposure for SFT assets	**869.3**	793.9
16	**Total securities financing transaction exposures (sum of lines 12 to 15a)**	**869.3**	793.9
	Other off-balance sheet exposures		
17	Off-balance sheet exposures at gross notional amount	**1,480.7**	1,689.7
18	(Adjustments for conversion to credit equivalent amounts)	**(743.9)**	(846.6)
19	**Other off-balance sheet exposures (sum of lines 17 to 18)**	**736.8**	843.1
	Capital and total exposures		
20	Tier 1 capital[1]	**1,800.8**	1,617.6
21	**Total leverage ratio exposures (sum of lines 3, 11, 16, 19, EU-19a and EU-19b)**	**43,891.6**	39,569.8
	Leverage ratio		
22	**Leverage ratio**	**4.1%**	4.1%
	Choice on transitional arrangements and amount of derecognised fiduciary items		
EU-23	Choice on transitional arrangements for the definition of the capital measure	**Fully phased in**	Fully phased in

Note:
1. Tier 1 capital is calculated to include the 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 only £329.2 million (2016: £296.8 million) is eligible for this measure.

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

		CRR leverage ratio exposures	
		2017 £m	2016 £m
EU-1	Total on-balance sheet exposures (excluding derivatives, SFTs, and exempted exposures), of which:	**42,267.5**	37,949.5
EU-3	Banking book exposures, of which:	**42,267.5**	37,949.5
EU-4	Covered bonds	**9.7**	9.9
EU-5	Exposures treated as sovereigns	**5,733.0**	4,315.4
EU-7	Institutions	**434.6**	461.3
EU-8	Secured by mortgages of immovable properties	**35,893.0**	32,841.6
EU-9	Retail exposures	**27.7**	33.2
EU-10	Corporate	**2.6**	3.3
EU-11	Exposures in default	**9.1**	12.7
EU-12	Other exposures (e.g. equity, securitisations, and other non-credit obligation assets)	**157.8**	272.1

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

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

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

The maximum theoretical leverage ratio requirement is 4.15% when buffers are at their maximum. 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%.

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

The leverage ratio has remained broadly static at 4.1% as the increase in eligible Tier 1 capital was matched by a 10.9% increase in leverage ratio exposures, largely driven by the growth in the mortgage book and a £1.4 billion increase in liquidity assets. This reflects the Society's strategy to remain low risk whilst retaining only sufficient profits to support leverage ratio at required levels.

Appendix 5: Countercyclical Capital Buffers - Disclosure Templates

The countercyclical buffer is an additional requirement introduced by CRD IV, calculated by applying a weighted average of country countercyclical buffer rates based on the geographical distribution of relevant exposures to the overall capital requirements of the Society. The following templates disclose information relevant for the calculation of the countercyclical buffer as at 31 December 2017 in accordance with Regulation (EU) 2015/1555 on a consolidated basis.

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

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

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

2017		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	Breakdown by country												
	UK	873.6	38,536.5	–	–	10.7	–	286.2	–	0.2	286.4	1.0	0.0
020	Total	873.6	38,536.5	–	–	10.7	–	286.2	–	0.2	286.4	1.0	0.0

2016		General credit exposures		Trading book exposures		Securitisation exposures		Own funds requirements					
Row		Exposure value for SA	Exposure value for IRB	Sum of long and short positions of trading book	Value of trading book exposures for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitisation exposures	Total	Own fund requirement weights	Countercyclical capital buffer rate
		010	020	030	040	050	060	070	080	090	100	110	120
		£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	Weighting	%
010	Breakdown by country												
	UK	946.4	35,484.0	–	–	13.8	–	281.3	–	0.2	281.5	1.0	0.0
020	Total	946.4	35,484.0	–	–	13.8	–	281.3	–	0.2	281.5	1.0	0.0

Table 2: Amount of institution specific countercyclical capital buffer

Row		2017 Column	2016 Column
			010
010	Total risk exposure amount	£4,213.1m	£4,099.3m
020	Institution specific countercyclical buffer rate	0%	0%
030	Institution specific countercyclical buffer requirement	Nil	Nil

Appendix 6: Abbreviated Liquidity Coverage Ratio (LCR) disclosures

This Appendix sets out abbreviated Liquidity Coverage Ratio (LCR) disclosures in the format prescribed in European Banking Authority Guidelines (EBA/GL/2017/01).

The LCR is a measure which aims to ensure that an entity maintains an adequate level of liquidity to meet its needs for a 30 day period under severe stress conditions. A binding minimum LCR of 80% applied to the Society from 1 October 2015, rising to 90% from 1 January 2017 and to 100% from 1 January 2018.

These disclosures complement the disclosure of liquidity risk management under the CRR which are included in the Annual Report & Accounts Risk Management Report in the Liquidity and Funding risk section.

