Interim Financial Report

for the period ended 30 June 2019

COVENTRY
Building Society

Contents

IFRS Results

This Interim Financial Report for the six months ended 30 June 2019 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 2018, 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 against its strategic goals in the first half of 2019, continuing its track record of savings and mortgage growth whilst taking forward its strategic investment programmes for the benefit of existing and future members.

The Society's performance across the measures aligned to its strategic goals is detailed below.

- **Strong mortgage growth:** Gross lending of £4.1 billion and net lending of £1.3 billion for the first half of 2019 (30 June 2018: gross lending of £4.6 billion, net lending of £1.5 billion). The Society's mortgage balances are expected to have grown by more than two and a half times the rate of the market for the 12 months to 30 June 2019[1].
- **Savings growth outperforms market:** Savings balances increased by £1.9 billion in the first half of 2019 (30 June 2018: £0.4 billion) taking total deposits to over £35 billion. In the 12 months to 30 June 2019, the Society's savings are expected to have grown by three times the rate of the market[1].
- **Giving value to members:** The average weighted savings rate paid to members was 1.52%, 0.69% higher than the average paid in the market (31 December 2018: 1.50%, 0.72% higher than the market)[2].
- **Delivering the right member outcomes:** The Society's overall Net Promoter Score has been maintained at a very strong +75[3] (31 December 2018: +75), supported by one of the lowest complaint overturn rates at the Financial Ombudsman Service[4].
- **Leading cost efficiency:** At 0.48%[5] (30 June 2018: 0.46%) the Society continues to report the lowest cost to mean asset ratio of any UK building society[6], whilst continuing to invest significantly in its technology infrastructure and branch network.
- **Low risk:** Loans where arrears were greater than 2.5% of the balance fell further to 0.09% compared to the market average of 0.72%[7] (31 December 2018: 0.10% compared to the market average of 0.74%).
- **Continued capital and liquidity strength:** Common Equity Tier 1 (CET 1) ratio remained strong at 34.2% (31 December 2018: 35.5%), one of the highest reported by any top 20 UK lender[8] whilst the Society's leverage ratio on a UK modified basis has been broadly maintained at 4.5% (31 December 2018: 4.6%). The Liquidity Coverage Ratio (LCR) of 232%[9] (31 December 2018: 202%) remains considerably above the regulatory 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[10].
- **Supporting communities:** 75% of colleagues (31 December 2018: 79%) have been actively involved in the Society's community programmes over the last 12 months.

This performance was achieved in what continues to be a challenging environment. While demand for cash savings has strengthened, economic and political uncertainty is affecting the UK's overall growth rate with reduced activity in the housing market, lower overall house price inflation and even some areas of house price decline. This, and the depth of competition in both mortgages and savings, has resulted in strong price competition.

In this context, our continued success in attracting and retaining borrowers and savers demonstrates the strength of the Society's business model and our ability to deliver tangible member value.

In the first six months of 2019 we grew savings balances by £1.9 billion (30 June 2018: £0.4 billion) helped by an average savings rate of 1.52% compared with a market average of 0.83%[2]. The strong demand we have experienced reflects both the value offered by our savings products and the excellent service we deliver. Throughout the first half of 2019 Net Promoter Scores[3] in our branches averaged +90 (31 December 2018: +90), in our savings contact centre they were +83 (31 December 2018: +83), and contact with our mortgage intermediary partners averaged +86 (31 December 2018: +81), representing outstanding levels of customer service.

As a result, we estimate that in the 12 months to 30 June 2019 we have grown savings balances by three times the market rate of growth[1]. Independent recognition of this performance came from our continued status as a Which? recommended savings provider and a Moneyfacts award for being the Best Building Society Savings Provider, as well as being the most highly rated savings provider by Fairer Finance. The growth was supported by our partnership with Hargreaves Lansdown, through which we were the first provider of an instant access savings account on its Active Savings platform.

We also delivered robust mortgage growth of £1.3 billion in the six months to 30 June 2019 (30 June 2018: £1.5 billion), a rate of growth that we estimate is more than two and a half times that of the market[1]. This has been achieved without losing sight of the Society's low risk approach to lending, which is evident in the further reduction in arrears with mortgages 2.5% or more in arrears reducing to 0.09% (31 December 2018: 0.10%) or one eighth of the industry average (31 December 2018: one seventh)[7]. We will continue to adapt our lending in a changing market, but always with a low risk approach which protects individual members and the Society as a whole.

Chief Executive's Review

(continued)

Equally, it is in the interest of both current and future members that we invest in developing our service capability and resilience and we have made good progress in the last six months in pursuing our three key strategic programmes.

Most visible amongst these is the branch redesign programme. We view our branches differently from those of high street banks – they are a successful channel for savings growth and an important means of delivering our service to members and supporting local communities. We are redesigning and updating our branches to better fit this purpose and we have now delivered 15 new style branches to much appreciation from members and colleagues alike, with the programme continuing at a good pace. Our plan to update our data centres is also progressing well. Having started to migrate services in 2018, we expect to deliver the majority of those remaining this year, enhancing resilience, service functionality and flexibility.

The most complex element of our strategic investment is focussed on our core technology platform. At the end of 2018 I reported that we needed to re-plan this activity to reduce execution risks. This re-planning work has now completed and a roadmap of initiatives is in place to deliver the changes, albeit over a longer time frame than originally expected and without the need to replace our core technology platform. The first wave of initiatives will mobilise in the second half of this year.

Our strong capital base, supported by our low cost, low risk business model, allows us to take a long term view when investing. Our capital ratios remain strong with a Common Equity Tier 1 ratio of 34.2% (31 December 2018: 35.5%) expected to be among the highest of any top 20 UK lender[8].

The impact of increasing strategic investment can be seen in the increase to our management expense ratio to 0.48% (30 June 2018: 0.46%)[5]. We anticipate this will remain the lowest reported by any UK building society, and the ratio excluding exceptional strategic investment of 0.39%[11] (30 June 2018: 0.41%) demonstrates our continued focus on running an efficient business. Higher investment costs, together with reduced margins arising from the competitive pricing environment and with our continuing focus on returning value to members, contributed to profit before tax for the first half of 2019 being £38 million lower than the same period last year at £75 million (30 June 2018: £113 million). Profit was also impacted by fair value volatility and non-repeat of the asset sale from 2018. At the same time we have maintained the value we provide to our members through above market average savings rates at £117 million (30 June 2018: £117 million)[2].

As a building society, delivering member value is clearly an important measure of success but it is not the only one. I have mentioned the Net Promoter Scores as a measure of our members' satisfaction with the service we provide and we continue to work hard to meet their expectations. Central to this is the professionalism and commitment of all those who work here. I was delighted to improve our standing amongst the UK's 100 Best Companies to Work For earlier this year and more recently to win Employer of the Year for Equality and Inclusion[12]. It is by providing colleagues with the support and opportunities they need that we deliver on our promise to members. In turn our colleagues are supported and guided by a strong board and this year we have welcomed Shamira Mohammed, who joined the Board as a Non-Executive Director bringing extensive financial and executive experience from her work with Aviva plc and the Phoenix Group.

Coventry Building Society is built on strong foundations and through its long history has demonstrated its ability to thrive through challenging market conditions. It has a long and successful record of operating in the best interests of its members to earn the trust of all those it serves. I am confident that the principles which have sustained us in the past remain just as relevant as we continue to grow and invest in our future.

Signed on behalf of the Board by

Mark Parsons
Chief Executive

29 July 2019

1. Source: Bank of England - latest published data as at 31 May 2019.
2. Based on the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits for the first five months of the year on the Society's mix of products.
3. A measure of customer advocacy that ranges between -100 and +100 which represents how likely a customer is to recommend our products and services. The overall Net Promoter Score of +75 is a calculated average from 6 surveys, branch survey of 16,500 customers, savings contact centre survey of 18,803 callers, mortgage contact centre survey of 2,050 callers, online survey of 4,051 users, opening a savings account survey of 5,872 customers and a survey of 1,824 brokers.
4. Source: Financial Ombudsman Service - latest published information: 1 July 2018 to 31 December 2018.
5. Administrative expenses, depreciation and amortisation/Average total assets.
6. As at 29 July 2019.
7. Source: Prudential Regulation Authority - latest available information as at 31 March 2019.
8. Source: UK Finance, 2018 top 20 mortgage lender (balance outstanding) latest published CET 1 data as at 29 July 2019.
9. In 2019 the Society rebased certain stress assumption in the LCR calculations which has the effect of reducing reported LCR. Had these assumptions been in place at 31 December 2018, the reported ratio would have been c. 175%.
10. Source: Best Companies Limited as at 31 December 2018.
11. Administrative expenses, depreciation excluding IFRS 16 and amortisation less increase in strategic investment costs compared to 2017/Average total assets.
12. Source: Employees network for equality & inclusion awards 2019.

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 only the profit we need to maintain capital ratios, whilst investing to improve services and providing favourable pricing for members.

Profits have fallen in the first half of the year, reflecting continued price competition in the market and our commitment to investing for the future whilst maintaining superior savings rates for as long as possible coupled with a number of one-off items. During the six months to 30 June 2019 we maintained the value provided to members through superior savings rates compared with the market average[1] at £117 million (30 June 2018: £117 million). Whilst member value was maintained, profit before tax decreased by £38 million to £75 million. This was as a result of continued spending on strategic investment programmes (£12 million) and volatility in the financial markets impacting the fair value of financial instruments used to manage interest risk exposures (£12 million). In addition, profits in the first half of 2018 included a one-off gain of £15 million relating to the sale of a £351 million buy to let loan portfolio. Without the impacts of these items, profit before tax is broadly in line with June 2018.

We added £33 million[2] (30 June 2018: £77 million) to General reserves to support growth and investment, and broadly maintained our leverage ratio[3] at 4.5% on a UK modified basis (31 December 2018: 4.6%).

