Interim Financial Report

for the period ended 30 June 2018

COVENTRY
Building Society

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IFRS Results

This Interim Financial Report for the six months ended 30 June 2018 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and with International Accounting Standard (IAS) 34 Interim Financial Reporting as adopted by the European Union (EU). This Interim Financial Report should be read in conjunction with the Annual Report & Accounts for the year ended 31 December 2017, which have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

Forward Looking Statements

Certain statements in this Interim Financial Report are forward looking. The Society, defined in this Interim Financial Report as Coventry Building Society and its subsidiary undertakings, believes that the expectations reflected in these forward looking statements are reasonable based on the information available at the time of the approval of this report. However, we can give no assurance that these expectations will prove to be an accurate reflection of actual results; because these statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by these forward looking statements. We undertake no obligation to update any forward looking statements whether as a result of new information, future events or otherwise.

Chief Executive's Review

Coventry Building Society performed strongly in the first half of 2018, continuing to attract and retain personal savings through a combination of good value products and excellent service, and using these funds to lend responsibly to UK mortgages borrowers.

The Society's performance across a range of measures aligned to our strategic goals is detailed below.

- **Strong mortgage growth:** Gross lending of £4.6 billion and net lending of £1.5 billion for the first half of 2018. The Society's mortgage balance is expected to have grown by more than three times the rate of the market for the 12 months to 30 June 2018[1].
- **Savings growth outperforms market:** Savings balances increased by £0.4 billion in the first half of 2018 taking overall deposits to a record £31.4 billion. In the 12 months to 30 June 2018, the Society's savings are expected to have grown by more than twice the rate of the market[1].
- **Giving value to members:** The average weighted savings rate paid to members was 1.53%, 0.76% higher than the average paid in the market (31 December 2017: 1.49%, 0.72% higher than the market)[2].
- **Delivering the right member outcomes:** The Society's overall Net Promoter Score increased to +75[3] (31 December 2017: +73), supported by low and falling complaints and one of the lowest overturn rates at the Financial Ombudsman Service[4].
- **Leading cost efficiency:** At 0.46%[5] the Society continues to report the lowest cost to mean asset ratio of any UK building society[6], whilst investing significantly in its technology infrastructure and branch network.
- **Low risk:** Loans where arrears were greater than 2.5% of the balance fell further to 0.12% compared to the market average of 0.77%[7] (31 December 2017: 0.13% compared to the market average of 0.78%).
- **Increased capital and liquidity strength:** Common Equity Tier 1 (CET 1) ratio increased to 35.5% (31 December 2017: 34.9%) and remains the highest reported by any top 20 UK lender[8] whilst the Society's leverage ratio on a UK modified basis has been maintained at 4.6% (31 December 2017: 4.6%). The Liquidity Coverage Ratio of 177% (31 December 2017: 208%) remains considerably above the minimum requirement.
- **Leading employee engagement:** The Society was rated 'Outstanding' for employee engagement and as one of the 100 Best Companies to Work For in the UK [9].
- **Supporting communities:** 78% of staff have been actively involved in the Society's community programmes over the last 12 months, and its work in schools was recognised by Business in the Community with its Education Partnership Award.

The strong performance continues the Society's track record of growth, with both savings and mortgage balances growing faster than the overall market over the last 12 months.

This is particularly notable in the savings market where growth has slowed over the last year, with overall savings rates unchanged despite an increase in the Bank of England Base Rate. Our average weighted savings rate for the first five months of 2018 was 1.53%, 0.76% higher than the market average in this period[2].

Our commitment to long term value is one reason why we continue to grow our savings balances at more than twice the rate of the market[1], and this is supported by our ongoing campaign to make savings simple and transparent for our new and existing members. We are one of only two savings providers to be recognised by Which?, and Fairer Finance has also endorsed our approach, again placing us first in its ranking of savings providers in April 2018.

The mortgage market in the first half of 2018 has continued to be very competitive with margins remaining tight. However, the Society continues to achieve strong growth both in absolute terms and in comparison to the market. While there has been some softening at the upper end of the London market, house price indices remain positive and the house purchase market, particularly in the owner occupier sector, remains healthy. We are a major provider of buy to let mortgages and this market remains resilient, despite the taxation changes that have taken effect over the last two years, with a strong focus on re-mortgaging as owners and landlords take advantage of current borrowing rates.

Net lending of £1.5 billion for the first six months of 2018 (2017: £1.6 billion) equates to an estimated 10% of the market[1]. This is after the sale of a £351 million buy to let mortgage portfolio in June 2018. In the 12 months to 30 June 2018, our mortgage balances have grown by 8%, estimated to be more than three times the rate of the market[1].

At the same time the level of mortgages in arrears and credit losses continue to fall, reflecting our commitment to low risk lending.

Chief Executive's Review

(continued)

Growth is not solely a matter of providing good long term value. We are committed to meeting our members' service expectations. This is demonstrated by increased member satisfaction and our record on complaints which, although already low, have fallen by more than 5% in the first half of 2018[10].

A commitment to providing great member service has been true of the Society for many years and has, at its heart, the professionalism of our highly engaged employees. Earlier this year we were confirmed again as one of the UK's 100 Best Companies to Work For[9]. Over 90% of our people say they are proud to work for the Coventry[11]. Part of this pride comes from the support we offer local communities and we were delighted to be awarded the Business in the Community Educational Partnership Award for the programme our staff volunteers run in local schools. It is just one example of the strong relationship that exists between employees, members and local communities.

Our service promise to members means we must invest to provide the new services they expect and to protect their interests. We have committed to do this. We have embarked on significant strategic investment programmes to further upgrade our core technology platforms and infrastructure. In addition, we are investing in our branch network and in May 2018 launched our first redesigned branch at Leicester ahead of a rollout across the network. These programmes will take time to fully implement and our priority is to do so in a structured, robust and secure way. A key strength of the Society is its ability to manage this investment whilst maintaining our low risk growth strategy and central to this is continued control of costs. Despite the increase in costs associated with the implementation of these programmes we remain the most cost-efficient of all UK building societies with a cost to mean asset ratio of 0.46%[5].

The investment we are making reflects the changes in expectations of our members in part driven by the advances in technology. We are making these changes in the context of a set of values that has underpinned the Society for many years. The same values underpin recent changes to the Board, with our new Chairman, Gary Hoffman, being joined by Iraj Amiri in June and Martin Stewart from September, all highly experienced and respected in their fields. I would like to welcome them to the Society, as well as thank Ian Geden, who retired from the Board in June, for his long and committed service.

Coventry Building Society is built on strong principles. These drive a simple and straightforward business model which focusses on Putting Members First and continues to deliver a robust financial performance. Our capital base has strengthened further, which provides security and supports our investment plans, and I am confident that this model will sustain success in the coming years.

Signed on behalf of the Board by

Mark Parsons
Chief Executive
26 July 2018

1. Source: Bank of England - latest published data as at 31 May 2018.
2. The Society's average month end savings rate compared with the Bank of England average rate for household interest bearing deposits on the Society's mix of products for the first five months of the year.
3. Net Promoter®, Net Promoter Score® and NPS® are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc. and Fred Reichheld. NPS of +75 is a calculated average from six surveys: branch survey of 8,193 customers, savings contact centre survey of 9,412 callers, mortgage contact centre survey of 971 callers, online survey amongst 2,225 users, opening a savings account survey of 2,447 customers and a survey amongst 1,003 brokers.
4. Source: Financial Ombudsman Service - latest published information: 1 July 2017 to 31 December 2017.
5. Administrative expenses, depreciation and amortisation/Average total assets.
6. As at 26 July 2018.
7. Source: Prudential Regulation Authority latest available information as at 31 March 2018.
8. Source: UK Finance, 2017 top mortgage lender (balance outstanding) latest published CET 1 data as at 26 July 2018.
9. Source: Best Companies Limited as at 31 December 2017.
10. Complaints received in 1 January 2018 to 30 June 2018 compared with 1 July 2017 to 31 December 2017.
11. Source: Internal Employee Opinion Survey – 31 December 2017.

Chief Financial Officer's Review

Summary

The Society is committed to providing long-term sustainable value to members through competitively priced savings and mortgage products. Each year we retain sufficient profit to ensure we have the capital we need, enabling us to provide favourable pricing for members. The interest rates paid to members in the six months to 30 June 2018 represented a return of value to members of £117.0 million when compared with the market average[1] (30 June 2017: £108.3 million).

During the six months to 30 June 2018, despite an increasingly price competitive market, we grew both mortgages and savings ahead of market growth and increased Net Interest Income whilst maintaining our low risk appetite as demonstrated by continuing low impairments.

We have made substantial strategic investments during the year, including the redesign of our branches and enhanced data centre capability. In addition, a programme has been initiated to upgrade the Society's core technology platform. The increased strategic investment is the major driver of the higher cost to mean asset ratio[2] of 0.46%, which is expected to remain the lowest reported in the sector. Absent this increased investment, the ratio would have been 0.41% a slight improvement on 2017 (0.42%).

As a result of the above, we added £77.1 million[3] (30 June 2017: £75.9 million) to reserves to support growth and investment, and maintained the leverage ratio[4] at 4.6% on a UK modified basis.

Income Statement

Net interest: Net interest income for the period was £213.7 million (30 June 2017: £192.3 million) and includes the gain on sale of a £350.9 million buy to let loan portfolio, which improved net interest margin by 7 basis points in the first half of 2018. Total net interest margin has increased by 1 basis point to 1.00% (30 June 2017: 0.99%), excluding this gain, the net interest margin decreased to 0.93%. This reduction reflects increased price competition in both savings and in particular mortgages which has reduced new business margins.

Other operating income: Other income for the period was £0.3 million. At 30 June 2017, other income of £5.1 million included £5.0 million gain on the sale of VocaLink Holdings Limited (VocaLink) to MasterCard.

Management expenses: Management expenses for the period were £99.6 million (30 June 2017: £81.9 million). Of the total increase of £17.7 million, £10.8 million relates to the Society's strategic investment programmes, with a £9.7 million increase in project costs in addition to a £1.1 million increase in depreciation and amortisation. The remaining increase in management expenses reflects the costs of servicing a larger membership.
The Society expects cost growth to continue in 2018 and 2019 as the change programmes progress. The Society is focused on spending members' money wisely and the cost to mean asset ratio[2] of 0.46% is expected to remain the lowest reported of all UK building societies[5] (30 June 2017: 0.42%).