As prescribed by the EBA Guidelines:

- The Liquidity buffer represents the amount of the Society's liquidity resources for regulatory purposes. Substantially all of the Society's liquidity buffer is made of up balances with the Bank of England and UK Government securities.
- The Total net cash outflow represents the total expected cash outflow on a stressed basis minus total expected contractual cash inflows for the subsequent 30 days.
- The values at each quarter end date are a simple average of month-end observations over the 12 months preceding the end of each quarter.

Liquidity Coverage Ratio (LCR)

	12 month weighted average			
	31-Mar-17	30-Jun-17	30-Sep-17	31-Dec-17
	£m	£m	£m	£m
Liquidity buffer	3,928.2	4,207.6	4,286.0	4,616.9
Total net cash outflow	2,539.6	2,593.0	2,611.1	2,615.1
Liquidity Coverage Ratio (LCR)	155%	163%	165%	177%

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

Glossary

The following glossary defines terminology within the Pillar 3 disclosures 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'.
Basel II	The Basel Committee on Banking Supervision's statement of best practice that defined the methods by which firms should calculate their regulatory capital requirements to retain sufficient capital to protect the financial system against unexpected losses, prior to 1 January 2014.
Basel III	The Basel Committee on Banking Supervision issued proposals for a strengthened capital regime in response to the financial crisis, which are referred to as Basel III. These standards were implemented in the European Union via CRD IV, which came into force on 1 January 2014.
Basel 4	The Basel Committee on Banking Supervision reforms published in December 2017 addressing credit risk (standardised approach with floors, and IRB), operational risk, and the leverage ratio. They are applicable from Jan 2022 and are phased in over five years
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.
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.
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%.
Countercyclical Buffer (CCyB)	A buffer that can be varied over the financial cycle to match the resilience of the banking system to the scale of risk it faces. Individual banks' buffers will depend on the geographical composition of their exposures. Applies now but currently set at 0%, rising to 0.5% from 27 June 2018 and rising further to 1.00% from 28 November 2018.
Countercyclical Leverage Buffer (CCLB)	As a guiding principle, the 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%.
Counterparty credit risk	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
Covered bonds	Debt securities that are backed by both the resources of the issuer and a portfolio of mortgages that are segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Society issues covered bonds as part of its funding activities.

Credit quality step	A credit quality assessment scale as set out in CRD IV.
Credit risk	The risk that borrowers or counterparties do not meet their financial obligations to the Society as they fall due.
Credit risk mitigation	Techniques used to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, set off or netting.
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.
Default	Circumstances in which the probability of default is taken as 100% for the purposes of the calculation of regulatory capital and compliance with CRD IV. This is defined as when a borrower reaches a predefined arrears status or when a borrower is considered unlikely to repay the credit obligation in full without the lender taking action such as realising security.
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.
Derivative financial instrument	A contract or agreement which derives its value or cash flows from changes in an underlying index such as an interest rate, foreign exchange rate or market index. The most common type of derivative instruments are interest rate swaps.
EEA parent institution	A parent financial institution situated in a Member State of the European Economic Area which is not a subsidiary of another financial institution also situated in the EEA.
Encumbered assets	Assets used to secure 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.
Expected loss	A calculation under the IRB approach to estimate the potential losses on current exposures due to expected defaults over a one year time period.
Exposure	The maximum loss that a financial institution might suffer if a borrower or wholesale counterparty fails to meet their obligations.
Exposure at Default (EAD)	A parameter used in IRB approaches to estimate the amount outstanding at the time of default.
External Credit Assessment Institution (ECAI)	An ECAI (e.g. Moody's, Standard and Poor's and Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
Fair value	The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.
Financial Conduct Authority (FCA)	A statutory body responsible for the conduct of business regulation and supervision of UK financial institutions in the UK.
Financial Policy Committee (FPC)	A committee based at the Bank of England, charged with identifying, monitoring and taking action to reduce or remove systemic risks with a view to protect and enhance the resilience of the UK financial system. It is also responsible for supporting the economic policy of the UK Government.
Fitch	A credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Forbearance	Forbearance takes place when a concession, which can be temporary or permanent, is made on the contractual terms of a loan in response to the borrower's financial difficulties.
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).
Gilts	The name given to long-term fixed income debt securities (bonds) issued by the UK Government.