Income Statement summary

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Net interest income	**201.1**	213.7	425.8
Fees and commissions	**(1.1)**	(1.3)	(2.3)
Other income	**2.2**	0.3	1.1
Losses on derivatives and hedge accounting	**(12.4)**	(0.6)	(0.3)
Total income	**189.8**	212.1	424.3
Management expenses	**(113.3)**	(99.6)	(221.7)
Impairment (charge)/credit	**(1.2)**	1.0	0.4
Provisions	**-**	0.4	-
Charitable donation to Poppy Appeal	**(0.6)**	(0.8)	(1.4)
Profit before tax	**74.7**	113.1	201.6

Net interest: Net interest income for the period was £201 million (30 June 2018: £214 million). In 2018, net interest income included a £15 million gain on sale of a £351 million buy to let loan portfolio. Excluding the portfolio sale, Net Interest Income increased by £2 million reflecting balance sheet growth offset by falling new business margins as a result of continued price competition in mortgages and savings acquisition and maintaining superior average savings rates compared to the market. Net interest margin was 0.86% (30 June 2018: 1.00%) which, for 30 June 2018, included 7 basis points as a result of the gain on sale of a £351 million buy to let loan portfolio.

Other operating income: Other income for the period of £2.2 million (30 June 2018: £0.3 million) relates to income from a small number of equity investments and included £1.4 million of deferred contingent consideration received in the period following the sale of our investment in VocaLink Holdings Limited in 2017.

Net losses from derivative financial instruments: The Society uses derivative financial instruments to manage interest rate and currency risk arising from its mortgage and savings activity and from non-sterling wholesale funding. During the first half of 2019 there has been considerable market volatility impacting swap valuations. Whilst the Society's derivative financial instruments have remained effective in economically hedging risks as they were designed to do, hedge accounting relief has not been fully obtained creating accounting volatility and, as a result, losses of £12 million have been recognised (30 June 2018: £0.6 million loss). These losses represent timing differences and are expected to reverse over the remaining life of the derivatives although further volatility may also be experienced.

Management expenses and depreciation: Management expenses including depreciation and amortisation for the period were £113 million (30 June 2018: £100 million). Substantially all of the increase relates to the Society's strategic investment programmes, with a £12 million increase in strategic investment costs[4] in addition to a £1 million increase in the ongoing costs of running the business. The costs of the strategic investment programmes are substantial and represent a £22 million increase in change activity since 2017[5] which we continue to regard as a reasonable benchmark level of spend for change investment.

Chief Financial Officer's Review
(continued)

The Society's strategic investment reflects three key investment projects:

- **Branch redesign**: Eight branches have been remodelled as planned during the first half of the year, bringing the total to 15, with a similar number planned to be remodelled during the second half of the year.
- **Enhanced data infrastructure**: Good progress has been made with migrations continuing. We expect to complete the majority of migrations by the end of this year as reported previously.
- **Core technology platform upgrade:** As I said in our year-end report, we experienced a number of challenges with this activity in 2018 and identified that progressing as planned was likely to be more complicated and expensive than originally envisaged. As a result we reported this as a risk event and set up a review of options to meet our objectives while reducing the risk of the upgrade. This review has now finished and the activity has been re-planned as a number of individual initiatives, giving us a roadmap of change projects. This more modular approach is designed to reduce execution risk and allow more flexibility in scheduling both activity and cost. We will start a number of these initiatives in the second half of the year including a multi-year programme to implement new mortgage origination tools to improve our service to intermediaries and borrowing members. The roadmap extends across the Strategic Planning period and as a result, we expect costs to remain elevated for a number of years. We are not planning to progress the replacement of our core technology platform within our planning horizon.

The level of strategic change investment we are making makes it even more important that we focus on spending members' money wisely. The cost to mean asset ratio of 0.48%[6] is expected to remain the lowest reported of all UK building societies[7] (30 June 2018: 0.46%). Without the strategic investment costs incurred in the period the Society's 'run cost' ratio is 0.39%[8] (30 June 2018: 0.41%) reflecting the continued efficiency of our core operations.

Arrears and impairment: The impairment charge during the period was £1.2 million (30 June 2018: credit of £1.0 million). The key measures of arrears and possessions have both improved in the first half of 2019 with balances three or more months in arrears falling to £60.1 million (31 December 2018: £67.6 million) and only 27 cases in possession (31 December 2018: 34). Despite this underlying improvement, we have increased impairment provisions reflecting a management view of the market and economic uncertainty driven by Brexit and a weakening macroeconomic backdrop.

Impairment provisions as a percentage of balances classified as being in Stage 3 (default) under IFRS 9 remains low reflecting our underlying low loss experience. Provisions as a percentage of Stage 3 balances have increased to 6.1% (31 December 2018: 5.6%) with coverage for Stage 3 loans in arrears higher at 9.8% (31 December 2018: 8.9%). Provisions continue to reflect 5.5 years coverage of the losses we have seen over the last 12 months (31 December 2018: 5.5 years).

Provisions for liabilities and charges: Provisions now relate almost exclusively to Payment Protection Insurance (PPI) with no provision being held for Financial Services Compensation Scheme (FSCS) charges given the repayment of the FSCS loans to HM Treasury in 2018. Although we have seen some increase in the number of PPI claims ahead of the August claims deadline, these have been within provision estimates and no charge has been made in the first six months of the year (30 June 2018: £0.4 million credit).

Charitable donation: The Society donated £0.6 million to The Royal British Legion's Poppy Appeal during the period (30 June 2018: £0.8 million).

Tax: The corporation tax charge represented an effective rate of tax of 18.9%. Following the amendments to IAS 12, the tax relief on distributions to holders of our Additional Tier 1 (AT 1) capital instruments are now shown in the tax charge rather than netted off from the distribution. The effective rate at 30 June 2018, after restating for the impact of this change, was 20.6%.

Chief Financial Officer's Review
(continued)

Balance Sheet summary

	30 Jun 2019 (Unaudited) £m	30 Jun 2018 (Unaudited) £m	31 Dec 2018 (Audited) £m
Assets			
Loans and advances to customers	**40,586.5**	37,409.3	39,264.6
Liquidity	**7,575.6**	5,973.2	6,401.9
Other	**572.0**	384.0	404.4
Total assets	**48,734.1**	43,766.5	46,070.9
Liabilities			
Retail funding	**35,158.7**	31,442.5	33,281.6
Wholesale funding	**10,906.0**	9,900.9	10,313.7
Subordinated liabilities and subscribed capital	**67.1**	67.1	67.1
Other	**420.1**	299.9	288.1
Total liabilities	**46,551.9**	41,710.4	43,950.5
Equity			
General reserve	**1,725.4**	1,631.2	1,693.5
Other equity instruments	**429.9**	396.9	396.9
Other	**26.9**	28.0	30.0
Total equity	**2,182.2**	2,056.1	2,120.4
Total liabilities and equity	**48,734.1**	43,766.5	46,070.9

Loans and advances to customers: The Society's business model remains focused on high quality, low loan to value owner-occupier and buy to let lending within the prime residential market, distributed mainly through mortgage intermediaries. During the period, the Society advanced £4.1 billion of mortgages (30 June 2018: £4.6 billion), with net mortgage lending of £1.3 billion (30 June 2018: £1.5 billion). We continue to focus on low risk lending and the average loan to value (balance weighted average) of loans originated in the six months to 30 June 2019 has remained unchanged at 54.6% (31 December 2018: 54.6%), despite a house price inflation environment which has been flatter and has notably seen falls in some locations. This reflects the low risk nature of the Society's lending activities.

Liquidity: On-balance sheet liquid assets have increased to £7.6 billion (31 December 2018: £6.4 billion) and the Liquidity Coverage Ratio (LCR) at 30 June 2018 was 232% (31 December 2018: 202%), significantly in excess of the regulatory minimum. During the period the Society revised a number of the stress outflow assumptions used in calculating the LCR to better reflect expected customer behaviour and regulatory guidelines. Had these been used at December 2018, LCR would have been reported at c. 175%. The increase in LCR despite this change reflects an increase in liquid assets held, partly to mitigate any Brexit risks. The cost of this extra liquidity of c. £5 million is absorbed within Net Interest Income in the period.

Retail savings: The Society continues to be predominantly funded by retail savings, with balances of £35.2 billion at 30 June 2019 (31 December 2018: £33.3 billion) and has achieved particularly strong growth of £1.9 billion (30 June 2018: £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[9] has increased to £10.9 billion (31 December 2018: £10.3 billion) reflecting a Covered Bond issuance and £525 million of Bi-lateral funding, offset by maturities during the year.

Pension benefit surplus (included in Other assets): During the period the Society has taken steps to transfer its Defined Benefit pension scheme to a new provider. The transfer was undertaken to improve the long term sustainability of the fund by ensuring continued governance and providing access to improved investment opportunities at lower cost in line with the Society's aim of achieving self sufficiency for the pension scheme. In line with this aim, the Society made a one-off contribution to the fund of £6 million bringing total contributions in the period to £6.6 million (six months to 30 June 2018: £0.7 million). This contribution fully covers the deficit reported in the last triennial valuation and therefore the Society expects to make no further contributions until the next valuation. Despite this contribution, the Pension surplus has remained stable at £22.9 million (31 December 2018: £22.9 million) as volatility in the financial markets impacted the valuation of the schemes assets by less than the movement in its obligations.

Chief Financial Officer's Review

(continued)

General reserves: The growth in General reserves of £33 million[2] (30 June 2018: £77 million) reflects retained profit for the period of £61 million (30 June 2018: £90 million), offset by a number of items. Volatility in the financial markets has impacted the valuation of the Defined Benefit pension scheme reducing General reserves by £5.1 million (30 June 2018: nil). During the first half of the year, the Society successfully tendered to repurchase the Additional Tier 1 (AT 1) instrument issued in 2014 ahead of its November 2019 call date and issued new AT 1. The costs of the tender and reissue totalling £11.8 million are deducted from General reserves (31 December 2018: nil) along with distributions to holders of the AT 1 instruments of £11 million (30 June 2018: £12.7 million).