Impairment: An impairment credit of £1.0 million was recognised during the period (30 June 2017: credit of £0.1 million) reflecting falling arrears levels and rising house prices. The business model continues to be focused on low risk lending and the average loan to value (balance weighted average) of loans originated in the six months to 30 June 2018 is broadly unchanged at 61% (31 December 2017: 60%). During the period, arrears cases have continued to fall from the already low levels that were seen during 2017. The Society implemented IFRS 9 *Financial Instruments* on 1 January 2018 which has changed the way impairment is calculated, see pages 7 to 9 for IFRS 9 transitional reporting.

Provisions for liabilities and charges: The £0.4 million credit in the period relates to a £1.9 million credit for Financial Services Compensation Scheme (FSCS) and other regulatory provisions (30 June 2017: £2.5 million charge), offset by a £1.5 million charge for Payment Protection Insurance (PPI) (30 June 2017: £1.0 million charge) which relates to an expected increase in claims ahead of the August 2019 deadline.

Charitable donation: The Society donated £0.8 million to The Royal British Legion's Poppy Appeal during the period (30 June 2017: £0.6 million).

Tax: The corporation tax charge represented an effective rate of tax of 23.6% (30 June 2017: 24.2%).

Chief Financial Officer's Review

(continued)

Balance Sheet

Loans and advances to customers: The Society's lending strategy is focused on high quality, low loan to value owner-occupier and buy to let loans within the prime residential market, distributed mainly through mortgage intermediaries in addition to our own distribution channels. During the period, the Society advanced £4.6 billion of mortgages (30 June 2017: £4.4 billion), with net mortgage lending of £1.5 billion after the sale of a £350.9 million buy to let loan portfolio which was completed in June 2018 (30 June 2017: £1.6 billion). The overall balance weighted average indexed loan to value of the mortgage book at 30 June 2018 has been maintained at 54% (31 December 2017: 54%), which reflects the low risk nature of the Society's lending activities.

Liquidity: On-balance sheet liquid assets have remained stable at £6.0 billion (31 December 2017: £6.2 billion), and the Liquidity Coverage Ratio at 30 June 2018 was 177% (31 December 2017: 208%), significantly in excess of the regulatory minimum.

Retail savings: The Society continues to be predominantly funded by retail savings, with balances of £31.4 billion at 30 June 2018 (31 December 2017: £31.0 billion) and growth of £0.4 billion during the first six months of the year.

Wholesale funding: The Society uses wholesale funding to provide diversification by source and term and also to provide value to members through lowering the overall cost of funding. During the period, wholesale funding[6] has increased to £9.9 billion (31 December 2017: £9.1 billion). This reflects further utilisation of the Term Funding Scheme (TFS) ahead of its closure in February 2018 offset by maturities of debt securities.

Capital Ratios

The table below provides a summary of the Society's capital resources and CRD IV ratios on an end-point basis (i.e. assuming all CRD IV requirements were in force in full with no transitional provisions permitted).

	End-point 30 Jun 2018 £m	End-point 30 Jun 2017 £m	End-point 31 Dec 2017 £m
Capital resources:			
Common Equity Tier 1 (CET 1) capital	**1,537.6**	1,391.5	1,471.6
Total Tier 1 capital	**1,934.5**	1,788.4	1,868.5
Total capital	**1,974.5**	1,792.8	1,910.0
Risk weighted assets	**4,336.9**	4,096.6	4,213.1
CRD IV ratios:	**%**	%	%
Common Equity Tier 1 (CET 1) ratio	**35.5**	34.0	34.9
Leverage ratio[4]	**4.1**	4.1	4.1
Leverage ratio (modified)[7]	**4.6**	4.5	4.6

Following a Supervisory Review process in the first half of 2016, the Society has been issued with an Individual Capital Guidance (ICG) of 12.8% by the Prudential Regulatory Authority (PRA), this is the sum of its Pillar 1 and Pillar 2A requirements. With a CET 1 ratio of 35.5% the Society comfortably meets this requirement using CET 1 capital alone. The CET 1 ratio has increased as a result of retained profit exceeding the increase in risk weighted assets which relates to mortgage book growth.

The capital disclosures above are on a Group basis, including all subsidiary entities. For regulatory purposes the Group also reports on an Individual Consolidated basis, which only includes those subsidiaries meeting particular criteria contained within CRD IV. The Individual Consolidated CET 1 ratio on an end-point basis at 30 June 2018 is 0.9% higher than the Group ratio due to assets held by entities that sit outside of the Individual Consolidation, primarily those held by the Group's securitisation and covered bond entities.

1. The Society's average month end savings rate compared with the Bank of England average rate for household interest bearing deposits on the Society's mix of products.
2. Administrative expenses, depreciation and amortisation/Average total assets.
3. Profit after tax including Additional Tier 1 capital distribution (net of tax).
4. The leverage ratio is calculated in accordance with the definitions of CRD IV as amended by the European Commission delegated regulation. The calculation reflects constraints on the inclusion of Additional Tier 1 capital, in accordance with the Financial Policy Committee's leverage ratio regime.
5. As at 26 July 2018.
6. Deposits from banks, Other deposits, Amounts owed to other customers and Debt securities in issue.
7. Leverage ratio modified under the UK regulatory regime by excluding central bank reserves from the calculation of leverage exposures.

Top and Emerging Risks

The Society's risk philosophy is to be a below median risk mutual, taking risks within appetite where those risks are understood and can be managed.

A description of the Top and Emerging risks is given in this report to the extent that they differ from those at 31 December 2017 as reported on pages 27 and 28 of the 2017 Annual Report & Accounts. The Society's principal risk categories were described in detail on pages 29 to 52 of the 2017 Annual Report & Accounts and the Society's view of these has not changed during 2018.

Economic and political uncertainty

In the first six months of 2018 the level of uncertainty surrounding both Brexit and the UK political landscape has grown. Whilst the Financial Policy Committee has commented that the UK Banking system could support the real economy through a disorderly Brexit, the potential range of outcomes for Brexit has widened. This may negatively impact the UK economy. Whilst the Society's UK focus means it is protected in the main from direct adverse implications from Brexit, it could be impacted by wider economic changes.

There is a risk that reduced economic confidence or a fall in either house prices or rental yields could result in a reduced demand for mortgages, which may, in turn, trigger further mortgage margin compression as lenders respond to lower opportunities to lend. Similarly, a reduction in confidence or pressure on real incomes may dampen savings demand. Political uncertainty may reduce the wholesale market's appetite to lend to the UK Bank and Building Society Sector.

In the view of the Board, the Society's simple low-cost operating model and very high quality loan book improves its resilience to these risks.

Market outlook

As noted in the 2017 Annual Report & Accounts there are a number of factors which could exert pressure on the Society's net interest margin. During the last six months price competition within the UK mortgage market has increased further. This and the continuation of a low base rate environment creates an industry wide pressure on new business margins. At the same time, there are early signs of increased price competition for savings reflecting both a modest slow down in the UK savings market and the ending of the Term Funding Scheme.

As expected, the attractiveness of the buy to let market to new investors is reducing as a result of tax policy changes. However, the buy to let remortgage market remains buoyant such that the Society continues to lend strongly in this sector.

Technology investment and branch redesign

The Society is committed to a programme of strategic investment which includes branch redesign and an upgrade of its data centres and core technology platform. During the first half of 2018, the Society has made good progress with these programmes. The data centre infrastructure build and initial data migrations are due to take place within the next 12 months, and the first redesigned branch was opened in May. The core technology platform upgrade has entered the detailed design phase which will involve significant management engagement in 2018.

This progress means that a number of inherent programme uncertainties have been resolved. However, it naturally follows that such uncertainties will be replaced by delivery and execution risks as these programmes move into their implementation phases. To manage this risk, additional business controls and monitoring are being put in place alongside additional independent risk management oversight.

IFRS 9 Transition Report

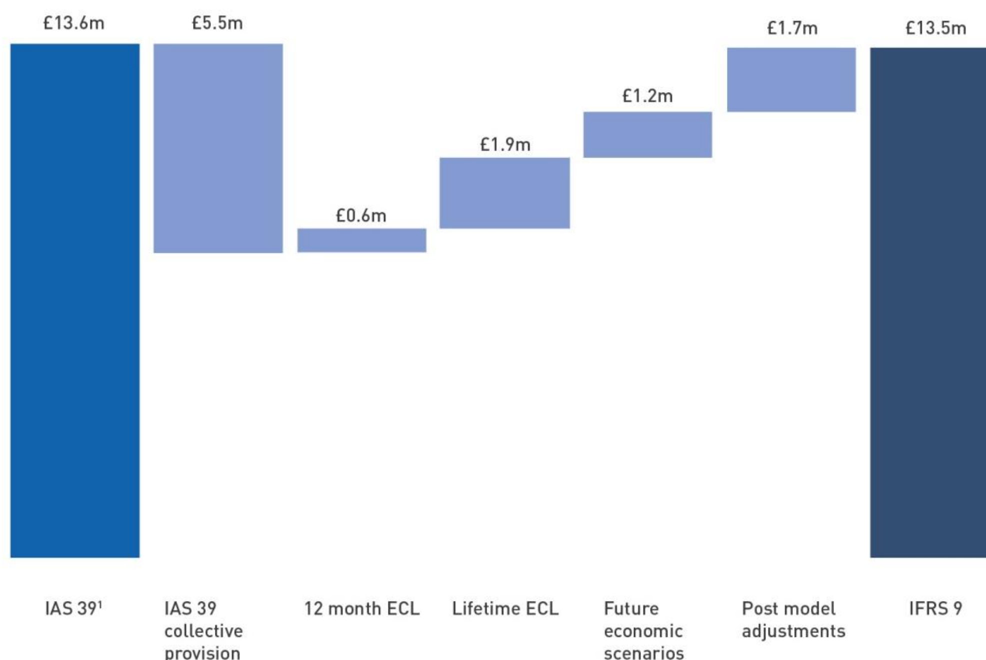
The Society implemented IFRS 9 Financial Instruments on 1 January 2018. This has required changes to the classification and measurement of financial assets and liabilities and the recognition of impairment.

This IFRS 9 transition report is provided in order to give an update on changes to the Society's financial results and explain the significant judgements which have been applied. The Society's first full set of financial statements prepared under IFRS 9 will be published in the 2018 Annual Report & Accounts.

The most significant change for the Society relates to the calculation of impairment provisions for its loans and advances to customers. This calculation is now performed on an expected credit loss (ECL) basis, rather than on an incurred loss basis. IFRS 9 requires the Society to categorise its financial assets into one of three stages at the balance sheet date. Assets that are performing are shown in stage 1; assets where there has been a significant increase in credit risk since initial recognition or 'deteriorating' assets are in stage 2 and accounts which are in 'default' are in stage 3. The Society is required to recognise a 12 month expected credit loss allowance on all stage 1 assets and a lifetime expected credit loss allowance on all stage 2 and 3 assets.