IFRS/IAS	International Financial Reporting Standards/ International Accounting Standards. A set of international accounting standards stating how particular types of transactions and other disclosures should be reported in financial statements.
Impaired loans	Impaired loans are defined as those which are 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 1 and Pillar 2A and informed by ICAAP.
Interest rate swap	A contract under which two counterparties agree to exchange periodic interest payments based on a predetermined notional principal amount.
Internal Capital Adequacy Assessment Process (ICAAP)	The Society's own assessment of the amount of capital that it needs to hold to support all relevant current and future risks. This assessment includes determination of a number of capital buffers to be held in case of potential future economic stress, and provides confirmation that the Society has appropriate processes in place to ensure compliance with regulatory requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The Society's own assessment of the liquidity resources that are required to remain within the risk tolerances it has set. This will include an evaluation of potential stresses based on regulatory benchmarks and on Society-specific tests.
Internal Ratings-Based 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.
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 and to 100% from 1 January 2018.
Loan to value	The amount of mortgage loan as a percentage of the value of the property.
Loss Given Default (LGD)	A parameter used to estimate the difference between exposure at default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Member	A person who holds a share in the Society or has a mortgage loan with the Society.
Minimum requirement for own funds and eligible liabilities (MREL)	A requirement under the Bank Recovery and Resolution Directive (BRRD) which requires deposit takers to hold minimum levels of capital plus debt eligible for bail-in.
Moody's	Moody's Investor Services is a credit rating agency which provides credit ratings and research covering financial institutions and governments and their debt instruments and securities.
Mortgage backed securities	Asset backed securities that represent interests in a group of mortgages which give the investor the right to cash received from future mortgage payments of both principal and interest.
Near-prime	Loans to borrowers with marginally weakened credit histories such that their credit risk is greater than 'prime' customers, but is not considered heavily adverse.
Netting	The ability to reduce credit risk exposures through entering into ISDA master netting agreements (whereby outstanding transactions with the same party can be settled net following a default or other predetermined event) and the receipt of financial collateral.
Output floor	A Basel 4 proposal that will prevent IRB risk weightings falling below a certain level.
Over-the-counter (OTC)	Contracts that are traded (and privately negotiated) directly between two parties without going through an exchange or other intermediary. They offer flexibility because, unlike standardised exchange-traded products, they can be tailored to fit specific needs.
Owner-occupier mortgage	A mortgage on residential property that is to be occupied by the borrower.

Past due	A financial asset such as a loan is past due when the counterparty has failed to make a payment when contractually due.
Permanent Interest Bearing Shares (PIBS)	Unsecured, perpetual deferred shares of the Society offering a fixed coupon. PIBS rank equally with each other and Perpetual Capital Securities. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than Perpetual Capital Securities) as to principal and interest. Under Basel III PIBS are included as Tier 1 under transitional rules only.
Perpetual Capital Securities (PCS)	Securities that pay a non-cumulative coupon at the discretion of the Society. They rank equally with each other and Permanent Interest Bearing Shares (also AT 1 capital) but behind all other creditors of the Society, including subordinated liabilities and the claims of Shareholding Members (other than Permanent Interest Bearing Shares), as to principal and interest.
Pillar 1	The part of the Basel Framework which sets out the regulatory minimum capital requirements for credit, market and operational risk.
Pillar 2	The part of the Basel Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – ICG (see above) is an outcome of Pillar 2.
Pillar 3	The part of the Basel Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.
Point in Time (PiT)	A modelling approach which assesses the credit risk of an exposure at a single point in time.
PRA Buffer	A buffer to ensure that banks that are more at risk of loss than the system in aggregate have additional capital buffers to reflect that risk.
Principal risk	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 savings and borrowing members.
Probability of Default (PD)	A parameter used to estimate the probability of an exposure defaulting within the next 12 months.
Prudential Regulation Authority (PRA)	The statutory body responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA is a subsidiary of the Bank of England.
Residential Mortgage Backed Securities (RMBS)	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.
Reverse stress test	Regulatory stress test that requires a firm to assess scenarios and circumstances that would render its business model unviable, thereby identifying potential business vulnerabilities.
Risk appetite	The articulation of the level of risk that the Society is willing to accept in order to safeguard the interests of the Society's members, whilst also achieving business objectives.
Risk weighted assets (RWAs)	The value of assets, after adjustment to reflect the degree of risk they represent in accordance with the relevant capital rules.
Sale and repurchase agreement (repo)	An agreement to sell a financial security together with a commitment by the seller to repurchase the asset at a specified price on a given date. In substance this forms a secured loan, with the difference between the purchase price and repurchase price being the interest rate.
Securitisation	A pool of loans used to back the issuance of new securities. The loans are transferred to a structured entity which then issues securities (RMBS) backed by the assets. The Group has used residential mortgages as the loan pool for securitisation purposes.
Self-certified mortgage	An owner-occupier mortgage where the lending decision has been based on the borrower's declaration of their income and the applicant has been suitably verified.
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 Buffer.
Systemic Risk Buffer (SRB)	Buffer set for ring-fenced banks and large building societies to reduce their probability of failure or distress commensurately with the greater cost their failure or distress would have for the UK economy.
Term Funding Scheme	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.
The Standardised Approach: operational risk	The standardised approach to operational risk, calculated using three year historical net income multiplied by a percentage factor depending on the underlying business being considered.
UK Finance	A trade association that incorporates residential mortgage lending (formerly the Council of Mortgage Lenders – CML)
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.
Wrong way risk	Defined by the PRA as a situation where there is an adverse correlation between the counterparty's probability of default and the mark-to market value of the underlying transaction.

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