Other Equity Instruments: The tender for the 2014 Additional Tier 1 instruments (AT1) resulted in the repurchase of £385 million of the £400 million AT1 capital instruments and the issue of a further £415 million of new instruments, with a first call date in 2024, were issued bringing total AT1 to £430 million (December 2018: £397 million). This transaction maintains the level of Tier 1 capital whilst de-risking the potential effect of Brexit on the wholesale markets.

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 2019 £m	End-point 30 Jun 2018 £m	End-point 31 Dec 2018 £m
Capital resources:			
Common Equity Tier 1 (CET 1) capital	**1,643.6**	1,537.6	1,614.8
Total Tier 1 capital	**2,058.6**	1,934.5	2,011.7
Total capital	**2,058.6**	1,974.5	2,011.7
Risk weighted assets	**4,811.8**	4,336.9	4,548.5
CRD IV ratios:	**%**	%	%
Common Equity Tier 1 (CET 1) ratio	**34.2**	35.5	35.5
CRR Leverage ratio[10]	**4.1**	4.1	4.2
UK Leverage ratio[3]	**4.5**	4.6	4.6

In line with its strategy of maintaining capital ratios, the leverage ratio, which the Society regards as its binding constraint, on both a CRR and UK modified basis has been broadly maintained at 4.1% and 4.5% (31 December 2018: 4.2% and 4.6%)

The CET 1 ratio has fallen to 34.2% (31 December 2018: 35.5%). Risk weighted Assets grew by 6% in the period in line with balance sheet growth. Capital resources have been impacted by the volatility in the financial markets which led to fair value adjustments in addition to the costs of tendering for and reissuing the Additional Tier 1 capital instruments. These factors taken together accounted for c. 60 bps of the reduction in CET 1 capital. The remaining reduction reflects the lower profits as a result of tightening margins and continuing strategic investment spend.

In 2018, the Society was issued with a Total Capital Requirement by the PRA equal to 11.2% of risk weighted assets or £539 million. This sets the minimum capital which the Society must hold under Pillar 1 and Pillar 2A and is driven by both balance sheet growth factors and risk factors determined by the PRA. With a CET 1 ratio of 34.2%, the Society significantly exceeds this requirement with CET 1 capital alone.

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 2019 is 1.1% 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. Based on the Society's average month end savings rate compared to the Bank of England average rate for household interest-bearing deposits for the first five months of the year on the Society's mix of products.
2. Movement in General reserves after restating for the changes on initial application of IFRS 16. More information is included note 2 to the accounts.
3. Leverage ratio modified under the UK regulatory regime by excluding central bank reserves from the calculation of leverage exposures.
4. Includes the increase in depreciation and amortisation net of the adoption of IFRS 16.
5. Increase in H1 2019 compared to H1 2017 after indexation.
6. Administrative expenses, depreciation and amortisation/Average total assets.
7. As at 29 July 2019.
8. Administrative expenses, depreciation excluding IFRS 16 and amortisation less increase in strategic investment costs compared to 2017/Average total assets.
9. Deposits from banks, Other deposits, Amounts owed to other customers and Debt securities in issue.
10. The CRR 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.

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 as an update to those set out at 31 December 2018 on page 26 of the 2018 Annual Report & Accounts. The Society's principal risk categories are described on page 12 of the 2018 Annual Report & Accounts, with more detail provided on pages 30 to 61, and the Society's view of these has not materially changed during 2019.

UK political and economic uncertainty

During 2019, there has been continued uncertainty around both Brexit and the wider UK political environment. As a result, there is ongoing potential for this uncertainty to reduce confidence in the UK economy and therefore impact the wholesale funding market, house prices and employment. There is also a risk that the very low interest rate environment will continue in the medium term. Alongside this, global macro-economic risks have also increased and may spill-over into the UK economy.

Whilst the Society's UK focus means that it is protected from direct impacts of Brexit outside of wholesale funding, the Society could be impacted by a wider UK economic downturn.

The UK mortgage and savings market fundamentals are expected to remain strong over the medium to long term. This, coupled with the Society's simple business model, focussed on straightforward, low-risk mortgages and retail savings products means that the Society expects to remain resilient to these economic challenges. The Society's mortgage book is geographically spread which mitigates the risk from a fall in London house prices and its low risk lending policy means that its mortgage book is expected to continue to perform well in a downturn. The Society has continued to attract both retail savings and well-priced wholesale funding in 2019, and this performance is set to continue, allowing it to manage risks in this area.

Market environment

The market environment has remained competitive during 2019 and there has been a further decrease in Net Interest Margin. This competition continues to reflect new entrants particularly in the savings market, and continuing competition in the mortgage market impacted both by the UK retail banks and the absence of notable growth in the housing market.

The Society's simple business model means that we continue to focus on simple, low risk mortgage products and are able to leverage our deep experience and effective partnerships with intermediaries. These strong business fundamentals mean that we can respond to market pressures effectively. In addition, our focus on low risk lending, combined with our cost-efficient business model allows us to remain financially strong whist continuing to offer superior value to members. At the same time our strong retail franchise ensures ongoing access to retail funding.

Change and execution risk

The Society is undertaking a number of strategic investment programmes which are more wide reaching than any that the Society has completed previously. This activity increases cost and execution risk.

The change programmes will deliver additional resilience and flexibility and therefore reduce risk once implemented. In particular, the programmes are focussed on enhancing the Society's data centre capability and upgrading our core technology platform.

The Society believes that it is putting the necessary risk management processes for change management programmes in place which will ensure change is delivered safely, without disruption to core operations, and within expectations. These control processes include detailed feasibility work and testing before change is made and a focus on looking for options which reduce execution and cost risk. In addition, following the re-planning of the core technology platform upgrade the more modular approach we are taking to this activity is designed to reduce execution risk and allow more flexibility on scheduling. The Society is satisfied that it has set appropriate investment budgets within its Strategic Plan.

Condensed Consolidated Income Statement

For the period ended 30 June 2019

	Notes	**Period to 30 Jun 2019 (Unaudited) £m**	Period to 30 Jun 2018 (Unaudited) Restated[2] £m	Year ended 31 Dec 2018 (Audited) Restated[2] £m
Interest receivable and similar income[1]	3	**501.7**	480.5	976.3
Interest payable and similar charges	4	**(300.6)**	(266.8)	(550.5)
Net interest income		**201.1**	213.7	425.8
Fees and commissions receivable		**3.9**	4.1	8.1
Fees and commissions payable		**(5.0)**	(5.4)	(10.4)
Other operating income	5	**2.2**	0.3	1.1
Net losses from derivative financial instruments	6	**(12.4)**	(0.6)	(0.3)
Total income		**189.8**	212.1	424.3
Administrative expenses	7	**(99.3)**	(89.2)	(200.2)
Amortisation of intangible assets		**(7.1)**	(6.7)	(13.7)
Depreciation of property, plant and equipment		**(6.9)**	(3.7)	(7.8)
Impairment (charge)/credit on loans and advances to customers	8	**(1.2)**	1.0	0.4
Provisions for liabilities and charges	9	**-**	0.4	-
Charitable donation to Poppy Appeal		**(0.6)**	(0.8)	(1.4)
Profit before tax		**74.7**	113.1	201.6
Taxation		**(14.1)**	(23.3)	(38.6)
Profit for the financial period		**60.6**	89.8	163.0

1. Interest receivable and similar income within the comparative periods includes £14.9 million gain on derecognition of financial assets held at amortised cost.
2. Taxation and Profit for the financial period have been restated in the comparative periods following amendments to IAS 12. See note 2 for more information.

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 2019

Profit for the financial period (restated)[1]		**60.6**	89.8	163.0
Other comprehensive income				
Items that will not be transferred to the Income Statement:				
Remeasurement of defined benefit plan		**(6.9)**	-	2.5
Taxation		**1.9**	-	(0.6)
Effect of change in corporation tax rate		**(0.1)**	-	0.1
Items that may be transferred to the Income Statement:				
Fair value through other comprehensive income investments:				
Fair value movements taken to reserves		**6.4**	(10.6)	(12.4)
Amount transferred to Income Statement	16	**(9.6)**	9.7	13.4
Taxation		**0.9**	0.2	(0.2)
Effect of change in corporation tax rate		**(0.1)**	-	-
Cash flow hedges:				
Fair value movements taken to reserves		**4.7**	5.0	24.4
Amount transferred to Income Statement		**(5.6)**	(0.2)	(18.9)
Taxation		**0.3**	(1.3)	(1.5)
Effect of change in corporation tax rate		**(0.1)**	0.1	0.1
Other comprehensive (expense)/income for the period, net of tax		**(8.2)**	2.9	6.9
Total comprehensive income for the period, net of tax (restated)[1]		**52.4**	92.7	169.9

1. Taxation and Profit for the financial period have been restated in the comparative periods following amendments to IAS 12. See note 2 for more information.

The notes on pages 13 to 30 form part of this Interim Financial Report.