The impact of this change on impairment of loans and advances to customers is not significant as a result of the Society's high credit quality, low risk mortgage lending. The previous IAS 39 impairment provision reflected both incurred losses on individual loans and amounts to reflect the underlying risk of credit losses which existed but had not been observed. Under IFRS 9, an expected credit loss is calculated at an individual account level basis which includes the incorporation of forward looking economic scenarios. The total impairment provision is broadly consistent under both reporting standards, although it is expected that the IFRS 9 provision will be more volatile in future periods due to the impact of forward looking economic scenarios.

The diagram below explains the movement in impairment on loans and advances to customers as reported at 31 December 2017 to 1 January 2018.



1. IAS 39 position is stated after reclassification of impairment of loan notes totalling £3.5 million which were fully provided for under IAS 39 and have been reclassified to fair value through profit and loss on transition to IFRS 9 and included within loans and advances to credit institutions on the Balance Sheet.

Information relating to the classification and measurement of financial assets under IFRS 9 and adjustments which have been made to the Society's balance sheet on transition is included on pages 15 to 18.

IFRS 9 Transition Report
(continued)

Loans and advances to customers, split by IFRS 9 Stage are shown below:

As at 30 June 2018	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
Residential mortgages					
Owner-occupier	**21,582.6**	**700.6**	**142.6**	**(5.1)**	**22,420.7**
Buy to let	**14,286.3**	**373.5**	**36.1**	**(3.5)**	**14,692.4**
Non-traditional mortgages					
Residential near-prime	**31.6**	**18.9**	**20.4**	**(0.2)**	**70.7**
Residential self-certified	**114.7**	**65.4**	**19.7**	**(1.5)**	**198.3**
Commercial lending	**-**	**2.0**	**0.5**	**(0.8)**	**1.7**
Unsecured loans	**25.4**	**0.4**	**0.4**	**(0.6)**	**25.6**
Mortgage pipeline	**-**	**-**	**-**	**(0.1)**	**(0.1)**
Total	**36,040.6**	**1,160.8**	**219.7**	**(11.8)**	**37,409.3**

The table below analyses loans by accounts which are past due and not past due at the reporting date. The criteria for determining a significant increase in credit risk which results in loans being classified in Stage 2 are relative to the expectation of the loan at origination. In addition, there are cure periods applied to each stage which work to delay transition of loans to a lower credit risk classification (i.e. from Stage 3 to Stage 2 or from Stage 2 to Stage 1) by requiring typically 12 months of sustained performance before a loan is reassessed. As a result, loans can be recorded as Stage 2 or 3 despite otherwise performing at the reporting period date.

Of the balances in Stage 2 as at the reporting date, £1,071.2 million (92%) were paid up to date as at the balance sheet date. In addition, of the £219.7 million balances in Stage 3, £80.8 million (37%) were paid up to date at the balance sheet date.

	Stage 2 'Deteriorating'			Stage 3 'Default'		
As at 30 June 2018	Not past due £m	Past due £m	Total £m	Not past due £m	Past due £m	Total £m
Residential mortgages						
Owner-occupier	**643.5**	**53.8**	**697.3**	**50.2**	**88.7**	**138.9**
Buy to let	**346.3**	**27.2**	**373.5**	**15.0**	**21.1**	**36.1**
Non-traditional mortgages						
Residential near-prime	**16.0**	**2.9**	**18.9**	**4.7**	**15.7**	**20.4**
Residential self-certified	**60.3**	**5.1**	**65.4**	**7.5**	**12.2**	**19.7**
Commercial lending	**1.8**	**0.2**	**2.0**	**0.5**	**-**	**0.5**
Unsecured loans	**-**	**0.4**	**0.4**	**-**	**0.4**	**0.4**
Equity release	**3.3**	**-**	**3.3**	**2.9**	**0.8**	**3.7**
Total	**1,071.2**	**89.6**	**1,160.8**	**80.8**	**138.9**	**219.7**

Possession levels have remained low and of the £219.7 million loans which are classified within Stage 3, only £7.0 million of these relate to properties which are in possession. This relates to 37 individual cases and represents 0.02% of the total mortgage book.

IFRS 9 Transition Report
(continued)

The loan to value distribution of the mortgage book has remained broadly stable during 2018. This is analysed by IFRS 9 Stage below.

As at 30 June 2018 Indexed loan to value:	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
< 50%	**14,533.8**	**427.4**	**82.4**	**(1.1)**	**15,042.5**
50% to 65%	**11,507.3**	**365.1**	**63.1**	**(2.4)**	**11,933.1**
65% to 75%	**6,044.8**	**207.5**	**30.3**	**(1.5)**	**6,281.1**
75% to 85%	**2,826.3**	**101.2**	**20.7**	**(1.8)**	**2,946.4**
85% to 95%	**1,090.8**	**51.0**	**14.3**	**(1.7)**	**1,154.4**
95% to 100%	**6.6**	**5.4**	**2.1**	**(0.5)**	**13.6**
> 100%	**5.6**	**2.8**	**6.4**	**(2.1)**	**12.7**
Unsecured loans	**25.4**	**0.4**	**0.4**	**(0.6)**	**25.6**
Mortgage pipeline	**-**	**-**	**-**	**(0.1)**	**(0.1)**
Total	**36,040.6**	**1,160.8**	**219.7**	**(11.8)**	**37,409.3**

The credit quality of the mortgage book, shown by IFRS 9 lifetime probability of default (PD) by stage is set out below. This table reflects the PD of a given loan over its life (i.e. PD <= 0.25 indicates a 0.25% or lower chance of default). Default includes cases which are three months in arrears, have been three months in arrears at some point in the last twelve months, and cases which have triggered a specified unlikeliness to pay indicator. This indicates that the mortgage book has a very low underlying risk of default, with 90% of the book having a PD of 0.5% or less.

As at 30 June 2018 Probability of default (%):	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Impairment £m	Total £m
<=0.25	**31,017.8**	**15.1**	**-**	**(0.2)**	**31,032.7**
<=0.5	**2,461.1**	**35.8**	**-**	**(0.1)**	**2,496.8**
<=1.5	**1,939.6**	**132.7**	**-**	**(0.2)**	**2,072.1**
<=5	**232.5**	**332.2**	**-**	**(0.2)**	**564.5**
<=20	**67.7**	**412.8**	**-**	**(0.4)**	**480.1**
<100	**47.0**	**225.7**	**-**	**(0.6)**	**272.1**
Other*	**274.9**	**6.5**	**2.5**	**(2.8)**	**281.1**
Default	**-**	**-**	**217.2**	**(7.2)**	**210.0**
Mortgage pipeline	**-**	**-**	**-**	**(0.1)**	**(0.1)**
Total	**36,040.6**	**1,160.8**	**219.7**	**(11.8)**	**37,409.3**

*includes mortgage portfolios and other loans where the probability of default is not assessed.

Additional information on the implementation of IFRS 9 is within the Notes to the Interim Financial Report on pages 15 to 21. This includes information relating to the classification and measurement of financial assets, adjustments to the Society's balance sheet on transition to IFRS 9 and the calculation of expected credit losses.

Condensed Consolidated Income Statement

For the period ended 30 June 2018

	Notes	**Period to 30 Jun 2018 (Unaudited) £m**	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Interest receivable and similar income[1]	3	**480.5**	430.5	895.1
Interest payable and similar charges	4	**(266.8)**	(238.2)	(484.1)
Net interest income		**213.7**	192.3	411.0
Fees and commissions receivable		**4.1**	4.7	9.1
Fees and commissions payable		**(5.4)**	(4.9)	(9.1)
Other operating income	5	**0.3**	5.1	5.1
Net (losses)/gains from derivative financial instruments		**(0.6)**	1.1	(0.3)
Total income		**212.1**	198.3	415.8
Administrative expenses	6	**(89.2)**	(72.6)	(148.9)
Amortisation of intangible assets		**(6.7)**	(6.0)	(12.3)
Depreciation of property, plant and equipment		**(3.7)**	(3.3)	(6.7)
Impairment credit/(charge) on loans and advances to customers	7	**1.0**	0.1	(0.2)
Provisions for liabilities and charges	8	**0.4**	(3.5)	(3.5)
Charitable donation to Poppy Appeal		**(0.8)**	(0.6)	(1.5)
Profit before tax		**113.1**	112.4	242.7
Taxation		**(26.7)**	(27.2)	(57.9)
Profit for the financial period		**86.4**	85.2	184.8

1. Interest receivable and similar income includes £14.9 million gain on derecognition of financial assets. In the year ended 31 December 2017 it included £12.6 million release of fair value adjustment.

Profit for the financial period arises from continuing operations and is attributable to the members of the Society.

Condensed Consolidated Statement of Comprehensive Income

For the period ended 30 June 2018

	Notes	Period to 30 Jun 2018	Period to 30 Jun 2017	Year ended 31 Dec 2017
Profit for the financial period		**86.4**	85.2	184.8
Other comprehensive income				
Items that will not be transferred to the Income Statement:				
Remeasurement of defined benefit plan		**-**	-	14.5
Taxation		**-**	-	(3.9)
Effect of change in corporation tax rate		**-**	-	0.2
Items that may be transferred to the Income Statement:				
Fair value through other comprehensive income investments[1]:				
Fair value movements taken to reserves		**(10.6)**	(9.8)	(21.6)
Amount transferred to Income Statement	15	**9.7**	9.2	20.1
Taxation		**0.2**	0.1	0.4
Effect of change in corporation tax rate		**-**	-	0.1
Cash flow hedges:				
Fair value movements taken to reserves		**5.0**	29.9	(10.9)
Amount transferred to Income Statement		**(0.2)**	(49.7)	(17.9)
Taxation		**(1.3)**	5.4	7.9
Effect of change in corporation tax rate		**0.1**	(0.2)	(0.4)
Other comprehensive income/(expense) for the period, net of tax		**2.9**	(15.1)	(11.5)
Total comprehensive income for the period, net of tax		**89.3**	70.1	173.3

1. Fair value through other comprehensive income (FVOCI) investments relates to assets classified as FVOCI under IFRS 9 from 1 January 2018, in previous reporting periods these were Available-for-sale investments.

The notes on pages 14 to 29 form part of this Interim Financial Report.