Condensed Consolidated Balance Sheet

As at 30 June 2019

	Notes	**30 Jun 2019 (Unaudited) £m**	30 Jun 2018 (Unaudited) £m	31 Dec 2018 (Audited) £m
Assets				
Cash and balances with the Bank of England		**6,044.2**	4,799.9	5,219.4
Loans and advances to credit institutions		**380.7**	215.4	231.3
Debt securities		**1,150.7**	957.9	951.2
Loans and advances to customers	10	**40,586.5**	37,409.3	39,264.6
Hedge accounting adjustment		**175.8**	(12.6)	6.5
Derivative financial instruments		**242.0**	275.8	268.9
Investment in equity shares		**4.0**	2.8	3.1
Intangible assets		**35.1**	48.9	37.2
Property, plant and equipment		**76.8**	37.1	48.8
Pension benefit surplus		**22.9**	19.4	22.9
Prepayments and accrued income		**15.4**	12.6	17.0
Total assets		**48,734.1**	43,766.5	46,070.9
Liabilities				
Shares		**35,158.7**	31,442.5	33,281.6
Deposits from banks		**5,320.7**	5,239.4	5,453.8
Other deposits		**12.5**	3.0	9.5
Amounts owed to other customers		**677.6**	763.6	496.5
Debt securities in issue	12	**4,895.2**	3,894.9	4,353.9
Hedge accounting adjustment		**58.8**	45.4	36.5
Derivative financial instruments		**255.2**	167.2	167.4
Current tax liabilities		**10.1**	26.7	15.4
Deferred tax liabilities		**14.7**	11.4	17.2
Accruals and deferred income		**38.0**	32.4	38.1
Other liabilities		**41.5**	12.3	10.5
Provisions for liabilities and charges	9	**1.8**	4.5	3.0
Subordinated liabilities	13	**25.5**	25.5	25.5
Subscribed capital	14	**41.6**	41.6	41.6
Total liabilities		**46,551.9**	41,710.4	43,950.5
Equity				
General reserve		**1,725.4**	1,631.2	1,693.5
Other equity instruments	15	**429.9**	396.9	396.9
Fair value through other comprehensive income reserve		**3.2**	4.1	5.6
Cash flow hedge reserve		**23.7**	23.9	24.4
Total members' interests and equity		**2,182.2**	2,056.1	2,120.4
Total members' interests, liabilities and equity		**48,734.1**	43,766.5	46,070.9

The notes on pages 13 to 30 form part of this Interim Financial Report.

Condensed Consolidated Statement of Changes in Members' Interests and Equity

For the period ended 30 June 2019

Period to 30 June 2019	Notes	**General reserve £m**	**Other equity instruments £m**	**Fair value through other comprehensive income reserve £m**	**Cash flow hedge reserve £m**	**Total £m**
As at 1 January 2019 (Audited)		**1,693.5**	**396.9**	**5.6**	**24.4**	**2,120.4**
Changes on initial application of IFRS 16		**(0.8)**	**-**	**-**	**-**	**(0.8)**
Restated balance at 1 January 2019		**1,692.7**	**396.9**	**5.6**	**24.4**	**2,119.6**
Profit for the financial period	2	**60.6**	**-**	**-**	**-**	**60.6**
Net remeasurement of defined benefit plan		**(5.1)**	**-**	**-**	**-**	**(5.1)**
Net movement in Fair value through other comprehensive income reserve		**-**	**-**	**(2.4)**	**-**	**(2.4)**
Net movement in Cash flow hedge reserve		**-**	**-**	**-**	**(0.7)**	**(0.7)**
Additional Tier 1 Capital repurchased (net of tax)	15	**(9.3)**	**(382.0)**	**-**	**-**	**(391.3)**
Additional Tier 1 Capital issued (net of tax)	15	**(2.5)**	**415.0**	**-**	**-**	**412.5**
Total comprehensive income		**43.7**	**33.0**	**(2.4)**	**(0.7)**	**73.6**
Distribution to Additional Tier 1 capital holders	2,15	**(11.0)**	**-**	**-**	**-**	**(11.0)**
As at 30 June 2019 (Unaudited)		**1,725.4**	**429.9**	**3.2**	**23.7**	**2,182.2**

Period to 30 June 2019 (restated)[1]						
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[1]	2	89.8	-	-	-	89.8
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[1]		89.8	-	(0.7)	3.6	92.7
Distribution to Additional Tier 1 capital holders[1]	2,15	(12.7)	-	-	-	(12.7)
As at 30 June 2018 (Unaudited)		1,631.2	396.9	4.1	23.9	2,056.1

Year ending 31 December 2018 (restated)[1]						
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 year[1]	2	163.0	-	-	-	163.0
Net remeasurement of defined benefit plan		2.0	-	-	-	2.0
Net movement in Fair value through other comprehensive income reserve		-	-	0.8	-	0.8
Net movement in Cash flow hedge reserve		-	-	-	4.1	4.1
Total comprehensive income[1]		165.0	-	0.8	4.1	169.9
Distribution to Additional Tier 1 capital holders[1]	2,15	(25.6)	-	-	-	(25.6)
As at 31 December 2018 (Audited)		1,693.5	396.9	5.6	24.4	2,120.4

1. Profit for the financial period/year, Total comprehensive income and Distributions to Additional Tier 1 capital holders have been restated in the comparative periods following amendments to IAS 12. See note 2 for more information.

The notes on pages 13 to 30 form part of this Interim Financial Report.

Condensed Consolidated Statement of Cash Flows

For the period ended 30 June 2019

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Cash flows from operating activities			
Profit before tax	**74.7**	113.1	201.6
Adjustments for:			
Impairment provisions and other provisions	**1.2**	(1.4)	(0.4)
Depreciation and amortisation	**14.0**	10.4	21.5
Interest on subordinated liabilities and subscribed capital	**3.3**	3.3	6.7
Changes to fair value adjustment of hedged risk	**(42.8)**	(2.0)	(19.4)
Other non-cash movements[1]	**1.3**	(37.4)	17.1
Non-cash items included in profit before tax	**(23.0)**	(27.1)	25.5
Loans and advances to credit institutions	**(156.4)**	(48.3)	(69.8)
Loans and advances to customers	**(1,323.1)**	(1,477.3)	(3,333.2)
Prepayments, accrued income and other assets	**(5.3)**	(2.9)	(8.5)
Changes in operating assets	**(1,484.8)**	(1,528.5)	(3,411.5)
Shares	**1,907.6**	454.4	2,238.4
Deposits and other borrowings	**51.0**	1,764.0	1,713.7
Debt securities in issue	**3.2**	(210.7)	(229.0)
Accruals, deferred income and other liabilities[1]	**(2.4)**	7.2	9.2
Changes in operating liabilities	**1,959.4**	2,014.9	3,732.3
Interest paid on subordinated liabilities and subscribed capital	**(3.3)**	(3.3)	(6.7)
Interest paid on lease liabilities[1]	**(0.4)**	-	-
Taxation	**(15.9)**	(19.6)	(41.6)
Net cash flows from operating activities	**506.7**	549.5	499.6
Cash flows from investing activities			
Purchase of investment securities	**(596.9)**	(340.7)	(454.2)
Sale and maturity of investment securities and equities	**385.8**	358.8	477.1
Purchase of property, plant and equipment and intangible assets	**(12.2)**	(19.6)	(31.5)
Net cash flows from investing activities	**(223.3)**	(1.5)	(8.6)
Cash flows from financing activities			
Distributions paid to Additional Tier 1 capital holders	**(11.0)**	(12.8)	(25.6)
Repurchase of Additional Tier 1 capital[2]	**(393.6)**	**-**	**-**
Issue of Additional Tier 1 capital[2]	**411.6**	**-**	**-**
Repurchase and repayment of debt securities	**(13.9)**	(765.4)	(780.7)
Principal elements of lease payments[1]	**(3.2)**	-	-
Issue of debt securities	**544.6**	-	499.0
Net cash flows from financing activities	**534.5**	(778.2)	(307.3)
Net increase/(decrease) in cash	**817.9**	(230.2)	183.7
Cash and cash equivalents at start of period	**5,122.3**	4,938.6	4,938.6
Cash and cash equivalents at end of period	**5,940.2**	4,708.4	5,122.3
Cash and cash equivalents:			
Cash and balances with the Bank of England[3]	**5,940.2**	4,708.4	5,122.3

1. Relates to the first time adoption of IFRS 16 from 1 January 2019, see note 2 for further information.
2. Net of transaction fees.
3. Excludes £104.0 million mandatory reserve with the Bank of England (30 June 2018: £91.5 million, 31 December 2018: £97.1 million).

The notes on pages 13 to 30 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 2019 and show the financial performance for the period from 1 January 2019 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 2019 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 2018, which have been prepared in accordance with International Financial Reporting Standards (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 risk exposure (including credit, market, liquidity and funding, conduct, operational and business risks) are contained in the Risk Management Report of the 2018 Annual Report & Accounts. An update on new Top and Emerging Risks has been provided on page 8 and does not identify any material changes to the Society's risk profile.

The directors also include a statement on long-term viability on page 93 of the 2018 Annual Report & Accounts. The current viability assessment has been over the period to 31 December 2021, in line with the Society's Strategic Plan and capital and liquidity stress testing process. 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 2018 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 its 2019 Interim Financial Report are consistent with those disclosed in the Annual Report & Accounts for the year ended 31 December 2018, with the exception of amendments to IAS 12 *Income Taxes* and the adoption of IFRS 16 *Leases*. The impact of these changes are described in more detail below. All other accounting policies adopted by the Group in its 2019 Interim Financial Report are consistent with those disclosed in the Annual Report & Accounts for the year ended 31 December 2018.

IAS 12 Amendments

Following amendments to IAS 12, the income tax relief on the distributions to holders of the Group's Additional Tier 1 instruments which was previously recognised within the Statement of Changes in Members Interest and Equity is now recognised within the Income Statement. The Group has applied this change retrospectively and the impact of restatement on comparative period information is set out below. There is no impact to the Group's General reserve overall as a result of this change in the current or comparative periods and the changes do not have a significant impact on the Group's financial statements.