Condensed Consolidated Balance Sheet

As at 30 June 2018

	Notes	**30 Jun 2018 (Unaudited) £m**	30 Jun 2017 (Unaudited) £m	31 Dec 2017 (Audited) £m
Assets				
Cash and balances with the Bank of England		**4,799.9**	3,773.3	4,995.2
Loans and advances to credit institutions		**215.4**	194.6	202.0
Debt securities		**957.9**	1,001.2	1,012.3
Loans and advances to customers	9	**37,409.3**	34,527.6	35,930.9
Hedge accounting adjustment		**(12.6)**	63.5	17.2
Derivative financial instruments		**275.8**	343.1	306.5
Investment in equity shares		**2.8**	2.2	2.5
Intangible assets		**48.9**	37.5	40.8
Property, plant and equipment		**37.1**	34.7	36.2
Investment properties		**-**	0.1	-
Pension benefit surplus		**19.4**	3.3	18.5
Deferred tax assets		**-**	1.9	-
Prepayments and accrued income		**12.6**	11.9	10.4
Total assets		**43,766.5**	39,994.9	42,572.5
Liabilities				
Shares		**31,442.5**	29,935.7	31,035.7
Deposits from banks		**5,239.4**	1,851.3	3,499.0
Other deposits		**3.0**	6.0	4.0
Amounts owed to other customers		**763.6**	903.8	735.5
Debt securities in issue	11	**3,894.9**	4,904.0	4,888.8
Hedge accounting adjustment		**45.4**	111.0	76.5
Derivative financial instruments		**167.2**	256.0	214.0
Current tax liabilities		**26.7**	22.7	23.2
Deferred tax liabilities		**11.4**	9.5	10.3
Accruals and deferred income		**32.4**	26.3	28.0
Other liabilities		**12.3**	8.7	8.7
Provisions for liabilities and charges	8	**4.5**	10.7	5.7
Subordinated liabilities	12	**25.5**	25.5	25.5
Subscribed capital	13	**41.6**	41.6	41.6
Total liabilities		**41,710.4**	38,112.8	40,596.5
Equity				
General reserve		**1,631.2**	1,452.0	1,553.1
Other equity instruments	14	**396.9**	396.9	396.9
Fair value through other comprehensive income reserve[1]	15	**4.1**	6.2	5.7
Cash flow hedge reserve		**23.9**	27.0	20.3
Total members' interests and equity		**2,056.1**	1,882.1	1,976.0
Total members' interests, liabilities and equity		**43,766.5**	39,994.9	42,572.5

1. Fair value through other comprehensive income reserve relates to assets classified as FVOCI under IFRS 9 from 1 January 2018, in previous reporting periods this was the Available-for-sale reserve.

The notes on pages 14 to 29 form part of this Interim Financial Report.

Condensed Consolidated Statement of Changes in Members' Interests and Equity

For the period ended 30 June 2018

	Notes	General reserve £m	Other equity instruments £m	Fair value through other comprehensive income reserve[1] £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2018 (Audited)		**1,553.1**	**396.9**	**5.7**	**20.3**	**1,976.0**
Changes on initial application of IFRS 9		**1.0**	**-**	**(0.9)**	**-**	**0.1**
Restated balance at 1 January 2018		**1,554.1**	**396.9**	**4.8**	**20.3**	**1,976.1**
Profit for the financial period		**86.4**	**-**	**-**	**-**	**86.4**
Net movement in Fair value through other comprehensive income reserve		**-**	**-**	**(0.7)**	**-**	**(0.7)**
Net movement in Cash flow hedge reserve		**-**	**-**	**-**	**3.6**	**3.6**
Total comprehensive income		**86.4**	**-**	**(0.7)**	**3.6**	**89.3**
Distribution to Additional Tier 1 capital holders[2]	14	**(9.3)**	**-**	**-**	**-**	**(9.3)**
As at 30 June 2018 (Unaudited)		**1,631.2**	**396.9**	**4.1**	**23.9**	**2,056.1**

	Notes	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2017 (Audited)		1,376.1	396.9	6.7	41.6	1,821.3
Profit for the financial period		85.2	-	-	-	85.2
Net movement in Available-for-sale reserve		-	-	(0.5)	-	(0.5)
Net movement in Cash flow hedge reserve		-	-	-	(14.6)	(14.6)
Total comprehensive income		85.2	-	(0.5)	(14.6)	70.1
Distribution to Additional Tier 1 capital holders[2]	14	(9.3)	-	-	-	(9.3)
As at 30 June 2017 (Unaudited)		1,452.0	396.9	6.2	27.0	1,882.1

	Notes	General reserve £m	Other equity instruments £m	Available-for-sale reserve £m	Cash flow hedge reserve £m	Total £m
As at 1 January 2017 (Audited)		1,376.1	396.9	6.7	41.6	1,821.3
Profit for the financial year		184.8	-	-	-	184.8
Net remeasurement of defined benefit plan		10.8	-	-	-	10.8
Net movement in Available-for-sale reserve		-	-	(1.0)	-	(1.0)
Net movement in Cash flow hedge reserve		-	-	-	(21.3)	(21.3)
Total comprehensive income		195.6	-	(1.0)	(21.3)	173.3
Distribution to Additional Tier 1 capital holders[2]	14	(18.6)	-	-	-	(18.6)
As at 31 December 2017 (Audited)		1,553.1	396.9	5.7	20.3	1,976.0

1. Fair value through other comprehensive income reserve relates to assets classified as FVOCI under IFRS 9 from 1 January 2018, in previous reporting periods this was the Available-for-sale reserve.
2. The distribution to Additional Tier 1 capital holders is shown net of an associated tax credit of £3.4 million (30 June 2017: £3.5 million, 31 December 2017: £7.0 million).

The notes on pages 14 to 29 form part of this Interim Financial Report.

Condensed Consolidated Statement of Cash Flows

For the period ended 30 June 2018

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Cash flows from operating activities			
Profit before tax	**113.1**	112.4	242.7
Adjustments for:			
Impairment provisions and other provisions	**(1.4)**	3.4	3.7
Depreciation and amortisation	**10.4**	9.3	19.0
Interest on subordinated liabilities and subscribed capital	**3.3**	3.3	6.7
Changes to fair value adjustment of hedged risk	**(2.0)**	(71.9)	(68.6)
Other non-cash movements	**(37.4)**	(42.1)	15.6
Non-cash items included in profit before tax	**(27.1)**	(98.0)	(23.6)
Loans and advances to credit institutions	**(48.3)**	67.1	7.5
Loans and advances to customers	**(1,477.3)**	(1,646.0)	(3,049.1)
Prepayments, accrued income and other assets	**(2.9)**	(3.6)	11.8
Changes in operating assets	**(1,528.5)**	(1,582.5)	(3,029.8)
Shares	**454.4**	1,947.2	2,987.7
Deposits and other borrowings	**1,764.0**	(1,002.0)	474.6
Debt securities in issue	**(210.7)**	165.4	159.6
Accruals, deferred income and other liabilities	**7.2**	(4.8)	(8.1)
Changes in operating liabilities	**2,014.9**	1,105.8	3,613.8
Interest paid on subordinated liabilities and subscribed capital	**(3.3)**	(3.3)	(6.7)
Taxation	**(19.6)**	(25.0)	(50.0)
Net cash flows from operating activities	**549.5**	(490.6)	746.4
Cash flows from investing activities			
Purchase of investment securities	**(340.7)**	(18.4)	(65.2)
Sale and maturity of investment securities and equities	**358.8**	333.5	357.0
Proceeds from sale of properties	**-**	0.1	0.2
Purchase of property, plant and equipment and intangible assets	**(19.6)**	(13.6)	(28.7)
Net cash flows from investing activities	**(1.5)**	301.6	263.3
Cash flows from financing activities			
Distributions paid to Additional Tier 1 capital holders	**(12.8)**	(12.8)	(25.6)
Repurchase and repayment of debt securities	**(765.4)**	(19.8)	(479.8)
Issue of debt securities	**-**	783.1	1,226.8
Net cash flows from financing activities	**(778.2)**	750.5	721.4
Net (decrease)/increase in cash	**(230.2)**	561.5	1,731.1
Cash and cash equivalents at start of period	**4,938.6**	3,207.5	3,207.5
Cash and cash equivalents at end of period	**4,708.4**	3,769.0	4,938.6
Cash and cash equivalents:			
Cash and balances with the Bank of England[1]	**4,708.4**	3,719.0	4,938.6
Loans and advances to credit institutions	**-**	50.0	-
	4,708.4	3,769.0	4.938.6

1. Excludes £91.5 million mandatory reserve with the Bank of England (30 June 2017: £54.3 million, 31 December 2017: £56.6 million).

The notes on pages 14 to 29 form part of this Interim Financial Report.

Notes to the Interim Financial Report

1. Reporting period

These results have been prepared as at 30 June 2018 and show the financial performance for the period from, and including, 1 January 2018 to this date.

2. Basis of preparation and changes to the Group's accounting policies

Basis of preparation

These condensed consolidated financial statements for the six months ended 30 June 2018 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority (FCA) and with IAS 34 Interim Financial Reporting as adopted by the EU. The Interim Financial Report does not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Annual Report & Accounts for the year ended 31 December 2017, which have been prepared in accordance with IFRSs as adopted by the EU.

The Group accounts consolidate the assets, liabilities and results of the Society and all its subsidiary companies.

The Group operates solely within the retail financial services sector and within the United Kingdom. As such, no segmental analysis is presented.

Going concern and long-term viability statement

Details of the Group's objectives, policies and processes for managing its exposure to credit, market, liquidity and funding, conduct, operational and business risks are contained in the Risk Management Report of the 2017 Annual Report & Accounts. The directors also include a statement on long-term viability on page 91 of the 2017 Annual Report & Accounts. The current assessment has been over the period to 31 December 2022, in line with the Society's Strategic Plan and capital and liquidity stress testing process. An update on new Top and Emerging Risks has been provided on page 6 and does not identify any material changes to the Society's risk profile.

Taking the Society's objectives, policies and processes into account alongside the current economic and regulatory environment, the directors confirm they are satisfied the Group has adequate resources to continue in business for the foreseeable future and that the long-term viability statement in the 2017 Annual Report & Accounts remains appropriate. Accordingly, it is appropriate to adopt the going concern basis in preparing this Interim Financial Report.

Accounting Policies

The accounting policies adopted by the Group in the preparation of its 2018 Interim Financial Report are consistent with those disclosed in the Annual Report & Accounts for the year ended 31 December 2017, with the exception of the adoption of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*. The impact of these new standards is set out below.

Notes to the Interim Financial Report

(continued)

IFRS 9 Financial Instruments

The Group adopted IFRS 9 *Financial Instruments* with effect from 1 January 2018. This has resulted in changes to accounting policies and adjustments to the amounts previously recognised in the financial statements. The Group has elected not to restate comparative financial information, as permitted by the transitional provisions of IFRS 9, and comparative information is presented in accordance with the previous reporting standard, IAS 39 *Financial Instruments: Recognition & Measurement*. In addition, any amendments to IFRS 7 *Financial Instruments: Disclosure* has also been applied to the current period only.