Classification	Primary statement impacted	30 Jun 2018 £m	31 Dec 2018 £m
Taxation	Income Statement	(3.4)	(6.9)
Distribution to Additional Tier 1 capital holders	Statement of Changes in Members Interests and Equity	3.4	6.9
General reserve	**Balance Sheet**	**-**	**-**

Notes to the Interim Financial Report
(continued)

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

IFRS 16 Implementation

The adoption of IFRS 16 *Leases* has resulted in changes to amounts recognised in the financial statements for leases classified as 'operating leases' under the previous accounting standard, IAS 17 *Leases*. The Group has implemented IFRS 16 using the modified retrospective approach and has recognised the impact of transition in General reserves. The Group has elected not to restate comparative financial information, as permitted by the transitional provisions of IFRS 16, and comparative information is presented in accordance with IAS 17.

The Group's new accounting policy is set out below.

Leases

The majority of the Group's leases relate to property including branches, head office buildings and data centres, in addition to other leases relating to cars and office equipment.

Where the Group enters into a lease or contract which meets the criteria for lease classification under IFRS 16, the Group recognises an asset representing its right to use the leased item and a corresponding liability on the Balance Sheet. The lease liability is measured at the present value of the lease payments including any incentives, additional lease components and lease extension or termination options where they are reasonably certain to be exercised. These payments are discounted using the Group's incremental borrowing rate since no interest rates are specified in the Group's leases. The right-of-use asset is measured at cost including the lease liability, any initial direct costs and committed restoration costs.

The right-of-use asset is depreciated over the shorter of its useful life or the lease term on a straight line basis through the Income Statement, and the interest charge is recognised within Interest Payable.

Expenses relating to leases which are for less than 12 months, of low value or relate to intangibles such as software are recognised in the Income Statement as charged.

On an ongoing basis the Group reviews the right-of-use asset and lease liability for any modifications that would require re-measurement and makes an assessment for impairment.

Impact of transition to IFRS 16

On adoption of IFRS 16, the Group has applied the recognition criteria to all leases previously treated as 'finance' or 'operating' leases under IAS 17. In measuring the present value of the lease obligations the Group has used an incremental borrowing rate at the point of transition of 2.1% to discount lease cash flows. The transition impact has been recognised on a 'modified retrospective' basis with the difference between the lease liabilities and right-of-use assets recognised in reserves on 1 January 2019.

For leases previously classified as finance leases the Group has recognised the carrying amount of the lease asset and liability at an amount equal to that of the carrying amount at 31 December 2018.

The adjustments to the Group's Balance Sheet on transition to IFRS 16 are set out in the tables below:

1 January 2019	**£m**
Right-of-use assets[1]	**29.6**
Deferred tax	**0.3**
Accruals[2]	**2.1**
Lease liability presented in Other liabilities[3]	**(32.8)**
General reserves	**0.8**

1. Presented within Property, plant and equipment and includes £2.1 million previously recognised as finance leases reclassified as right-of-use assets.
2. Release of rental accruals which are now included within the lease liability.
3. Included within Other liabilities is £2.1 million relating to finance leases which were previously recognised in Other liabilities.

Notes to the Interim Financial Report
(continued)

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

The recognised right-of-use assets above relate to the following types of assets:

1 January 2019	£m
Property	27.5
Motor vehicles	1.8
Equipment	0.3
Total	**29.6**

A reconciliation of the operating lease commitments which were disclosed in the 2018 Annual Report & Accounts as at 31 December 2018 to the opening lease liabilities recognised under IFRS 16 as at 1 January 2019 is shown below:

IFRS 16 reconciliation	£m
Operating lease commitment disclosed as at 31 December 2018	20.0
Impact of discounting using the Society's incremental borrowing rate at 1 January 2019	(2.1)
Add: Finance lease liabilities recognised at 31 December 2018	2.1
Add: Adjustments as a result of extension options and additional lease components	6.8
Add: Contracts reassessed as leases under IFRS 16	6.3
Less: Short-term leases recognised as an expense on a straight line basis	(0.3)
Lease liability recognised as at 1 January 2019	**32.8**

In applying IFRS 16 for the first time the Group has used the following practical expedients as permitted by the standard:

- The use of a single incremental borrowing rate to a portfolio of leases with reasonably similar characteristics;
- Accounting for operating leases with a remaining term of less than 12 months as at 1 January 2019 as short-term leases;
- Exclusion of initial direct costs from the measurement of the right-of-use asset; and
- The use of hindsight in determining the lease liability.

The Society's first full set of financial statements prepared under IFRS 16 will be published in the 2019 Annual Report & Accounts.

Judgement in applying accounting policies and significant accounting estimates

There are judgements relating to the application of the Group's accounting policies which have had a significant effect on the amounts recognised in the financial statements. The Group has also made significant judgements relating to assumptions and estimates that could affect the reported amount of assets and liabilities both in the accounts and in the following financial periods.

The most significant judgements and assumptions and estimates made by the Group are disclosed below:

Significant accounting policy judgements
Classification and measurement of equity release loans
Determining a significant increase in credit risk under IFRS 9
Capitalisation of intangible assets and assessment for impairment

Significant assumptions and estimates
Mortgage Effective Interest Rate
Expected credit loss provision on loans and advances to customers

Notes to the Interim Financial Report
(continued)

3. Interest receivable and similar income

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
On loans fully secured on residential property	**493.0**	475.5	965.5
On other loans	**0.8**	0.9	1.7
On debt securities	**12.7**	12.7	23.4
On other liquid assets	**18.7**	12.6	30.6
Net expense on financial instruments hedging assets	**(23.3)**	(35.9)	(60.0)
Gain on derecognition of financial assets	**-**	14.9	14.9
Foreign currency (losses)/gains	**(0.2)**	(0.2)	0.2
Total	**501.7**	480.5	976.3

In the periods to 30 June 2018 and 31 December 2018 total interest receivable includes a £14.9 million gain relating to the sale of a £350.9 million mortgage portfolio and associated derivative financial instruments.

Significant assumptions and estimates – Effective Interest Rate

The Group recognises interest on loans and advances to customers on the basis of their Effective Interest Rate (EIR). This is a constant rate that averages out the effect of fixed and variable rates of interest and fees across the expected life of the loan account.

As at 30 June 2019, the EIR method resulted in an asset of £81.0 million (30 June 2018: £88.5 million, 31 December 2018: £84.2 million), gross of fees, within loans and advances to customers. This asset represents 0.2% (30 June 2018: 0.2%, 31 December 2018: 0.2%) of the Balance Sheet carrying value of mortgages. The movement in the period of £3.2 million was recognised in the Income Statement.

A critical assumption in the calculation is the expected life of the mortgages, as this determines the assumed period over which customers may be paying various differentiated interest rates. The calculation of the EIR uses assumptions on expected life that are based on the experience of similar products. These assumptions are monitored to ensure their ongoing appropriateness. Changes in the loan balance arising from actual product life experience, differing from the assumptions, are periodically calculated and an adjustment is made to the loan balance with a corresponding adjustment to interest receivable and similar income. An increase of 5% in the redemption rate of a loan for 12 months after the initial incentive period would result in a decrease in loans and advances to customers of £12.9 million, with a corresponding reduction to income in the Income Statement. Assumptions of future market interest rates also affect the calculation. A relative decrease in the interest rate received by the Society after the initial incentive period of 25 basis points would result in a decrease in loans and advances to customers of £13.4 million with a corresponding reduction to income in the Income Statement.

Notes to the Interim Financial Report

(continued)

4. Interest payable and similar charges

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Bank and customer			
Subordinated liabilities	**0.9**	0.9	1.8
Other	**21.6**	12.4	33.0
Debt securities in issue	**49.0**	55.2	102.1
Other borrowed funds			
On shares held by individuals	**238.0**	220.1	444.2
On subscribed capital	**2.4**	2.4	4.9
Net income on financial instruments hedging liabilities	**(11.5)**	(24.0)	(35.5)
Foreign currency gains	**(0.2)**	(0.2)	-
Other interest payable	**0.4**	-	-
Total	**300.6**	266.8	550.5

5. Other operating income

Other operating income of £2.2 million includes £1.4 million relating to receipt of deferred contingent consideration following the sale of the Society's equity investment in VocaLink Holdings Limited in 2017 as well as the gain of £0.7 million on the remaining investments in equity shares of Visa Inc. measured at fair value through profit and loss.

6. Net losses from derivative financial instruments

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Derivatives designated as fair value hedges			
(Losses)/gains on derivatives designated as fair value hedges	**(138.1)**	33.9	10.6
Movement in fair value of hedged items attributable to hedged risk	**138.1**	(34.7)	(10.8)
Ineffectiveness on fair value hedges	**-**	(0.8)	(0.2)
Derivatives designated as cash flow hedges			
Foreign exchange	**-**	-	-
Foreign exchange and interest rate	**0.6**	(0.8)	(1.0)
Interest rate	**(0.2)**	1.0	0.9
Ineffectiveness on cash flow hedges	**0.4**	0.2	(0.1)
Losses on other derivatives	**(12.8)**	-	-
Total	**(12.4)**	(0.6)	(0.3)

Losses on other derivatives of £12.8 million have been recognised in the Income Statement reflecting the fair value movements on derivatives where hedge accounting relief has not been fully obtained. The loss has been driven by considerable market volatility which has impacted swap valuations. The losses represent timing differences and are expected to reverse over the remaining life of the derivatives although further volatility may also be experienced.

Notes to the Interim Financial Report
(continued)

7. Administrative expenses

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Employee costs			
Wages and salaries	**43.3**	40.0	82.0
Social security costs	**4.6**	4.2	8.7
Pension costs			
Defined benefit plan	**(0.3)**	(0.2)	(0.5)
Defined contribution plan	**2.8**	2.6	5.4
	50.4	46.6	95.6
Other non-employee expenses	**48.9**	42.6	104.6
Total	**99.3**	89.2	200.2

The costs above relate to both ongoing business as usual activity and delivering change as shown below. Costs of delivering change includes both third party and employee costs which relate to change activity.

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Business as usual run costs	**71.8**	72.2	145.8
Costs of delivering change	**27.5**	17.0	54.4
Total	**99.3**	89.2	200.2

8. Impairment provisions on loans and advances to customers

Impairment provisions have been deducted from the loans and advances to customers in the Condensed Consolidated Balance Sheet.

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Impairment charge/(credit) for the period	**1.2**	(1.0)	(0.4)
Impairment provision at the end of the period:			
Residential mortgages	**10.7**	10.4	10.3
Other loans	**1.3**	1.4	1.3
Total	**12.0**	11.8	11.6

The table below shows a reconciliation of the impairment provision from 1 January 2019 to 30 June 2019. This shows an increase in the provision of £0.4 million as a result of a reduction in specific and possession provision cases resolved during the year, offset by a £1.5 million increase relating to management judgement overlays.

	£m
31 December 2018 opening provision	**11.6**
Specific provision cases resolved	(0.7)
Increase in Expected Credit Loss	1.5
Possession cases favourably resolved	(0.4)
30 June 2019 closing provision	**12.0**

Notes to the Interim Financial Report
(continued)

8. Impairment provisions on loans and advances to customers continued

A reconciliation of the impairment provision split by IFRS 9 stage from 31 December 2018 to 30 June 2019 is set out in the following table.

Loans and advances to customers	Stage 1 'Performing' £m	Stage 2 'Deteriorating' £m	Stage 3 'Default' £m	Total £m
Loss allowance at 31 December 2018	**1.4**	**3.9**	**6.3**	**11.6**
Movements with Income Statement impact				
Transfers:				
Transfers from Stage 1 to Stage 2	**-**	**0.6**	**-**	**0.6**
Transfers from Stage 1 to Stage 3	**-**	**-**	**0.5**	**0.5**
Transfers from Stage 2 to Stage 1	**0.1**	**(0.4)**	**-**	**(0.3)**
Transfers from Stage 3 to Stage 1	**-**	**-**	**(0.1)**	**(0.1)**
New mortgages originated	**0.3**	**-**	**-**	**0.3**
Remeasurement of ECL	**(0.3)**	**(0.2)**	**1.4**	**0.9**
Financial assets derecognised during the period	**(0.2)**	**(0.1)**	**(0.3)**	**(0.6)**
Net write off to Income Statement	**0.1**	**-**	**(0.2)**	**(0.1)**
Total net Income Statement charge in the period	**-**	**(0.1)**	**1.3**	**1.2**
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	**-**	**0.2**	**(0.2)**	**-**
Net write off	**-**	**-**	**(0.8)**	**(0.8)**
Loss allowance at 30 June 2019	**1.4**	**3.9**	**6.7**	**12.0**

A reconciliation of the impairment provision split by IFRS 9 stage from 1 January 2018 to 30 June 2018 is set out in the following table.

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 credit 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**

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8. Impairment provisions on loans and advances to customers continued

A reconciliation of the impairment provision split by IFRS 9 stage from 1 January 2018 to 31 December 2018 is set out in the following table.

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	(0.1)	1.1	-	1.0
Transfers from Stage 1 to Stage 3	-	-	0.8	0.8
Transfers from Stage 2 to Stage 1	0.1	(0.5)	-	(0.4)
Transfers from Stage 3 to Stage 1	-	-	(0.1)	(0.1)
New mortgages originated	0.6	-	-	0.6
Remeasurement of ECL	(0.1)	(0.7)	0.4	(0.4)
Financial assets derecognised during the period	(0.4)	(0.2)	(1.0)	(1.6)
Net write off to Income Statement	0.1	-	(0.4)	(0.3)
Total net Income Statement credit in the period	**0.2**	**(0.3)**	**(0.3)**	**(0.4)**
Other movements with no Income Statement Impact				
Transfers:				
Transfers from Stage 2 to Stage 3	-	(0.2)	0.2	-
Transfers from Stage 3 to Stage 2	-	0.5	(0.5)	-
Net write off	(0.1)	-	(1.4)	(1.5)
Loss allowance at 31 December 2018	**1.4**	**3.9**	**6.3**	**11.6**

Significant assumptions and estimates – forward looking information incorporated in the ECL models

The assessment of a significant increase in credit risk and the calculation of expected credit losses (ECL) both incorporate forward looking information and therefore require significant management judgement. Consistent with the methodology applied at 31 December 2018, the Group has used four economic scenarios to assess ECL for its core owner-occupier and buy to let portfolios which represent 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 aligned to the Group's Strategic Plan, updated for the latest forecasts.	60%
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).	10%
Upside – based on an improved credit environment (best case), given the current benign conditions the improvement on base case is minor.	1%
Midpoint – a scenario between the downside and upside cases which reflects a more moderate downturn than the downside scenario.	29%

The most significant assumptions used in these scenarios are:

Scenario		Base %	Downside %	Upside %	Midpoint %
Bank of England base rate	Five year average	0.8	3.3	0.5	1.9
Unemployment	Five year average	4.2	8.1	3.8	5.9
House Price Index	Peak to trough	7.0	(37.7)	14.3	(15.7)
	Five year average	2.6	(24.8)	5.3	(9.8)
UK GDP	Peak to trough	7.3	(4.7)	15.0	(7.8)
	Five year average	3.6	(2.5)	7.3	2.4

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8. Impairment provisions on loans and advances to customers continued

The ECL calculation is particularly sensitive to changes in:

- House Price Index (HPI), given the significant impact it has on mortgage collateral valuations.
- 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. The weightings which have been applied to the scenarios are consistent with those reported at 31 December 2018. These weightings reflect the uncertainty over Brexit and the wider global economy.

In order to demonstrate the sensitivity to scenario weightings, 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 decrease by £2.4 million (from £12.0 million to £9.6 million), 20% less than the reported provision.

Scenario	IFRS 9 Provision £m	(Decrease)/ increase %
IFRS 9 weighted average	12.0	-
Base	9.6	(20.0)
Downside	25.3	110.8
Upside	9.1	(24.2)
Midpoint	12.1	0.8

9. Provisions for liabilities and charges

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
At 1 January	**3.0**	5.7	5.7
Credit for the period	**-**	(0.4)	-
Provision utilised	**(1.2)**	(0.8)	(2.7)
Total	**1.8**	4.5	3.0

The group's provisions at the period end relate to Payment Protection Insurance (PPI) and other regulatory provisions.

The Group held a provision at 30 June 2019 for PPI and other regulatory provisions of £1.8 million (30 June 2018: £3.4 million, 31 December 2018: £2.6 million) which are held in respect of circumstances that may give rise to various customer claims. No additional charge has been raised in the period (30 June 2018: £1.5 million, 31 December 2018: £1.5 million) with the provision continuing to be utilised as the deadline for PPI claims in August 2019 approaches.

At the 30 June 2019 there is no provision held for FSCS levy (30 June 2018: £1.1 million, 31 December 2018: £0.4 million) following the final payment being made to HM Treasury and the additional amount levied in November 2018 following the failure of a number of credit unions in the second half of 2018.

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10. Loans and advances to customers

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Residential mortgages			
Owner-occupier mortgages	**24,065.7**	22,420.7	23,255.5
Buy to let mortgages	**16,265.3**	14,692.4	15,734.2
Near-prime mortgages[1]	**63.2**	70.7	66.1
Self-certification mortgages[1]	**169.5**	198.3	184.0
Other loans			
Commercial mortgages[2]	**1.3**	1.7	1.5
Unsecured loans[2]	**21.6**	25.6	23.4
Mortgage pipeline	**(0.1)**	(0.1)	(0.1)
Total	**40,586.5**	37,409.3	39,264.6

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

The loan to value distribution of the mortgage book has remained stable during 2019. This is shown by IFRS 9 stage in the following tables.

As at 30 June 2019 **Indexed loan to value:**	**Stage 1 'Performing' £m**	**Stage 2 'Deteriorating' £m**	**Stage 3 'Default' £m**	**Impairment £m**	**Total £m**	**Proportion of book %**
< 50%	**15,294.5**	**394.9**	**73.5**	**(1.1)**	**15,761.8**	**38.8**
50% to 65%	**12,058.4**	**355.7**	**60.7**	**(1.4)**	**12,473.4**	**30.7**
65% to 75%	**6,762.4**	**240.8**	**27.9**	**(1.9)**	**7,029.2**	**17.3**
75% to 85%	**3,546.8**	**116.1**	**18.9**	**(2.3)**	**3,679.5**	**9.1**
85% to 90%	**1,400.2**	**48.1**	**6.2**	**(1.1)**	**1,453.4**	**3.6**
90% to 95%	**136.1**	**10.1**	**3.4**	**(0.7)**	**148.9**	**0.4**
95% to 100%	**6.9**	**2.4**	**1.3**	**(0.8)**	**9.8**	**-**
> 100%	**4.3**	**1.8**	**4.9**	**(2.1)**	**8.9**	**-**
Unsecured loans	**21.6**	**0.4**	**0.2**	**(0.5)**	**21.7**	**0.1**
Mortgage pipeline	**-**	**-**	**-**	**(0.1)**	**(0.1)**	**-**
Total	**39,231.2**	**1,170.3**	**197.0**	**(12.0)**	**40,586.5**	**100.0**
	%	**%**	**%**			
Total gross loans	**96.6**	**2.9**	**0.5**			