The Group has elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9. The adoption of IFRS 9 has resulted in changes to accounting policies for the classification and measurement of financial assets and impairment of financial assets. These new policies are set out below. There are no significant changes to the classification and measurement of financial liabilities under IFRS 9 for the Group.

IFRS 9 has resulted in changes to accounting policies for financial asset classification, measurement and impairment and the new policies are set out below. The Society's first full set of financial statements prepared under IFRS 9 will be published in the 2018 Annual Report & Accounts.

Financial Instruments

At initial recognition, the Group measures financial assets and liabilities at their fair value. Subsequently, financial instruments are classified in one of the following measurement categories:

- Amortised cost;
- Fair value through other comprehensive income (FVOCI); or
- Fair value through profit and loss (FVTPL).

Financial assets are classified based on the Group's business model for managing the assets in addition to their cash flow characteristics. The assessment of cash flow characteristics considers whether the payments received by the Group are solely payments of principal and interest, where principal is the fair value of the financial asset at initial recognition, and interest consists of consideration for the time value of money, credit and other risks in addition to a profit margin.

Amortised cost

In line with IFRS 9, assets which are classified as amortised cost are all held for the purpose of collecting contractual cash flows i.e. they are not held for the purpose of selling. The cash flows which are received by the Group are solely payments of principal and interest on the outstanding balance. Assets in this category include the Group's residential mortgage loans, unsecured lending and loans to credit institutions and certain debt securities.

Assets are recognised when the funds are advanced to customers and are carried at amortised cost using the Effective Interest Rate (EIR) method less provisions for impairment.

Assets acquired through a business combination or portfolio acquisition are recognised at fair value at the acquisition date. The fair value at acquisition becomes the opening amortised cost for acquired assets. Fair value adjustments are made to reflect both credit risk and interest yield associated with the acquired loan assets. Any discount between the amount due and the fair value is subsequently recognised in interest receivable and similar income using the EIR method.

Fair value through other comprehensive income (FVOCI)

Assets which are classified as FVOCI are held for the purpose of collecting contractual cash flows and being sold by the Group. The cash flows received by the Group are solely payments of principal and interest on the outstanding balance or sale proceeds in the event of a sale. Assets in this category are debt securities (e.g. certificates of deposit or Government investment securities (gilts)).

Assets are measured at fair value based on quoted market prices or prices obtained from market intermediaries where available. In cases where quoted market prices are not available, discounted cash flow valuations are used.

Unrealised gains and losses arising from changes in fair value are recognised directly in other comprehensive income, except for impairment losses and foreign exchange gains and losses, which are recognised in the Income

Fair value through other comprehensive income (FVOCI) (continued)

Statement. Gains and losses arising on the sale of FVOCI assets, including any cumulative gains or losses previously recognised in other comprehensive income, are recognised in the Income Statement.

When a decline in the fair value of a FVOCI financial asset has been recognised directly in other comprehensive income and there has been a significant increase in credit risk since initial recognition, the cumulative loss recognised in reserves is removed and recognised in the Income Statement.

Fair value through profit and loss (FVTPL)

FVTPL is the default category for financial assets which do not meet the criteria for amortised cost or FVOCI assets. Assets which are classified as FVTPL include derivative financial instruments and investments in equity shares.

All derivatives are carried at fair value and are initially recognised at the trade date.

Changes in the fair value of derivatives other than the effective portion of those in cash flow hedge accounting relationships are recognised in the Income Statement. The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivatives and hedge accounting policy on page 111 of the 2017 Annual Report & Accounts.

Impairment of loans and advances to customers

The Group assesses, on a forward looking basis, the expected credit losses (ECL) associated with its financial assets carried at amortised cost and FVOCI and with the exposure arising from pipeline mortgage commitments. Investments in equity shares are not subject to impairment under IFRS 9.

IFRS 9 requires the Society to categorise its financial assets into one of three stages at the Balance Sheet date. Assets that are performing are shown in stage 1; assets where there has been a significant increase in credit risk since the origination of the loan are in stage 2 and accounts which are in default are in stage 3. The Society is required to recognise a 12 month expected credit loss allowance on all stage 1 assets and a lifetime expected credit loss allowance on all stage 2 and 3 assets. The Society does not have any purchased or originated credit-impaired financial assets. More information on how the Group assesses a significant increase in expected credit loss and default is included below.

The measurement of expected credit loss reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Expected credit losses are determined by projecting the probability of default, loss given default and exposure at default. More information on ECL inputs, assumptions and estimation techniques is included below together with the forward looking information incorporated in the ECL calculations.

ECLs for financial assets measured at amortised cost reduce the carrying amount of these assets in the Balance Sheet and are included in impairment losses in the Income Statement. ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these assets which remain at fair value in the Balance Sheet. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount with a corresponding charge to impairment losses in the Income Statement. The accumulated loss recognised in OCI is then recycled to the Income Statement upon derecognition of the assets.

The Group writes off financial assets when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery.

Notes to the Interim Financial Report
(continued)

Impact of IFRS 9 implementation

The table below sets out the classification and measurement category and carrying amount of financial assets and liabilities in accordance with IAS 39 and IFRS 9 at 1 January 2018.

	IAS 39		IFRS 9	
Financial assets	**Measurement Category**	**Carrying Amount £m**	**Measurement Category**	**Carrying Amount £m**
Cash and balances with the Bank of England	Loans and receivables	**4,995.2**	Amortised cost	**4,995.2**
Loans and advances to credit institutions	Loans and receivables	**202.0**	Amortised cost	**202.0**
Debt securities (Gilts)	Available-for-sale	**990.3**	FVOCI	**990.3**
Debt securities (MBS, FRNs)	Available-for-sale	**22.0**	Amortised cost	**21.0**
Loans and advances to customers	Loans and receivables	**35,930.9**	Amortised cost	**35,931.0**
Hedging derivatives	FVTPL	**323.7**	FVTPL	**323.7**
Investment in equity shares	Available-for-sale	**2.5**	FVTPL	**2.5**
Total		**42,466.6**		**42,465.7**

IFRS 9 adjustments to the Balance Sheet

The adjustments to the Group's Balance Sheet arising on the adoption of IFRS 9 are set out below. Impairment of loans and advances to customers is £0.1m lower under IFRS 9 than IAS 39. Debt securities under IFRS 9 are valued at £1.0 million less than under IAS 39, reflecting the reclassification of certain assets to amortised cost and reversal of gains which had previously been recognised in Other Comprehensive Income. Changes in classification under IFRS 9 are explained in the notes below.

Measurement Category	**As at 31 December 2017 £m**	**Classification £m**	**Measurement £m**	**As at 1 January 2018 £m**
Amortised Cost				
Cash and balances with the Bank of England	**4,995.2**	**-**	**-**	**4,995.2**
Loans and advances to credit institutions	**202.0**	**-**	**-**	**202.0**
Loans and advances to customers (i)	**35,930.9**	**-**	**0.1**	**35,931.0**
Debt securities (ii)	**-**	**22.0**	**(1.0)**	**21.0**
Total financial assets measured at amortised cost	**41,128.1**	**22.0**	**(0.9)**	**41,149.2**
Fair value through other comprehensive income (FVOCI)				
Debt securities (ii)	**1,012.3**	**(22.0)**	**-**	**990.3**
Investment in equity shares (iii)	**2.5**	**(2.5)**	**-**	**-**
Total financial assets measured at FVOCI	**1,014.8**	**(24.5)**	**-**	**990.3**
Fair value through other profit or loss (FVTPL)				
Investment in equity shares (iii)	**-**	**2.5**	**-**	**2.5**
Hedging derivatives	**323.7**	**-**	**-**	**323.7**
Total financial assets measured at FVTPL	**323.7**	**2.5**	**-**	**326.2**

Notes to the Interim Financial Report
(continued)

(i) Loans and advances to customers previously classified as amortised cost

Included within Loans and advances to customers are £3.5 million of loan notes which the Group had fully provided for within its IAS 39 impairment provision. On transition to IFRS 9, the notes no longer meet business model tests for amortised cost and have been reclassified as fair value through profit and loss. As the notes were already fully provided for, there is no impact on the balance sheet overall, although the impact of the reclassification reduces the Society's impairment provision by £3.5 million as detailed below.

(ii) Debt securities previously classified as fair value through other comprehensive income

The Group has reassessed the classification and measurement of its debt securities and certain listed debt securities meet the criteria for amortised cost classification following application of the business model tests required by IFRS 9. These assets are held for collecting contractual cash flows and are not routinely sold by the Group. They have therefore been reclassified under IFRS 9. Had these items continued to be included at fair value through other comprehensive income then a gain of £0.8 million would have been recognised in Other Comprehensive Income during the period.

(iii) Investment in equity shares previously classified as fair value through other comprehensive income

The Group's investments in equity shares no longer meet the business model tests for fair value through other comprehensive income and have therefore been reclassified as fair value through profit or loss on transition to IFRS 9.

Adjustments to the Group's impairment provision

The adjustments to the Group's impairment provision as a result of the transition from IAS 39 to IFRS 9 are set out in the table below.

Impairment provision	IAS 39 £m	Reclassification £m	Remeasurement £m	IFRS 9 £m
Loans and advances to customers	**(17.1)**	**3.5***	**0.1**	**(13.5)**
Total impairment	**(17.1)**	**3.5***	**0.1**	**(13.5)**

*Reclassification of assets which were fully provided for under IAS 39 and therefore do not have a carrying value under IAS 39 or IFRS 9. Please see note (i) above for more information.

Calculation of Expected Credit Loss under IFRS 9

IFRS 9 requires the Group to categorise its financial assets, principally its mortgage loans, into one of three stages at the Balance Sheet date. Assets that are performing are shown in stage 1; assets where there has been a significant increase in credit risk since initial recognition (usually origination, but includes any purchased assets) are in stage 2 and accounts which are in default are in stage 3. The Group is required to recognise a 12 month expected credit loss allowance on all stage 1 assets and a lifetime expected credit loss allowance on all stage 2 and 3 assets. The assessment of whether a significant increase in credit risk has occurred is a key aspect of the IFRS 9 methodology and involves quantitative measures such as forward looking probabilities of default that are derived from reasonable and supportable forecasts of future economic conditions, as well as from other qualitative factors and therefore requires significant management judgement. The stage 2 assessment is also supported by an objective 'back stop' measure of arrears.