As at 31 December 2018 **Indexed loan to value:**	**Stage 1 'Performing' £m**	**Stage 2 'Deteriorating' £m**	**Stage 3 'Default' £m**	**Impairment £m**	**Total £m**	**Proportion of book %**
< 50%	14,745.5	384.8	78.0	(0.6)	**15,207.7**	38.7
50% to 65%	11,817.2	348.8	62.8	(1.3)	**12,227.5**	31.2
65% to 75%	6,501.7	223.3	26.8	(1.7)	**6,750.1**	17.2
75% to 85%	3,249.0	108.7	20.9	(2.1)	**3,376.5**	8.6
85% to 90%	1,202.0	47.4	6.1	(1.2)	**1,254.3**	3.2
90% to 95%	382.5	12.1	6.2	(1.2)	**399.6**	1.0
95% to 100%	7.4	4.6	2.0	(0.9)	**13.1**	-
> 100%	6.1	2.5	5.8	(2.0)	**12.4**	-
Unsecured loans	23.3	0.4	0.3	(0.5)	**23.5**	0.1
Mortgage pipeline	-	-	-	(0.1)	**(0.1)**	-
Total	**37,934.7**	**1,132.6**	**208.9**	**(11.6)**	**39,264.6**	100.0
	%	**%**	**%**			
Total gross loans	**96.6**	**2.9**	**0.5**			

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10. Loans and advances to customers continued

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	Proportion of book %
< 50%	14,533.8	427.4	82.4	(1.1)	**15,042.5**	40.2
50% to 65%	11,507.3	365.1	63.1	(2.4)	**11,933.1**	31.9
65% to 75%	6,044.8	207.5	30.3	(1.5)	**6,281.1**	16.8
75% to 85%	2,826.3	101.2	20.7	(1.8)	**2,946.4**	7.9
85% to 90%	932.3	40.9	9.3	(0.9)	**981.6**	2.6
90% to 95%	158.5	10.1	5.0	(0.8)	**172.8**	0.5
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**	0.1
Mortgage pipeline	-	-	-	(0.1)	**(0.1)**	-
Total	**36,040.6**	**1,160.8**	**219.7**	**(11.8)**	**37,409.3**	100.0
	%	**%**	**%**			
Total gross loans	**96.3**	**3.1**	**0.6**			

The Group's lending strategy has remained focused on high quality low risk residential mortgages. This low risk approach is reflected in the low loan to value of the mortgage book and low levels of arrears and possessions.

At the reporting date, 96.6% of loans are in Stage 1 with only 2.9% in Stage 2 and 0.5% in Stage 3, which is consistent with the position as at 31 December 2018. Cure periods are applied to accounts in Stages 2 and 3 that have hit certain quantitative triggers such as arrears. These cure periods 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 12 months of sustained performance before a loan is reassessed. As a result, loans can be recorded in Stage 2 or Stage 3 despite otherwise performing at the reporting date.

Of the balances in Stage 2 as at the reporting date, only £97.2 million (8.3%) (31 December 2018: £86.3 million, 7.7%) are in arrears by 30 days or more. This demonstrates that the major drivers for Stage 2 classification are non-arrears factors. Loans which are classified as Stage 3 are currently three or more months in arrears, have been three or more months in arrears in the last 12 months, or have unlikeliness to pay indicators present. Of the loans classified as Stage 3 at the reporting date, 69.5% (or £136.9 million) are less than three months in arrears, and 37.6% (or £74.1 million) of Stage 3 assets are paid up to date (31 December 2018: 67.6%, 37.4%).

		Stage 2 'Deteriorating'		Stage 3 'Default'			
As at 30 June 2019	Stage 1 'Performing' £m	Not past due £m	Past due £m	Not past due £m	Past due £m	Impairment £m	Total £m
Residential mortgages							
Residential mortgages Owner-occupier	**23,261.5**	**626.1**	**60.4**	**46.3**	**77.9**	**(6.5)**	**24,065.7**
Residential mortgages Buy to let	**15,814.4**	**391.2**	**26.1**	**13.3**	**24.0**	**(3.7)**	**16,265.3**
Total traditional residential mortgages	**39,075.9**	**1,017.3**	**86.5**	**59.6**	**101.9**	**(10.2)**	**40,331.0**
Non-traditional mortgages							
Residential near-prime	**28.4**	**12.0**	**4.2**	**6.4**	**12.4**	**(0.2)**	**63.2**
Residential self-certified	**105.2**	**42.1**	**6.1**	**7.7**	**8.6**	**(0.2)**	**169.5**
Commercial lending	**-**	**1.7**	**-**	**0.4**	**-**	**(0.8)**	**1.3**
Total non-traditional mortgages	**133.6**	**55.8**	**10.3**	**14.5**	**21.0**	**(1.2)**	**234.0**
Unsecured loans	**21.7**	**-**	**0.4**	**-**	**-**	**(0.5)**	**21.6**
Mortgage pipeline	**-**	**-**	**-**	**-**	**-**	**(0.1)**	**(0.1)**
Total gross loans	**39,231.2**	**1,073.1**	**97.2**	**74.1**	**122.9**	**(12.0)**	**40,586.5**
	%	**%**	**%**	**%**	**%**		
Total gross loans	**96.6**	**2.7**	**0.2**	**0.2**	**0.3**		

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10. Loans and advances to customers continued

As at 31 December 2018	Stage 1 'Performing' £m	Stage 2 'Deteriorating' Not past due £m	Stage 2 'Deteriorating' Past due £m	Stage 3 'Default' Not past due £m	Stage 3 'Default' Past due £m	Impairment £m	Total £m
Residential mortgages							
Residential mortgages Owner-occupier	22,444.9	630.9	54.4	50.0	81.3	(6.0)	**23,255.5**
Residential mortgages Buy to let	15,323.9	353.0	22.6	14.6	23.9	(3.8)	**15,734.2**
Total traditional residential mortgages	37,768.8	983.9	77.0	64.6	105.2	(9.8)	**38,989.7**
Non-traditional mortgages							
Residential near-prime	28.7	14.3	3.4	5.3	14.6	(0.2)	**66.1**
Residential self-certified	113.7	46.4	5.4	7.9	10.8	(0.2)	**184.0**
Commercial lending	-	1.7	0.2	0.4	-	(0.8)	**1.5**
Total non-traditional mortgages	142.4	62.4	9.0	13.6	25.4	(1.2)	**251.6**
Unsecured loans	23.5	-	0.3	-	0.1	(0.5)	**23.4**
Mortgage pipeline	-	-	-	-	-	(0.1)	**(0.1)**
Total gross loans	**37,934.7**	**1,046.3**	**86.3**	**78.2**	**130.7**	**(11.6)**	**39,264.6**
	%	%	%	%	%		
Total gross loans	**96.6**	**2.7**	**0.2**	**0.2**	**0.3**		

As at 30 June 2018	Stage 1 'Performing' £m	Stage 2 'Deteriorating' Not past due £m	Stage 2 'Deteriorating' Past due £m	Stage 3 'Default' Not past due £m	Stage 3 'Default' Past due £m	Impairment £m	Total £m
Residential mortgages							
Residential mortgages Owner-occupier	21,582.6	646.8	53.8	53.1	89.5	(5.1)	**22,420.7**
Residential mortgages Buy to let	14,286.3	346.3	27.2	15.0	21.1	(3.5)	**14,692.4**
Total traditional residential mortgages	35,868.9	993.1	81.0	68.1	110.6	**(8.6)**	**37,113.1**
Non-traditional mortgages							
Residential near-prime	31.6	16.0	2.9	4.7	15.7	(0.2)	**70.7**
Residential self-certified	114.7	60.3	5.1	7.5	12.2	(1.5)	**198.3**
Commercial lending	-	1.8	0.2	0.5	-	(0.8)	**1.7**
Total non-traditional mortgages	146.3	78.1	8.2	12.7	27.9	(2.5)	**270.7**
Unsecured loans	25.4	-	0.4	-	0.4	(0.6)	**25.6**
Mortgage pipeline	-	-	-	-	-	(0.1)	**(0.1)**
Total gross loans	**36,040.6**	**1,071.2**	**89.6**	**80.8**	**138.9**	**(11.8)**	**37,409.3**
	%	%	%	%	%		
Total gross loans	**96.3**	**2.9**	**0.2**	**0.2**	**0.4**		

Possession levels have remained low with only £5.2 million (31 December 2018: £6.7 million) of the Stage 3 loan properties in possession. This relates to 27 (31 December 2018: 34) individual cases and represents 0.01% (31 December 2018: 0.02%) of the total mortgage book.

Provision coverage has been maintained at 5.5 times the gross losses before recoveries in the last 12 months as shown below.

		12 months to 30 Jun 2019	12 months to 30 Jun 2018	Year ended 31 Dec 2018
Impairment losses before recoveries	£m	**2.2**	2.3	2.1
Total impairment provision	£m	**12.0**	11.8	11.6
Loss coverage	Years	**5.5**	5.1	5.5

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11. Pension Scheme

The Coventry Building Society Defined Benefit pension scheme (the Fund) is administered by a separate trust that is legally separated from the Society. The Fund has been closed to new members since December 2001 and provides benefits based on final pensionable salary but was closed to future service accrual from 31 December 2012. The trustees of the Fund are required to act in the best interest of the Fund members. The appointment of the trustees is determined by the Fund's trust documentation and one third of trustees are nominated by the members of the pension fund.

In June 2019 the Society commenced the process of transferring its Defined Benefit pension scheme to a new scheme administered by TPT Retirement Solutions. At the same time a deficit contribution of £6.0 million was made to the scheme, taking total contributions to £6.6 million for the six months to 30 June 2019. The Society met and continues to meet the Fund's expenses including levies to the Pension Protection Fund.

The assumptions used in calculating the present value of the defined benefit obligation at 30 June 2019 are broadly consistent with those used at 31 December 2018 with the exception of a reduction in the discount rate following market movements leading to an increase in the obligation in the period. The present value of plan liabilities is measured by discounting the best estimate of future cash flows to be paid out by the plan using the projected unit credit method. The value calculated in this way is then deducted from the fair value of plan assets and the net surplus is presented on the Balance Sheet. At 30 June 2019 the value of scheme assets and liabilities are:

	31 Dec 2018 £m	Movement £m	**30 Jun 2019** **£m**
Present value of defined benefit obligation	(196.0)	(22.8)	**(218.8)**
Fair value of plan assets	218.9	22.8	**241.7**
Funded status/pension benefit surplus	22.9	-	**22.9**

The surplus reflects the Society's ability to recover a surplus either through reduced contributions in the future or through refunds from the Fund after the last benefit has been paid in line with IAS 19.