Significant increase in credit risk – Retail credit risk

The Group considers a loan to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

Quantitative criteria

The Group uses internal credit risk gradings that reflects its assessment of the probability of default (PD) of individual counterparties. Where there has been a three risk grade decrease and remaining lifetime PD has doubled since origination, providing that the remaining lifetime PD is also above the Group's current risk appetite decline limit, the loan will be assessed as Stage 2. Given the Society's very low risk book, a three grade decrease may still result in a very low PD and the application of the current decline limit ensures that loans below this threshold are regarded as still being of sufficiently high quality that they should be allocated to Stage 1.

Notes to the Interim Financial Report

(continued)

Qualitative criteria

The qualitative measures used to allocate a loan to stage 2 are aligned to forbearance, underwriting and provisioning practices. In some cases, the qualitative criteria will occur before the credit score is impacted and are therefore lead indicators of a deteriorating credit risk. The most significant qualitative criteria include bankruptcy, cancelled direct debits or poor external credit bureau data which would exceed the Society's underwriting policy at the reporting date, even if the loan is currently performing. Qualitative criteria are monitored and reviewed periodically for appropriateness by the independent Credit Risk team.

Arrears backstop measure

A backstop is applied and a loan is considered to have experienced a significant increase in credit risk if it is one month in arrears when compared to the current monthly repayment amount. Loans subject to this backstop measure will continue to be classified as subject to a significant increase in credit risk for a further period of 12 months after all arrears are cleared (a 12 month cure period). A cure period is not applied to the quantitative and qualitative criteria as the credit score will be adversely affected for some time after the trigger event and to add a further 12 month period beyond this would double count the impact.

Default and credit impaired – Retail credit risk

The Society considers a loan to be in default under IFRS 9 when the loan is three months or more in arrears i.e. current arrears balances are equal to three or more monthly repayments. Alternatively, a loan is considered to be in default if certain unlikeliness to pay triggers are present:

- A payment concession has been agreed with the borrower whereby a sum less than the contractual monthly payment is made for a limited period of time;
- litigation proceedings against the borrower have begun;
- the customer is bankrupt and the account is in arrears;
- the loan is interest-only and has gone 12 months past the scheduled term date;
- the property has been taken into possession by the Group; or
- a specific provision has been raised indicating a potential issue that may give rise to a loss (e.g. title or boundary issues).

A loan is considered to be no longer in default (i.e. to have been cured) when a consecutive period of 12 months has passed since it met any of the above qualitative and quantitative criteria. The 12 month period has been determined based on an analysis which considers the likelihood of a loan returning to default status after cure using different possible cure definitions.

Inputs, assumptions and estimation techniques – Retail credit risk

The Expected Credit Loss (ECL) is measured on either a 12 month or lifetime basis. The lifetime basis is where a significant increase in credit risk has occurred since initial recognition or where the asset is considered to be in default. Expected credit losses, being forward looking, are discounted back to the reporting date and are calculated by multiplying the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) where:

- The PD represents the likelihood of a borrower defaulting over either the next 12 months or over the remaining lifetime of the mortgage (being the contractual lifetime).
- EAD is the amount the Society expects to be owed at the time of default. The Society does not have any significant revolving commitments where guaranteed further amounts can be drawn down by the borrower.
- LGD represents the Society's expectation of the extent of loss on a default and takes account of available collateral, likely sales cost and potential discount needed to secure a sale.

The Society has based the IFRS 9 ECL calculations on the models used to calculate regulatory expected losses, with the following amendments:

- The IFRS 9 PD is based on a point in time calculation adjusted to take into account estimates of future economic conditions. The regulatory PD is long run and is averaged throughout a full economic cycle;
- The IFRS 9 EAD has been modelled based on expected payments over the term up to the point of default. The regulatory EAD cannot be lower than the current balance;
- The IFRS 9 LGD includes the impact of future economic conditions such as changes in value of collateral and does not include any floors. Only costs associated with obtaining/selling the collateral are included

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Inputs, assumptions and estimation techniques – Retail credit risk (continued)

and the discounting of the expected cash flows is performed using the effective interest rate of the loan. The regulatory LGD is based on downturn conditions and includes all collection costs, is subject to regulatory floors and is discounted using a stressed measure of the cost of capital; and

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

Key assumptions and judgements within the ECL calculations, such as whether the forward-looking views remain appropriate or whether staging rules require adjustment are monitored and reviewed on a quarterly basis. There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

Forward looking information incorporated in the ECL models – Retail credit risk

The assessment of a significant increase in credit risk and the calculation of ECL both incorporate forward looking information and therefore require significant management judgment. The Group has used four economic scenarios to assess expected credit losses for its core owner occupier and buy to let portfolios (representing over 99% of total loans and advances to customers). An explanation of each scenario and its relative weighting in calculating ECL is as follows:

Scenario	Weighting
Base - a central scenario based on the Group's Strategic Plan	**67%**
Downside - based on the Internal Capital Adequacy Assessment Process (ICAAP) high rate stress (being the worst case scenario from a credit loss perspective used in capital stress testing)	**2%**
Upside - based on an improved credit environment (best case), given the current benign conditions the improvement on base case is minor	**2%**
Midpoint - A scenario between the downside and upside cases which reflects a more moderate downturn than the downside scenario.	**29%**

The most significant period end assumptions used in these models as at the reporting date are as follows:

		2018	2019
Interest rates	Base	0.75%	0.75%
	Range	0.50% to 0.75%	0.50% to 4.00%
Unemployment	Base	5.19%	5.80%
	Range	4.42% to 5.69%	4.42% to 8.75%
HPI growth	Base	1.01%	1.04%
	Range	0.97% to 1.03%	0.83% to 1.08%
UK GDP growth	Base	1.01%	1.02%
	Range	0.99% to 1.01%	0.96% to 1.03%
SVR	Base	4.99%	4.99%
	Range	4.74% to 4.99%	4.74% to 6.74%

Sensitivity analysis

The ECL calculation is particularly sensitive to changes in:

- House Price Index, given the significant impact it has on mortgage collateral valuations; and
- Unemployment rate, given its impact on borrowers' ability to meet their loan repayments.

The most significant degree of judgement relates to the relative weightings of the scenarios themselves, incorporating different views of the House Price Index and Unemployment as indicated above. In order to demonstrate this sensitivity, the impact of applying 100% of a particular scenario on the reported IFRS 9 impairment provision is shown below, for example, if the provision was wholly calculated on the base case scenario it would be £11.0 million, 6.8% less than the reported provision.

Scenario	IFRS 9 Provision £m	Increase / (decrease) %
IFRS 9 weighted average	11.8	-
Base	11.0	(6.8)%
Downside	26.1	121.2%
Upside	9.9	(16.1)%
Midpoint	12.9	9.3%

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Calculation of Expected Credit Loss under IFRS 9 – Treasury credit risk

Treasury assets comprise cash and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Credit losses on treasury assets are rare for the Group. In accordance with IFRS 9, impairment for treasury credit exposures is calculated taking the exposure value and applying an externally published probability of default (PD) for the credit rating applicable to the exposure. Exposures are monitored by the Treasury Credit Committee, who review whether any change in the counterparty credit profile reflects a significant increase in credit risk.

ECL's are calculated on a 12 month or, where a significant increase in risk is seen, lifetime basis using the PD for the remaining term of the exposure.

In addition to IFRS 9, the following new standard has been implemented during 2018:

IFRS 15 Revenue from contracts with customer

The Group has also adopted IFRS 15 *Revenue from Contracts with Customers* in this Interim Financial Report but this has not had a significant impact on the Group's financial statements.

Judgement in applying accounting policies and significant accounting estimates

The preparation of financial statements requires significant judgement relating to assumptions and estimates that could affect the reported amount of assets and liabilities both in the accounts and in the following financial years. The most significant assumptions and estimates are disclosed below. The assumptions and estimates relating to mortgage Effective Interest Rate are unchanged from the year ended 31 December 2017 and details are provided on page 114 of the 2017 Annual Report & Accounts.

From 1 January 2018, the significant assumptions and estimates relating to impairment on loans and advances to customers have changed as a result of the implementation of IFRS 9. Information relating to these is included on pages 15 to 21.

Areas of significant judgement and estimation
Mortgage Effective Interest Rate
Impairment provisions on loans and advances to customers

3. Interest receivable and similar income

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
On loans fully secured on residential property	**475.5**	465.2	958.4
On other loans	**0.9**	0.9	1.9
On debt securities	**12.7**	16.5	30.3
On other liquid assets	**12.6**	4.0	9.9
Net expense on financial instruments hedging assets	**(35.9)**	(57.4)	(106.7)
Gain on derecognition of financial assets	**14.9**	-	-
Foreign currency (losses)/gains	**(0.2)**	1.3	1.3
Total	**480.5**	430.5	895.1

The £14.9 million gain on derecognition of financial assets of relates to the derecognition of a £350.9 million mortgage portfolio and associated derivative financial instruments. In the year ended 31 December 2017, interest receivable included £12.6 million from the release of fair value adjustments for credit risk initially made on the merger with Stroud & Swindon Building Society.

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4. Interest payable and similar charges

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Bank and customer			
Subordinated liabilities	**0.9**	0.9	1.8
Other	**12.4**	8.7	14.1
Debt securities in issue	**55.2**	60.7	125.4
Other borrowed funds			
On shares held by individuals	**220.1**	203.1	410.4
On other shares	**-**	-	-
On subscribed capital	**2.4**	2.4	4.9
Net income on financial instruments hedging liabilities	**(24.0)**	(38.7)	(73.7)
Foreign currency (gains)/losses	**(0.2)**	1.1	1.2
Total	**266.8**	238.2	484.1

5. Other operating income

Other operating income of £0.3 million relates to the fair value gain on investment in equity shares measured at fair value through profit and loss.

In 2017, other operating income of £5.1 million included £5.0 million relating to the gain on completion of the sale of the Society's equity investment in VocaLink Holdings Limited (VocaLink) to MasterCard.

6. Administrative expenses

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Employee costs			
Wages and salaries	**40.0**	34.7	73.7
Social security costs	**4.2**	3.4	7.7
Pension costs			
Defined benefit plan	**(0.2)**	-	(0.1)
Defined contribution plan	**2.6**	2.5	4.9
	46.6	40.6	86.2
Project costs	**14.8**	5.9	12.6
Other expenses	**27.8**	26.1	50.1
Total	**89.2**	72.6	148.9

Included within employee costs is £2.2 million relating to employees who are wholly dedicated to the Society's strategic investment programmes (30 June 2017: £1.4 million, 31 December 2017: £2.8 million).

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7. Impairment provisions on loans and advances to customers

Impairment provisions have been deducted from the appropriate asset values in the Condensed Consolidated Balance Sheet.