12. Debt securities in issue

As at 30 June 2019, the Group had a total of £4,895.2 million debt securities in issue (30 June 2018: £3,894.9 million, 31 December 2018: £4,353.9 million).

In March 2019, the Society issued an additional £100 million on the 5 year Sonia Covered Bond issued in November 2018 and a €500 million 7 year fixed rate Covered Bond was issued in June 2019.

13. Subordinated liabilities

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (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.

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14. Subscribed capital

	Call date	**Period to 30 Jun 2019 (Unaudited) £m**	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (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.

15. Other equity instruments

In June 2014, the Society issued £400 million of new PCS capital. These instruments rank equally with each other and PIBS. These 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 with an optional redemption in November 2019.

A tender offer for the PCS was completed in April 2019 with £385.1 million of the £400 million PCS repurchased for £391.3 (net of tax) following permission obtained from the PRA. The combined cost of tender and initial issuance fees of £9.3 million (net of tax) has been recognised within the Society's General reserve.

In April 2019, the Society issued £415.0 million of new PCS. These PCS pay a fully discretionary, non-cumulative fixed coupon at an initial rate of 6.875% per annum with an optional redemption in September 2024. The rate will reset on 18 September 2024 and every five years thereafter to the prevailing rate on a benchmark gilt plus 6.111%. Coupons are paid semi-annually in September and March. The cost of issuance of £2.5 million (net of tax) has been recognised within the Society's General reserve.

Coupon payments of £11.0 million (gross of tax) relating to the June 2014 issuance, covering the period 1 November 2018 to 30 April 2019 were approved and recognised in the Statement of Changes in Members' Interests and Equity in the period ended 30 June 2019 (30 June 2018: coupon payment of £12.7 million (gross of tax), covering the period from 1 November 2017 to 30 April 2018).

All issued PCS 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.

Notes to the Interim Financial Report
(continued)

16. Fair value through other comprehensive income reserve

Amounts within the fair value through other comprehensive income 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 £9.6 million profit was transferred to the Income Statement, this is summarised in the table below:

	Period to 30 Jun 2019 (Unaudited) £m	Period to 30 Jun 2018 (Unaudited) £m	Year ended 31 Dec 2018 (Audited) £m
Items recognised transferred to the Income Statement			
Interest receivable and similar income[1]	**5.5**	1.5	1.5
Net profit/(loss) from derivative financial instruments[2]	**4.1**	(11.2)	(14.9)
Total	**9.6**	(9.7)	(13.4)

1. Transfer to the Income Statement relates to the disposal of FVOCI debt securities.
2. Transfer to the Income Statement offsets the effects of changes in the fair value of derivatives hedging FVOCI debt securities.

17. Financial instruments – fair value of financial assets and liabilities

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.

Notes to the Interim Financial Report
(continued)

17. Financial instruments – fair value of financial assets and liabilities continued

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 2019 (Unaudited) £m	**Fair value 30 Jun 2019 (Unaudited) £m**	Carrying amount 30 Jun 2018 (Unaudited) £m	Fair value 30 Jun 2018 (Unaudited) £m	Carrying amount 31 Dec 2018 (Audited) £m	Fair value 31 Dec 2018 (Audited) £m
Financial assets						
Cash and balances with the Bank of England	**6,044.2**	**6,044.2**	4,799.9	4,799.9	5,219.4	5,219.4
Loans and advances to credit institutions	**380.7**	**380.7**	215.4	215.4	231.3	231.3
Debt securities	**16.2**	**16.1**	18.3	19.1	16.3	16.5
Loans and advances to customers	**40,586.5**	**40,509.8**	37,409.3	37,310.9	39,264.6	39,175.5
Financial liabilities						
Shares	**35,158.7**	**35,235.0**	31,442.5	31,582.4	33,281.6	33,369.4
Deposits from banks	**5,320.7**	**5,329.8**	5,239.4	5,239.4	5,453.8	5,453.8
Other deposits	**12.5**	**12.5**	3.0	3.0	9.5	9.5
Amounts owed to other customers	**677.6**	**677.6**	763.6	763.6	496.5	496.5
Debt securities in issue	**4,895.2**	**4,936.9**	3,894.9	4,008.5	4,353.9	4,419.1
Subordinated liabilities	**25.5**	**29.1**	25.5	28.9	25.5	27.6
Subscribed capital	**41.6**	**77.0**	41.6	80.6	41.6	77.0

Loans and advances to credit institutions

The fair value of loans and advances to credit institutions over the longer term is estimated by discounting expected cash flows at a market discount rate. Amounts maturing in the short term are valued at carrying amount.

Debt securities

For debt securities where recent market prices or executable bids for the security are available, these are used as the basis for establishing a year end valuation. Otherwise, a security is valued based on its relative value to comparable bonds.

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.

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.

Deposits from banks, other deposits and amounts owed to other customers

The fair value of deposits taken from wholesale counterparties over the longer term is estimated by discounting expected cash flows at a market discount rate. Amounts maturing in the short term are valued at carrying amount.

Notes to the Interim Financial Report
(continued)

17. Financial instruments – fair value of financial assets and liabilities continued

Debt securities in issue, subordinated liabilities and subscribed capital

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

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 2019 (Unaudited)	Level 1 £m	Level 2 £m	Level 3 £m	Total fair value £m
Derivative financial instruments - assets	**-**	**242.0**	**-**	**242.0**
Debt securities	**1,134.5**	**-**	**-**	**1,134.5**
Investment in equity shares	**0.6**	**-**	**3.4**	**4.0**
Derivative financial instruments - liabilities	**-**	**(192.5)**	**(62.7)**	**(255.2)**
Total	**1,135.1**	**49.5**	**(59.3)**	**1,125.3**

30 June 2018 (Unaudited)				
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

31 December 2018 (Audited)				
Derivative financial instruments - assets	-	268.9	-	268.9
Debt securities	934.9	-	-	934.9
Investment in equity shares	0.4	-	2.7	3.1
Derivative financial instruments - liabilities	-	(110.3)	(57.1)	(167.4)
Total	935.3	158.6	(54.4)	1,039.5

Level 1 - Debt securities – fair value through other comprehensive income - Listed

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

Level 1 - Investment in equity shares – fair value through other profit and loss - Listed

Market prices have been used to determine the fair value of listed Investments in equity shares.

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.

Notes to the Interim Financial Report
(continued)

17. Financial instruments – fair value of financial assets and liabilities continued

Level 3 - Investment in equity shares – fair value through profit and loss - 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.

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 £0.6 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 £0.5 million change in the value of the swaps. However, changes in the projection of interest and prepayment rates of the underlying mortgage portfolio impact both the swap and hedged item so that the net Income Statement and Balance Sheet impact would not be significant.

The following table analyses movements in the Level 3 portfolio:

	Total £m
As at 1 January 2018 (Audited)	(53.5)
Items recognised in the Income Statement	
Interest payable and similar expense	(5.6)
Net unrealised gains on derivatives and hedge accounting	6.4
Settlements	5.8
Transfers out of Level 3 portfolio	(7.5)
As at 31 December 2018 (Audited)	**(54.4)**
Items recognised in the Income Statement	
Interest payable and similar expense	(2.6)
Net unrealised losses on derivatives and hedge accounting	(4.9)
Settlements	2.6
As at 30 June 2019 (Unaudited)	**(59.3)**

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.

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 26 of the 2018 Annual Report & Accounts as amended by those detailed on page 8 of this Interim Financial Report.

A full list of the Board of directors can be found in the 2018 Annual Report & Accounts. Following the publication of those Accounts, on 1 May 2019, Shamira Mohammed was appointed to the Board as a Non-Executive Director. Shamira has held a number of roles including senior positions within the financial services sector. Roger Burnell retired from the Board on 24 April 2019.

Signed on behalf of the Board by

Mark Parsons	Michele Faull
Chief Executive	Chief Financial Officer
29 July 2019	

Independent Review Report

Independent review report to Coventry Building Society

Report on the condensed consolidated financial statements

Our Conclusion

We have reviewed Coventry Building Society's condensed consolidated financial statements (the "interim financial statements") in the interim financial report of Coventry Building Society for the 6 month period ended 30 June 2019. Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

What we have reviewed

The interim financial statements comprise:

- the Condensed Consolidated Balance Sheet as at 30 June 2019;
- the Condensed Consolidated Income Statement and Condensed Consolidated Statement of Comprehensive Income for the period then ended;
- the Condensed Consolidated Statement of Cash Flows for the period then ended;
- the Condensed Consolidated Statement of Changes in Members' Interests and Equity for the period then ended; and
- the explanatory notes to the interim financial statements.

The interim financial statements included in the interim financial report have been prepared in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union and the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority.

As disclosed in note 2 to the interim financial statements, the financial reporting framework that has been applied in the preparation of the full annual financial statements of the Group is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Responsibilities for the interim financial statements and the review

Our responsibilities and those of the directors

The interim financial report, including the interim financial statements, 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 sourcebook of the United Kingdom's Financial Conduct Authority.

Our responsibility is to express a conclusion on the interim financial statements in the interim financial report based on our review. This report, including the conclusion, has been prepared for and only for the Society for the purpose of complying with the Disclosure Guidance and Transparency Rules sourcebook of the United Kingdom's Financial Conduct Authority and for no other purpose. We do not, in giving this conclusion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

What a review of interim financial statements involves

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.

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 interim financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants
Birmingham
29 July 2019

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 2018 has been extracted from the Annual Report & Accounts for that year. The Annual Report & Accounts for the year ended 31 December 2018 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/interim2019. 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.

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