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited)[1] £m	Year ended 31 Dec 2017 (Audited)[1] £m
Impairment (credit)/charge for the period	**(1.0)**	(0.1)	0.2
Impairment provision at the end of the period:			
Residential mortgages	**10.4**	13.1	12.5
Other loans	**1.4**	5.1	4.6
Total	**11.8**	18.2	17.1

1. Included with Other loans at 30 June 2017 and 31 December 2017 is a £3.5 million provision in relation to loan notes which have been reclassified under IFRS9. See Accounting Policies for further information.

A reconciliation of the impairment provision split by IFRS 9 Stage from 1 January 2018 to 30 June 2018 is set out below:

Loans and advances to customers	**Stage 1 'Performing' £m**	**Stage 2 'Deteriorating' £m**	**Stage 3 'Default' £m**	**Total £m**
Loss allowance at 1 January 2018	**1.3**	**3.9**	**8.3**	**13.5**
Movements with Income Statement impact				
Transfers:				
Transfers from Stage 1 to Stage 2	**-**	**0.4**	**-**	**0.4**
Transfers from Stage 1 to Stage 3	**-**	**-**	**0.2**	**0.2**
Transfers from Stage 2 to Stage 1	**-**	**(0.4)**	**-**	**(0.4)**
Transfers from Stage 3 to Stage 1	**-**	**-**	**(0.1)**	**(0.1)**
New mortgages originated	**0.3**	**-**	**-**	**0.3**
Remeasurement of ECL	**(0.3)**	**(0.8)**	**0.8**	**(0.3)**
Financial assets derecognised during the period	**(0.2)**	**(0.1)**	**(0.6)**	**(0.9)**
Net write off to Income Statement	**-**	**-**	**(0.2)**	**(0.2)**
Total net Income Statement charge in the period	**(0.2)**	**(0.9)**	**0.1**	**(1.0)**
Other movements with no Income Statement Impact				
Transfers:				
Transfers from Stage 2 to Stage 3	**-**	**(0.1)**	**0.1**	**-**
Transfers from Stage 3 to Stage 2	**-**	**0.3**	**(0.3)**	**-**
Net write off	**-**	**-**	**(0.7)**	**(0.7)**
Loss allowance at 30 June 2018	**1.1**	**3.2**	**7.5**	**11.8**

Further information on the transition to IFRS 9 can be found in the IFRS 9 Transition Report. Information relating to changes to accounting policies, adjustments to the Group's balance sheet on transition to IFRS 9 and the calculation of ECLs is included on pages 15 to 21.

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8. Provisions for liabilities and charges

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
At 1 January	**5.7**	7.5	7.5
(Credit)/charge for the period	**(0.4)**	3.5	3.5
Provision utilised	**(0.8)**	(0.3)	(5.3)
Total	**4.5**	10.7	5.7

As at 30 June 2018, a provision of £1.1 million (30 June 2017: £6.9 million, 31 December 2017: £2.5 million) was held for amounts payable to the Financial Services Compensation Scheme (FSCS). During the period, a credit was made in respect of the FSCS totalling £1.4 million (30 June 2017: £2.5 million charge, 31 December 2017: £2.5 million charge). This is as a result of the final repayment by the FSCS to HM Treasury and therefore a lower than expected interest charge.

Other provisions totalling £3.4 million (30 June 2017: £3.8 million, 31 December 2017: £3.2 million) are held in respect of circumstances that may give rise to various customer claims. During the period, the Group raised a further £1.5 million provision (30 June 2017: £1.0 million, 31 December 2017: £1.0 million) for Payment Protection Insurance (PPI) redress to customers, reflecting an increase in the number of claims received in the period and the deadline for PPI claims in August 2019. This was offset by a credit of £0.5 million in respect of the other regulatory provisions.

9. Loans and advances to customers

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Residential mortgages			
Owner-occupier mortgages	**22,420.7**	21,173.1	21,710.6
Buy to let mortgages	**14,692.4**	13,005.1	13,899.0
Near-prime mortgages[1]	**70.7**	82.1	76.8
Self-certification mortgages[1]	**198.3**	234.5	214.5
Other loans			
Commercial mortgages[2]	**1.7**	2.3	2.0
Unsecured loans[2]	**25.6**	30.5	28.0
Mortgage pipeline	**(0.1)**	-	-
Total	**37,409.3**	34,527.6	35,930.9

1. No new near prime or self-certification mortgages have been originated since November 2008 and February 2009 respectively.
2. No new unsecured loans or commercial mortgages have been originated since March 2009 and September 2010 respectively.

10. Interest in unconsolidated structured entity

The Group completed a whole loan sale of its beneficial interests in £350.9 million of buy to let mortgages originated by its subsidiary Godiva Mortgages Limited (Godiva), which the Society continues to service, to a third party in the June 2018. The gain on derecognition of the mortgages and associated derivative financial instruments is included in interest receivable and similar income in the Income Statement.

These assets were initially assessed for derecognition under IFRS 9 and a subsequent assessment was made as to whether there was any requirement to consolidate the results of the third party who purchased the loan book under IFRS 10 *Consolidated Financial Statements*.

Derecognition

To derecognise the loan book, the Group has to transfer its rights to receive the cash flows and transfer substantially all risks and rewards associated with them. Although Godiva continues to receive the contractual cash flows it has an obligation to pay these cash flows to the third party by the next business day.

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10. Interest in unconsolidated structured entity continued

Derecognition (continued)

With regard to risks and rewards, the beneficial interests in the mortgages were sold for cash and neither Godiva nor the Society has any interest in the third party. Godiva will retain any fees relating to further advances and product switches on the mortgages but the income is expected to cover processing costs and procurement fees paid by the Society to brokers. Any loan repurchase commitments relate to all loans, and would only arise as a result of a breach of representations and warranties which are limited to 12 months from the point of sale. Any repurchase commitments are also expected to be de minimis.

Taking all of the facts and circumstances into account, the Group has transferred substantially all the risk and rewards of ownership and it is therefore appropriate to derecognise the assets.

Consolidation of the results of the structured entity

The Group is required to consolidate another entity from the date on which the Group: has power over the entity; is exposed to, or has rights to, variable returns from its involvement with the entity; and has the ability to affect those returns through the exercise of its power.

Under the Mortgage Sale Agreement and the Service Agreement, Godiva retains the right to set lending criteria in relation to further advances on the transferred mortgages; to set policies and subsequently amend mortgages in line with these policies; and to set the Standard Variable Rate (SVR). However, in exercising these powers the Group is not exposed to any variable return and therefore does not benefit from the exercise of its discretionary powers. The Society is in receipt of a service provider fee but this is set on an arms-length basis and on market standard terms. The Group has therefore concluded that it is acting as agent for the beneficial holders of the loan book and not as a principal acting in its own interests. The purchasing entity is therefore not consolidated in the Group results.

11. Debt securities in issue

As at 30 June 2018, the Group had a total of £3,894.9 million debt securities in issue (30 June 2017: £4,904.0 million, 31 December 2017: £4,888.8 million).

In April 2018, a £750 million 7 year fixed rate Covered Bond matured in addition to £212 million of Certificate of Deposits (CDs) during the first half of 2018.

12. Subordinated liabilities

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Fixed rate subordinated notes 2026 - 6.327%	**10.2**	10.2	10.2
Fixed rate subordinated notes 2032 - 7.54%	**15.3**	15.3	15.3
Total	**25.5**	25.5	25.5

All subordinated liabilities are denominated in sterling and are repayable in the years stated, or earlier in accordance with their terms at the option of the Society, subject to prior consent of the Prudential Regulation Authority (PRA). The subordinated notes rank equally with each other and behind all other creditors of the Society and the claims of Shareholding Members, other than holders of Permanent Interest Bearing Shares (PIBS) and Perpetual Capital Securities (PCS), for both principal and interest.

13. Subscribed capital

	Call date	**Period to 30 Jun 2018 (Unaudited) £m**	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Permanent Interest Bearing Shares 1992 - 12.125%	n/a	**41.6**	41.6	41.6
Total		**41.6**	41.6	41.6

Subscribed capital comprises the Permanent Interest Bearing Shares (PIBS) issued in 1992 that are only repayable in the event of the winding up of the Society. Interest is paid in arrears in half yearly instalments at 12.125% per annum.

PIBS rank equally with each other and Perpetual Capital Securities (PCS). They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than holders of PCS) for both principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

14. Other equity instruments

In June 2014, the Society issued £400 million of new PCS capital raising £396.9 million (net of issuance costs and associated tax). These instruments rank equally with each other and PIBS. They rank behind all other creditors of the Society including subordinated liabilities and the claims of Shareholding Members (other than PIBS), for both principal and interest. The holders of PCS are not entitled to any share in any final surplus upon a winding up or final dissolution of the Society.

The PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.375% per annum. The rate will reset on 1 November 2019 and every five years thereafter to the five year mid swap rate plus 4.113%. Coupons are paid semi-annually in May and November.

A coupon payment of £12.8 million, covering the period 1 November 2017 to 30 April 2018 was approved and recognised in the Statement of Changes in Members' Interests and Equity in the period ended 30 June 2018 (30 June 2017: coupon payment of £12.8 million, covering the period from 1 November 2016 to 30 April 2017).

The instruments have no maturity date. They are repayable at the option of the Society in 2019 and on every fifth anniversary thereafter, but only with the prior consent of the PRA. If the end-point Common Equity Tier 1 ratio for the Group, on either an individual consolidated or a consolidated basis, falls below 7% they convert to Core Capital Deferred Shares (CCDS) at the rate of one CCDS for every £67 PCS held.

15. Fair value through other comprehensive income reserve

Amounts within the Fair value through other comprehensive income reserve (previously called Available-for-sale reserve) are transferred to the Income Statement upon the disposal of the related debt securities, and where a hedging relationship exists between the debt securities and a derivative instrument.

During the period, a £9.7 million loss was transferred to the Income Statement, this is summarised in the table below:

	Period to 30 Jun 2018 (Unaudited) £m	Period to 30 Jun 2017 (Unaudited) £m	Year ended 31 Dec 2017 (Audited) £m
Items recognised transferred to the Income Statement			
Interest receivable and similar income	**1.5**[1]	1.3[2]	1.3[2]
Other operating income	**-**	5.0[3]	5.0[3]
Net losses from derivative financial instruments	**(11.2)**[4]	(15.5)[5]	(26.4)[5]
Total	**(9.7)**	(9.2)	(20.1)

1. Transfer to the Income Statement relates to the disposal of FVOCI debt securities.
2. Transfer to the Income Statement relates to the disposal of Available-for-sale debt securities.
3. Transfer to the Income Statement relates to the disposal of Available-for-sale equity instruments.
4. Transfer to the Income Statement offsets the effects of changes in the fair value of derivatives hedging FVOCI debt securities.
5. Transfer to the Income Statement offsets the effects of changes in the fair value of derivatives hedging Available-for-sale debt securities.

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16. Financial instruments – classification and fair value measurement

For the purpose of calculating fair values, fair value is assessed as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

The Group measures fair value using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

Level 1: unadjusted quoted prices in active markets for identical instruments.
Level 2: valuation techniques for which all significant inputs are based on observable market data.
Level 3: valuation techniques for which significant inputs are not based on observable market data.

Where applicable, the Group measures fair value using the quoted price in an active market for that instrument. A market is regarded as active if transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. Where this is not applicable, the Group determines fair values using other valuation techniques.

Fair value of assets held at amortised cost

The following table summarises the fair value of the Group's financial assets and liabilities measured at amortised cost on the face of the Group's Balance Sheet:

	Carrying amount 30 Jun 2018 (Unaudited) £m	**Fair value 30 Jun 2018 (Unaudited) £m**	Carrying amount 30 Jun 2017 (Unaudited) £m	Fair value 30 Jun 2017 (Unaudited) £m	Carrying amount 31 Dec 2017 (Audited) £m	Fair value 31 Dec 2017 (Audited) £m
Financial assets						
Cash and balances with the Bank of England	**4,799.9**	**4,799.9**	3,773.3	3,773.3	4,995.2	4,995.2
Loans and advances to credit institutions	**215.4**	**215.4**	194.6	194.6	202.0	202.0
Debt securities	**18.3**	**19.1**	-	-	-	-
Loans and advances to customers	**37,409.3**	**37,310.9**	34,527.6	34,443.9	35,930.9	35,824.6
Financial liabilities						
Shares	**31,442.5**	**31,582.4**	29,935.7	30,193.8	31,035.7	31,158.8
Deposits from banks	**5,239.4**	**5,239.4**	1,851.3	1,851.3	3,499.0	3,499.0
Other deposits	**3.0**	**3.0**	6.0	6.0	4.0	4.0
Amounts owed to other customers	**763.6**	**763.6**	903.8	903.3	735.5	735.8
Debt securities in issue	**3,894.9**	**4,008.5**	4,904.0	5,065.8	4,888.8	5,030.2
Subordinated liabilities	**25.5**	**28.9**	25.5	28.9	25.5	28.6
Subscribed capital	**41.6**	**80.6**	41.6	82.5	41.6	90.1

Debt securities

Certain debt securities have been reclassified to amortised cost from Available-for-sale on transition to IFRS 9. The fair value of assets held at amortised historical cost is calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote.

Loans and advances to customers

The fair value of loans and advances to customers is assessed as the value of the expected future cash flows, using contractual interest payments, and repayments and the expected prepayment behaviour of borrowers. Assumptions are applied regarding expected levels of customer prepayments and the risk of defaults.

The estimated future cash flows are discounted at current market rates for the loans types and adjusted to determine a fair value where necessary to reflect any observable market conditions.

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16. Financial instruments – classification and fair value measurement continued

Shares and deposits

The fair value of shares available on demand approximates to the carrying value. The fair value of fixed term or restricted access deposits is determined from the estimated projected cash flows discounted at the current market rates for those types of deposit.

Debt securities in issue, subordinated liabilities and subscribed capital

The estimated fair value of longer-dated liabilities is calculated based on quoted market prices where available or using similar issues as a proxy for those liabilities that are not of sufficient size or liquidity to have an active market quote. For those liabilities where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate to the remaining term to maturity.

Fair value of assets held at fair value, and classification within the fair value hierarchy

The following table summarises the fair value of the Group's financial assets and liabilities measured at fair value on the face of the Group's Balance Sheet by fair value hierarchy and product type:

30 June 2018 (Unaudited)	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Derivative financial instruments - assets	**-**	**275.8**	**-**	**275.8**
Debt securities	**939.6**	**-**	**-**	**939.6**
Investment in equity shares	**-**	**-**	**2.8**	**2.8**
Derivative financial instruments - liabilities	**-**	**(109.7)**	**(57.5)**	**(167.2)**
Total	**939.6**	**166.1**	**(54.7)**	**1,051.0**
30 June 2017 (Unaudited)				
Derivative financial instruments - assets	-	343.1	-	343.1
Debt securities	993.9	-	7.3	1,001.2
Investment in equity shares	-	-	2.2	2.2
Derivative financial instruments - liabilities	-	(192.5)	(63.5)	(256.0)
Total	993.9	150.6	(54.0)	1,090.5
31 December 2017 (Audited)				
Derivative financial instruments - assets	-	306.5	-	306.5
Debt securities	1,004.5	0.3	7.5	1,012.3
Investment in equity shares	-	-	2.5	2.5
Derivative financial instruments - liabilities	-	(150.5)	(63.5)	(214.0)
Total	1,004.5	156.3	(53.5)	1,107.3

Level 1 - Debt securities – Fair Value - Listed

Market prices have been used to determine the fair value of listed debt securities.

Level 2 - Derivatives

Derivative products utilise observable market inputs for interest rate swaps and cross currency swaps. Valuations are generated by swap models which use present value calculations and incorporate assumptions for interest rate curves and foreign exchange spot and forward rates.

16. Financial instruments – classification and fair value measurement continued

Level 3 - Investment in equity shares – FVTPL - Unlisted

Level 3 investment in equity shares represent the Group's holding in Visa Inc. preference shares and VocaLink Holdings Limited shares. These shares are valued based on future cash consideration which the Group expects to receive on sale of these instruments, or the underlying market value. Currently deferred consideration has been assigned a value of £nil.

Where appropriate a discount is applied to the valuation to reflect marketability and other risks in relation to the instrument. A change in the discount of 10% would result in a change in the carrying value of the investment of £0.5 million.

Level 3 - Derivatives

The items included within Level 3 are balance tracking swaps, which have remained in place during the period. These are valued using present value calculations based on market interest rates curves. The unobservable inputs relate to the projection of the swap notional amount, which changes over time to match the balance of the underlying mortgage portfolio. Projected mortgage prepayment amounts are used in the modelling of the mortgage portfolio profile. A change of 10% in the prepayment rates used results in a £0.6 million change in the value of the swaps. However, changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact the swap and hedged item equally so that the net Income Statement and Balance Sheet impact would be negligible.

The following table analyses movements in the Level 3 portfolio:

	Total £m
As at 1 January 2017 (Audited)	(56.7)
Items recognised in the Income Statement	
Interest payable and similar expense	(6.4)
Net unrealised gains on derivatives and hedge accounting	4.9
Available-for-sale reserve fair value movement	3.3
Settlements	1.4
As at 31 December 2017 (Audited)	**(53.5)**
Items recognised in the Income Statement	
Interest payable and similar expense	**(2.9)**
Net unrealised losses on derivatives and hedge accounting	**6.0**
Fair value movement taken to members' interests and equity	**0.2**
Settlements	**3.0**
Transfers out of Level 3 portfolio	**(7.5)**
As at 30 June 2018 (Unaudited)	**(54.7)**

Transfers only occur when either it becomes possible to value a financial instrument using a method that is higher up the valuation hierarchy or it is no longer possible to value it using the current method and therefore it is valued using a method lower down the hierarchy.

Following the adoption of IFRS 9 on 1 January 2018, four Level 1 securities valued at £14.2 million, one Level 2 security valued at £0.3 million and one Level 3 debt security valued at £7.5 million changed from being fair valued through OCI to being held at amortised cost.

Responsibility Statement

The directors confirm that this Interim Financial Report has been prepared in accordance with IAS 34 as adopted by the EU. The Interim Financial Report has been prepared in accordance with the applicable set of accounting standards giving a true and fair view of the assets, liabilities, financial position and profit or loss. This includes a fair review of the important events that have occurred during the first six months of the financial year and their impact on the Interim Financial Report, as required by the Disclosure and Transparency Rules (DTR 4.2.7). The principal risks and uncertainties continue to be those reported within the Risk Management Report starting on page 22 of the 2017 Annual Report & Accounts as amended by those detailed on page 6 of this Interim Financial Report.

A full list of the Board of directors can be found in the 2017 Annual Report & Accounts. Following the publication of those Accounts, on 26 April 2018, Gary Hoffman was appointed to the Board. Gary Hoffman is a Non-Executive Director and Chairman. He has held a number of roles including executive and non-executive positions in banking, insurance and payment services. Ian Geden retired from the Board on 27 June 2018 and Iraj Amiri was appointed to the Board, on 6 July 2018, as a Non-Executive Director. He has held a number of roles including executive and non-executive positions with public and member organisations covering auditing, investments and pensions. Martin Stewart will join the Board as Non-Executive Director with effect from 1 September 2018. He is a leading figure in UK financial services with extensive business experience and a successful career at the UK's prudential regulator.

Signed on behalf of the Board by

Mark Parsons	Michele Faull
Chief Executive	Chief Financial Officer
26 July 2018	

Independent Review Report

Independent review report to Coventry Building Society

Introduction

We have been engaged by the Society to review the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2018 which comprises of the Condensed Consolidated Income Statement, Condensed Consolidated Statement of Comprehensive Income, Condensed Consolidated Balance Sheet, Condensed Consolidated Statement of Changes in Members' Interests and Equity, Condensed Consolidated Statement of Cash Flows and the related explanatory notes 1 to 16. We have read the other information contained in the Interim Financial Report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Society in accordance with guidance contained in International Standard on Review Engagements 2410 (UK and Ireland) "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society for our work, for this report, or for the conclusions we have formed.

Directors' Responsibilities

The Interim Financial Report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the Interim Financial Report in accordance with the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2, the annual financial statements of the Society are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this Interim Financial Report has been prepared in accordance with International Accounting Standard 34, "Interim Financial Reporting", as adopted by the European Union.

Our Responsibility

Our responsibility is to express to the Society a conclusion on the condensed set of financial statements in the Interim Financial Report based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the Interim Financial Report for the six months ended 30 June 2018 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Ernst & Young LLP
London
26 July 2018

Other Information

The Interim Financial Report information set out in this document is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986.

The financial information for the year ended 31 December 2017 has been extracted from the Annual Report & Accounts for that year. The Annual Report & Accounts for the year ended 31 December 2017 have been filed with the Financial Conduct Authority. The Auditors' report on these Annual Report & Accounts was unqualified.

A copy of the Interim Financial Report is placed on the website of Coventry Building Society, at www.coventrybuildingsociety.co.uk/interim2018. The directors are responsible for the maintenance and integrity of the information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Coventry Building Society.
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